



## Specialty Food Stores

QUARTERLY UPDATE **10/12/2009**

SIC CODES: 5421, 5431, 5441, 5461, 5499

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### Industry Overview

The US specialty food store industry includes about 20,000 stores with combined annual revenue of \$20 billion. Major companies include Whole Foods Market and Trader Joe's. The industry is **fragmented**: the 50 largest companies account for less than 50 percent of sales.

The industry includes gourmet food stores, natural/organic food stores, health food stores, meat or seafood markets, fruit and vegetable markets, bakeries, and candy and nut stores. Grocery stores and supermarkets and superstores and warehouse clubs that sell food are covered in separate industry profiles.

### COMPETITIVE LANDSCAPE

**Consumer spending** and **tastes** drive demand. The profitability of individual companies depends on effective merchandising and the ability to generate store traffic. Large companies can offer a wide selection of products and have advantages in purchasing, distribution, and marketing. Small companies can compete effectively by offering specialty products, providing superior service, or serving a local market. The industry is **labor-intensive**: average annual revenue per worker is about \$100,000.

Competition includes traditional grocery stores, mass merchandisers, and warehouse clubs. Specialty food stores also compete with any venue serving food, including restaurants.

### PRODUCTS, OPERATIONS & TECHNOLOGY

Major products sold by specialty food stores include **meat, fish, and poultry** (40 percent of sales); **produce** (15 percent); and **baked goods** and **candy** (10 percent each). Other products include dry grocery products, dairy products, prepared foods, and kitchenware. Companies may place special orders for customers looking for unique items.

Specialty food stores include **chains, independent retailers, franchises, and cooperatives**. Franchises include companies such as Great Harvest Bakery, Cinnabon, and Rocky Mountain Chocolate Factory. Specialty food cooperatives are typically member-owned and -operated. Store size and format can differ significantly. A large specialty grocery store can exceed 20,000 square feet, while a candy store can be less than 1,000. Companies may use a **kiosk** format to offer a small selection of products and to fit into non-traditional spaces.

Store layout is typically organized by product type, and companies often place complementary departments near each other to promote incremental sales. Specialty food stores may have instore bakeries, kitchens, or delis (also known as charcuteries). Retailers offering **organic food** must follow strict procedures to prevent contact with non-organic foods and substances. Organic merchandise also requires companies to keep records regarding product handling and vendor relationships.

**Merchandise mix** helps determine locations. For example, specialty grocery stores with a broad range of products may seek out strip malls or areas with other large retailers to help drive traffic. Because customers are willing to travel to buy unique merchandise, stores specializing in a few categories (meat or produce markets) may be farther from major shopping areas. When evaluating store locations, companies typically consider population density, traffic patterns, tenant mix, visibility, and accessibility. Because specialty food products tend to appeal to **affluent consumers**, companies may also consider education and income levels for the surrounding area.

Specialty grocery stores offer categories similar to traditional supermarkets, but stock unique or hard to find products within each category. Popular specialty food categories include **specialty coffee/tea, olive oil/specialty oil, cheese,** and **chocolate**. Companies may also focus on a particular category, such as baked goods. Stores specializing in **ethnic foods** offer imported merchandise. **Perishables**, such as produce and meat, require careful inventory management due to potential spoilage. Some specialty food stores offer **private-label** products.

While companies may buy directly from manufacturers, distributors and farm cooperatives are important because the supply and retail segments for many categories in the specialty food industry are highly fragmented. Large companies may have multi-year contracts with key suppliers and enjoy volume discounts. Small companies may join **cooperatives** to leverage increased purchasing power. Chains often have separate distribution centers for products requiring special handling, such as seafood.

Most specialty food retailers use **computerized information systems** to manage **point-of-sale (POS)** transactions and inventory movement. POS systems use scanners to track individual items by **Universal Product Codes (UPC)**. Integrated systems linking sales and inventory allow companies to identify fast- and slow-moving products and minimize out-of-stocks and excess inventory. Large companies may use **price-optimization software** to maximize profitability. **Voice-activated stock picking** improves the efficiency of warehouse operations.

