

How a fragmenting grocery market is creating new opportunities for growth



The grocery store can no longer be all things to all people.

It used to be that grocery shopping behavior was the same regardless of age, income or ethnicity. Everyone shopped once or twice a week at their local grocery store and everyone bought the same brands.

But a combination of factors—a renewed interest in healthful, fresh food; an ever-more-diverse population; and, most importantly, the polarization of income groups—has led to a new set of shopping behaviors.

And with them have emerged a new set of opportunities.

Shopping based on income and occasion

While the move to more healthful eating and an increasingly diverse population have caused and will continue to produce fundamental changes in the way Americans shop for groceries, it is the growing gap between the rich and the poor that is having the most profound impact.

Much in the same way that the country’s increasing income disparity has produced new shopping behaviors for apparel (the rise of high-low fashion) and home improvement (the success of DIY megastores like Home Depot and the steady shift upmarket for home furniture and accessories retailers like Restoration Hardware), when it comes to groceries, the rich shop for different reasons than the poor do.

To better illustrate the discrepancy, we have segmented grocery shopping occasions into four types: regular (recipe items needed for

preparation that will take place anywhere from that day to up to a week out), convenience (“dinner tonight,” which typically takes the form of freshly prepared meals), stock-up and special (parties, holidays, etc.). As Exhibit 1 illustrates, the rich not only shop for groceries based on convenience and special occasions far more often than the poor—28% and 33%, respectively—they shop at more stores overall.

Income- and occasion-based shopping has, in turn, fundamentally altered the grocery landscape itself. As seen in Exhibit 2, upper-income consumers and their frequent convenience-based grocery shopping have helped drive the success of Whole Foods, which offers a rich selection of made-to-order and prepared meals, while high unemployment has forced a growing share of the population to reduce the number of trips it makes for special occasions and instead concentrate on regular grocery shopping

at the likes of hard discounters like Aldi and WinCo and, increasingly, dollar stores.

Emerging opportunities

But as both Exhibits 1 and 2 also make clear, the diverging set of grocery shopping behaviors has created new growth opportunities.

At the high end, grocers are serving the convenience occasion-driven shopper in myriad ways. Regional chains like Fairway and Bi-Rite are offering freshly prepared foods that are near restaurant-like in quality, for example, a model with which Fresh & Easy

could have succeeded had their real estate strategy not consisted of too many locations populated with the wrong demographics.

Stores like Sprouts and Fresh Market, meanwhile, are focused on providing an exceptionally personalized, neighborhood-store style of service, with enough staff to ensure quick counter assistance, short checkout lines and help in carrying groceries out to shoppers' cars.

Targeting the high-income special-occasion shoppers are stores like BevMo, a regional

chain whose core offering is wine but also features an ever-widening array of party staples including liquor, soda, gourmet finger food—even hostess gifts. And Smart & Final is using its large food service–sized SKUs to target the special occasion needs of companies.

While the stock-up trip continues to be owned by Costco, a few ethnic superstores are creating hypermarkets targeted at key segments of the population. Great Wall in the Mid-Atlantic region, for example, has a huge format focused on Asian cuisine with

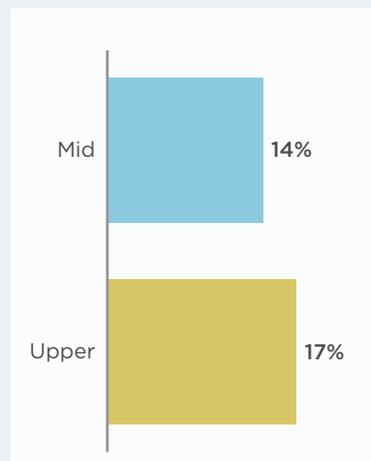
imported products and many of the features of an Asian wet market, where customers can select from tanks of live fish and crabs and have their selection cleaned one of five different ways. Great Wall also has an extensive selection of frozen convenience foods that are attractive to second-generation Asians who lack the time or patience to cook from scratch.

High-end grocers to watch: Fresh Market, Sprouts, Bristol Farms, New Seasons, Great Wall