## SALES & MARKETING

The typical specialty food customer is a **young, affluent adult**. Surprisingly, gender doesn't play a significant role in demographics, as specialty food appeals to both men and women, according to Mintel. Specialty food consumers cook meals from scratch almost three times weekly. Ethnic food stores typically rely on a customer base of immigrants.

**Marketing** and **promotional** vehicles include instore signage, newspaper and print advertising, direct mail, and coupons. **Grassroots** marketing and **word-of-mouth** are important to generate awareness, as most companies have relatively small marketing budgets. Product tastings, cooking classes, and sampling help create excitement and draw traffic. Stores may sponsor local events or charities to develop **community support**.

**Superior service** can be especially important because the specialty food customer is typically a food enthusiast. Knowledgeable workers help customers find uncommon ingredients, make meal suggestions, and help with recipes. Upon request, a retailer may place **special orders** for products not normally stocked.

Specialty food stores may have **websites** offering store and product information, price promotions, recipes, or nutritional advice. Companies with highly specialized merchandise can reach customers beyond local markets by offering products for sale through the Internet. Through websites, specialty food retailers may also sell **exotic foods** not found in stores.

The **average transaction** in a specialty food store is about \$30, according to Mintel. Specialty food products are typically premium priced compared to traditional grocery products.

## FINANCE & REGULATION

Companies may experience **seasonal sales** depending on what types of specialty food products they offer. For example, business in candy stores peaks during Christmas, Easter, and Valentine's Day. Companies depend on **rapid inventory turns** and inventory is typically less than 15 days sales. **Gross margins** range from 40 to 50 percent, and are significantly higher than margins in traditional grocery stores. Most customers pay with cash or third-party credit cards, so **receivables** are basically nonexistent.

**Leases** typically include a fixed initial term and renewal options. Rent includes a base payment and possibly additional payments based on a percentage of sales over a certain amount. Some leases include a tenant improvement allowance.

**Franchise** agreements may include an initial fee, royalty payments, and marketing costs. Franchises typically cover a fixed period of time with renewal options. Most franchisers assess a potential owner's net worth and liquidity before approving a franchise.

Numerous government agencies, including the FDA, FTC, USDA, EPA, and the Consumer Products Safety Commission (CPSC), regulate the manufacturing, labeling, advertising, and sale of food products. To be certified as an organic grocer, a company must adhere to strict standards set by the USDA. The FDA governs the standards for nutritional supplements.

## REGIONAL & INTERNATIONAL ISSUES

While specialty food has widespread appeal throughout the US, **ethnic food stores** tend to be concentrated in areas with diverse populations. **California, New York, Texas, and Florida** have large Hispanic and Asian populations.

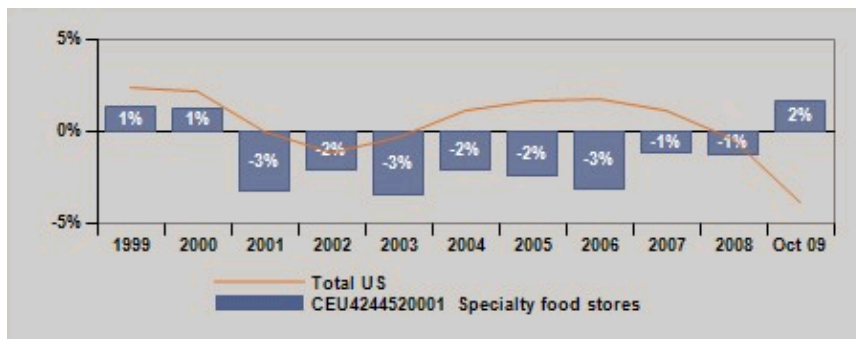
Specialty food customers tend to favor imported products due to both real and perceived differences in quality versus American counterparts. Retailers import produce, such as grapes, to offer products out of season in the US. The FDA and US customs can examine imported food shipments and delay delivery for safety reasons.

## HUMAN RESOURCES

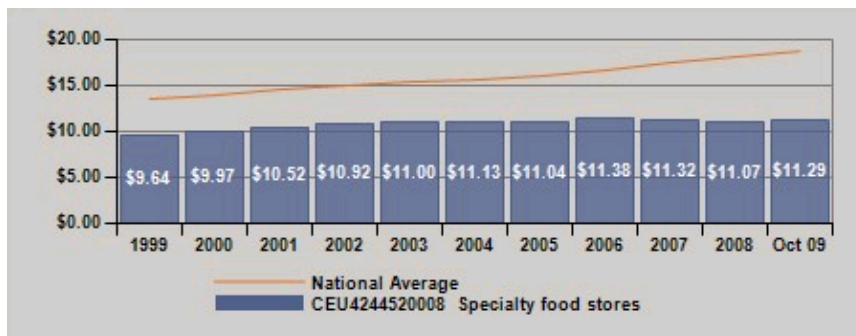
In general, workers in specialty food stores require **minimal skills**, and average hourly industry wages are significantly lower than the average for all US workers. Companies may rely on part-time or temporary workers. Positions involving direct food handling, such as meat-cutting or food preparation, require training in safety and sanitation procedures. Unions have tried to organize workers of some large specialty food retailers.

The industry **injury rate** is slightly higher than the US average, with more employees suffering from cuts and carpal tunnel syndrome. Jobs involving handling and processing meat, poultry, and seafood account for the higher injury rate.

### Industry Employment Growth Bureau of Labor Statistics



### Average Hourly Earnings & Annual Wage Increase Bureau of Labor Statistics



## Recent Developments

### INDUSTRY INDICATORS

US consumer spending on nondurable goods, an indicator of specialty food sales, fell 2 percent in October 2009 compared to the same month in 2008.

The consumer price index for food, an indicator of specialty food store values, fell a slight 0.7 percent in November 2009 compared to the same month in 2008.

## MONTHLY NEWS



### [Earth Fare offers free upgrade for your food](#)

The News & Observer, 09 December, 2009, 285 words

Earth Fare wants people to get rid of their unhealthy pantry staples, so the store is offering to replace them for free. Here's what you need to do: Sign up for Earth Fare's Healthy Journey at [earthfare.com/CreateAccount.aspx](http://earthfare.com/CreateAccount.aspx) to receive ...

### [I made chowder, you made pickles. Let's trade; The concept of preparing large batches of food to exchange portions is gaining popularity among ...](#)

The Globe and Mail, 09 December, 2009, 896 words

VANCOUVER -- You've cooked up a giant pot of Moroccan chickpea and vegetable stew that could feed you for days. It's healthy, hearty and saves you time and money. The trouble is you're now stuck eating the whole thing yourself. Innovative ...

### [Calculating the 'New Normal'; Supervalu's Craig Herkert Leans on Cut-Rate Chain and Tweaks Everyday Prices](#)

The Wall Street Journal (Online and Print), 07 December, 2009, 871 words

Supervalu Inc. hired Craig Herkert away from Wal-Mart Stores Inc. in May to help the grocery chain solve its identity crisis. While competitors were targeting recession-wracked consumers with discounts and deals, Supervalu, the nation's ...

## QUARTERLY INDUSTRY UPDATE

**Consumers Skeptical of Organic Claims** - Consumers are more skeptical of organic and all-natural food claims but are still willing to purchase them if the price is right. More than 75 percent of shoppers say they would buy organic or all-natural products if they are comparably priced to other leading brands, according to a recent survey by marketing firm Pavone. Consumers know the difference between and definitions of both food categories, the survey further finds. The conclusions are good news to the specialty food store industry, which, along with suppliers, spends heavily to educate customers about the value of organic and all-natural products.

**Biotech Food Testing Planned** - A US industry group plans to test organic and natural food products and label those that are free of biotech ingredients. The Non-GMO Project has campaigned to start testing and labeling foods in response to fears that genetically engineered crops may be included in organic and natural foods, according to the *New York Times*. The group says testing is necessary because of the proliferation of genetically modified food crops in recent years. Whole Foods is among the companies that plan to use the project's seal on hundreds of its products.