EXHIBIT 1: Mid- and Upper-Income Grocery Shopping

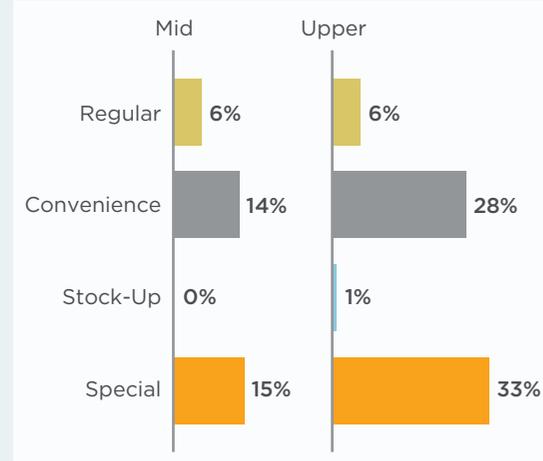
Stores Shopped*

% more than low income



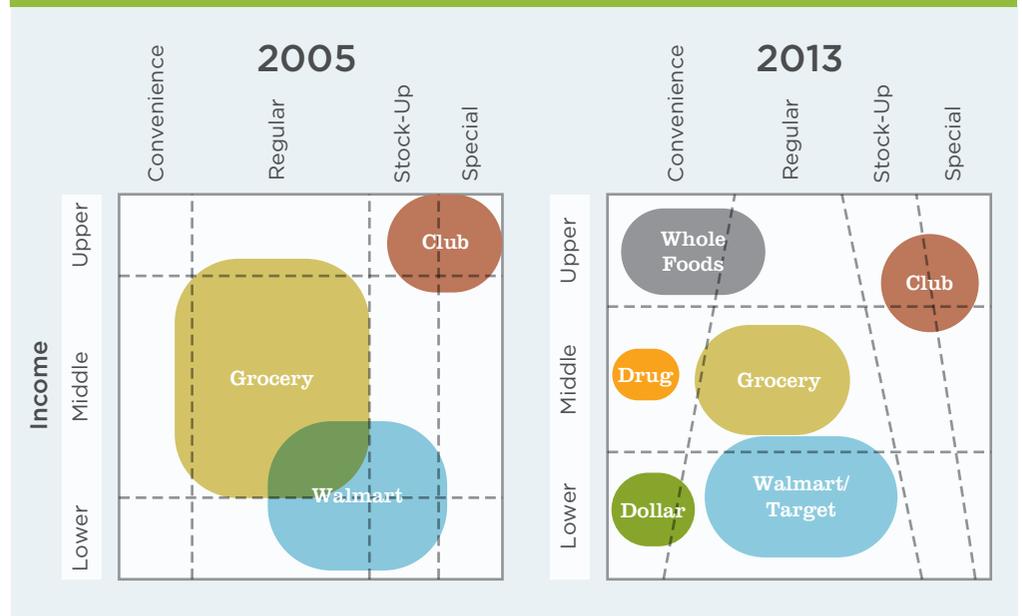
Occasions Shopped

% more than low income



* Excluding traditional grocery

EXHIBIT 2: Grocery Penetration by Income and Occasion



At the low end, grocers are primarily serving regular-occasion shoppers and in the process are taking customers away from supercenters like Walmart and Target—which are already losing share as the number of low-income shoppers who can afford to stock up on large-format items falls—with lower prices and more convenient locations. Notably, dollar stores have become a favorite of many low-income consumers whose regular-occasion shopping trips depend on cash flow.

Hard discounters like Aldi, which carries private-label brands and has done away with high-labor perimeter departments, are particularly well positioned to successfully compete for the low-income, regular-occasion shopper. Another contender is WinCo, which boasts employee-centric policies coupled with a regional anti-Walmart bent.

A growing number of ethnic grocers, meanwhile, are targeting a low-income customer base that traditionally shops every day and purposely chooses not to buy produce from supercenters like Walmart. Some, like La Michoacana, aren't designed to be one-stop shops but to augment the needs of people who also shop such supercenters.

Low-income grocers to watch: Aldi, Lidl, Northgate González, La Michoacana

The growing polarization of income groups and their related changes in shopping behav-

ior are forcing traditional grocers to either shift their offerings upmarket or down or to consolidate in the middle in an effort to increase their share and improve their cost positions.

In Chicago, for example, the number of traditional full-service grocers has fallen nearly 3% since 2009, while the number of discount grocers has risen more than 23% and the number of gourmet grocers has more than doubled. (See Exhibit 3.) Among them is Mariano's Fresh Market, a high-end offering from Wisconsin-based traditional grocery chain Roundy's.

With Mariano's, whose locations measure some 70,000 square feet each and include the telltale feature of high-end grocers, the attractive perimeter department, Roundy's chose not to compete with the likes of Dominick's and Jewel in the shrinking middle, but to instead evolve and grow its footprint in the expanding upper tier. There are now 10 Mariano's in the region, and Roundy's plans to open an additional three by the end of 2013.

Another threat to the upper end of the regular shopping occasion is AmazonFresh, through which the online retail giant has begun delivering fresh groceries (including produce) to Amazon Prime members in select cities, with same-day and next-day morning delivery free on orders over \$35. It remains to be seen how the service will com-

EXHIBIT 3: Chicago Grocery Market Penetration by Category



Source: Mid-America Real Estate Corp.'s Urban Grocery Study

pete with smaller, regional online grocery delivery services, such as FreshDirect in New York City.

At the lower end, many grocery stores have become "light" versions of hard discounters. Chains like Food 4 Less, a Kroger banner, keep prices low by using a box format that reduces labor, for example, and Grocery Outlet offers a strong price proposition by purchasing manufacturer closeouts and franchising operations.

For those left standing in the middle, what is clear is that survival is becoming increasingly challenging. In the past few months alone, Supervalu sold five grocery chains, including Albertson's, to a consortium of private equity

firms; Kroger agreed to pay \$2.4 billion to buy Harris Teeter; and Great Atlantic & Pacific Tea Co., which emerged from bankruptcy in 2012, recently put itself on the block. ❖

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