**Suggestion Box Goes Virtual** - More US companies, including coffee retailer Starbucks, are using the Web and social networking sites to solicit suggestions from customers. The customized websites enable customers to offer suggestions or criticisms and allow companies to track and engage in the dialogue. Companies that already offer high-contact customer service in their stores and don't have a negative reputation in cyberspace are more likely to succeed in creating effective online suggestion forums, according to *Investor's Business Daily*.

## Business Challenges

### CRITICAL ISSUES

**Competition from Alternative Retailers** - Specialty food stores face intense competition from grocery stores and mass merchandisers. Grocery stores hold almost 70 percent of specialty food sales, according to Mintel. To capitalize on growing demand, some large retailers are expanding specialty food selections and carrying more organic and gourmet products. Target has launched a certified organic line of private-label foods and Wal-Mart also is expanding organic food sections.

**Dependence on Consumer Spending** - While food purchases are generally stable regardless of economic conditions, consumer spending can affect sales of specialty foods. Most specialty foods are considered luxury items and typically have higher retail prices than traditional grocery items. Consumers may switch to less expensive food products or stop buying high-end items when money is tight.

## OTHER BUSINESS CHALLENGES

**Regulatory Changes Affect Operations** - Changes in government regulations can affect the availability, formulation, and marketing of specialty food products. Certain segments of the specialty food industry, especially natural and organic foods, are highly regulated. The organic food market is relatively young, and future modifications to standards are likely. Regulatory changes could require reformulating or discontinuing products, altering handling procedures, and keeping additional records.

**Product Liability** - Product recalls or contamination can result in liability claims, lost sales, and a damaged reputation. Some consumers hold specialty food retailers to a higher safety standard than traditional grocery stores due to both real and perceived differences in product quality. Periodic incidents of food contamination have caused heightened awareness regarding food safety from both the public and government.

**Impact of Weather** - Bad weather can affect the supply of produce, an important category in many specialty food stores. Droughts, floods, and long winters can affect crops and disrupt the supply chain. Product shortages can result in out-of-stocks, reduced product selections, and higher prices.

**Special Handling for Perishables** - Perishable products, such as meat and produce, have short shelf lives and may require special handling procedures. Meat, dairy, and some produce items require refrigeration and frequent restocking. Overbuying or poor handling can result in damage, spoilage, and write-offs. Most product "shrink" (or losses) in grocery stores comes from perishables. Because specialty food stores typically stock high-quality perishables, losses can be significant.

## Trends & Opportunities

### BUSINESS TRENDS

**Growth in Specialty Food Sales** - Specialty food sales increased are increasing. Products introduced in gourmet stores, specialty retailers, and health food stores have driven growth. Most new products came from the confectionery, beverage, and fruit and vegetable categories. Increased availability through mainstream channels has exposed specialty foods to a broad range of consumers and helped grow the market.

**Strong Demand for Natural/Organic Products** - Sales of natural products are growing. Rapidly growing categories include produce, baked goods, food supplements, and pet products. Increased awareness of the role food plays in long-term health has helped grow sales of natural and organic products. Baby boomers, who tend to be affluent and more concerned with nutrition, will help drive future demand.

**Imports Increasing** - Imported foods are a growing segment of the US food market and especially important to specialty food retailers. Increased international travel has driven demand for imported and ethnic products in the US. Large growing immigrant populations continue to seek out food from home countries.

**Declining Employment** - Employment in specialty food stores has declined in recent years. While sales of specialty foods have grown, grocery stores and other large retailers have captured much of the market growth at the expense of smaller stores. In particular, meat markets and confectionery/nut stores have suffered from increased competition. Employment has declined 2 to 3 percent annually since 2001, and has yet to recover from the early 2000s recession.

### INDUSTRY OPPORTUNITIES

**Specialty Products** - Unique merchandise helps specialty food retailers differentiate from competition and justify premium pricing. A wide selection of ethnic, gourmet, natural, organic, or kosher foods can be difficult to find in traditional food retailers. Locally produced products can be fresher and reflect regional preferences. Prepared foods made with proprietary recipes, and private-label products, give companies a competitive advantage.

**Leveraging the Internet** - Internet retailing offers specialty food stores ways to reach more customers and sell a broader range of products. Websites allow customers from well beyond local markets to buy goods. Internet sites also let companies offer unique food items that don't have the sales volume to justify shelf space in physical stores. By partnering with an online specialty foods retailer, Schnuck's Markets' website allows customers to access an expanded inventory of international, organic, and kosher foods.

**Creating Distinctive Store Image** - By developing a store image or brand, companies can better communicate the

type of shopping experience they deliver. Unique décor and displays can create a distinctive store environment and help shape a retailer's image. Instore preparation of food (such as sushi) and open kitchens convey an image of freshness. Employee personalities and attitudes help define customer perception. Publicly supporting non-profit causes also affects company image.

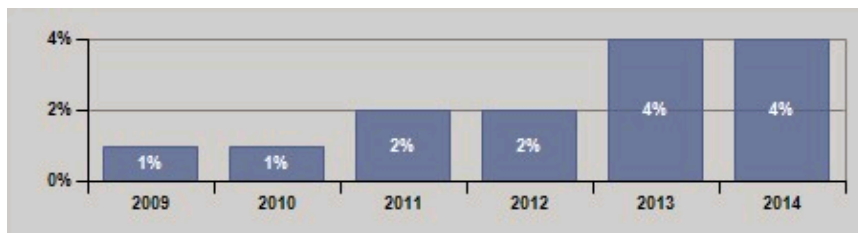
**Additional Services** - Special services improve the customer shopping experience and help create loyalty. Home or curbside delivery provides added convenience and gives companies an advantage over most grocery stores and mass merchandisers. Valet parking can give an image of exclusivity. Creating customized gift baskets allows companies to add value to merchandise and promote the store beyond existing customers.

**Educating Customers** - Companies can develop a strong customer base by teaching consumers about the advantages of specialty products over traditional products. Specialty food customers are likely to try new things, and are willing to pay premium prices for the best ingredients. Knowledgeable employees can introduce customers to new flavors and forms of specialty foods, such as cheeses, oils, and spices. Offering cooking classes can teach customers how to use and enjoy unfamiliar food products.

## Industry Forecast

US personal consumption expenditures at specialty food stores are forecast to grow at an annual compounded rate of 3 percent between 2009 and 2014. Data Published: October 2009

### Consumer Spending Growth for Food Specialty Stores Continues to Improve



First Research forecasts are based on INFORUM forecasts that are licensed from the Interindustry Economic Research Fund, Inc. (IERF) in College Park, MD. INFORUM's "interindustry-macro" approach to modeling the economy captures the links between industries and the aggregate economy.

## First Research Industry Growth Rating

The First Research Industry Growth Rating reflects the expected industry growth relative to other industries, based on INFORUM's forecasted average annual growth for the combined years of 2010 and 2011. INFORUM forecasts were prepared by the Interindustry Economic Research Fund, Inc.



- Demand: Tied to consumer income
- Need good merchandising
- Risk: Slow economy pushes consumers to low-margin products

## First Research Industry Drivers

Changes in the economic environment that may positively or negatively affect industry growth. Data provided by First Research analysts and reviewed annually.



**Consumer Spending:** Change in overall level of consumer spending on goods and services

## **Weblinks & Acronyms**

### **Industry Websites**

#### **Food Marketing Institute**

<http://www.fmi.org/>

News, trends, statistics, government and regulatory issues for the food industry.

#### **Gourmet Retailer**

<http://www.gourmetretailer.com/>

News and trends for specialty food and housewares industries.

#### **Progressive Grocer**

<http://www.progressivegrocer.com/>

News, trends, statistics for grocery retail industry.

#### **Specialty Food.com**

<http://www.specialtyfood.com/do/Home>

News, trends, and annual survey from National Association for the Specialty Food Trade.

#### **The Natural Foods Merchandiser**

<http://www.naturalfoodsmerchandiser.com/>

News and trends for the natural foods market.

#### **Whole Foods**

<http://www.wholefoods.com/>

Leading organic/natural foods retailer.

### **Glossary of Acronyms**

**CPSC** - Consumer Products Safety Commission

**POS** - point-of-sale

**NASFT** - National Association for the Specialty Food Trade

**UPC** - Universal Product Code

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