Report Highlights

The year 2010 was one of mixed signals and great inconsistency for the economy, consumer grocery shopper behaviors and food retailing performance:

- On the one hand, a number of economic indicators started to improve in 2010 such as declining unemployment figures and positive growth in GDP. On the other, none of the measures improved enough to kick start the economy into true recovery. In 2011, growth in the first quarter was curtailed by a sharp pull back in consumer spending in reaction to rapidly rising fuel and food prices.
- On the consumer end, some shoppers continue to be focused on making ends meet through a relentless focus on price and value. Others, primarily higher-income shoppers, have started to ease up on money-saving measures and are creating an increased demand for convenient meal solutions, luxury food products and natural/organic foods.
- Food retailers are divided over whether the economic downturn impacts them positively or negatively. The range of performance varied widely for nearly every benchmark in the report with some retailers losing significant ground in sales and profits in 2010, while net profits among the top-performing retailers are more than three times higher than the industry average.

Because the economic recovery has been — and will continue to be — uneven, it is having a different impact on each of the various market segments. This has led to an incredibly complex marketplace in which retailers and food manufacturers must have a clear understanding of where growth is likely to occur, where the opportunities lie and how to customize these initiatives to each shopper audience. Differences between those successfully navigating this environment and those that are struggling are growing larger. This report presents a means to benchmark operations against the industry average, as well as the best in the industry — providing companies a vital tool for making adjustments necessary to elevate their performance in the complex marketplace.

Just how complex the marketplace has become is well-illustrated by the FMI Worry Index —a list of 15 industry issues rated on a scale of 1 to 10, where 10 is the highest impact on the retailer's business. Now in its eighth year, the top five issues on the chart have changed every year. Additionally, the intensity of each of the issues has increased every year to reach never-before-seen levels for many of the factors rated in 2011.

2004 Top Five Worry Index

7.0 — Competition
6.4 — Interchange fees
6.2 — Healthcare costs
5.9 — Staffing, hiring and retention
5.6 — Energy

2011 Top Five Worry Index

8.4 — Economy
8.3 — Healthcare costs
8.1 — Competition
7.2 — Interchange fees
7.0 — Energy

In 2011, the economy leads the Worry Index with an average score of 8.4. While half of retailers believe the economy is hurting same-store sales growth, the other half say they are uniquely positioned to attract shoppers and grow sales in this climate. Likewise, more than six in 10 believe the current economy is unfavorable for growing net profits, whereas 40 percent believe the environment is helping net profit growth. The fiscal year 2010 financial and operational results perfectly reflect this dichotomy. Weighted sales growth in 2010 stood at 3.4 percent, up from 0.1 percent in 2010. However, not all companies fared well. In fact, 46.5 percent of companies reported sales losses and 51.5 percent of food retailers had sales gains that were less than the rate of inflation. Double-digit sales growth was limited to fewer than 7 percent of survey respondents.

Identical store sales stood at $278,760 in 2010. Sales gains for comparable stores were much lower than overall sales gains at a median of -0.6 percent — meaning, when comparing sales of stores that were in operation both years, the industry effectively lost ground. The identical-store sales gain is also lower than the results booked last year. Half of retailers reported identical-store sales losses and 54.5 percent had gains below the rate of inflation.

The tough economic climate led to a drop in the median net income to 0.98 percent of sales for the industry as a whole. This is down from 1.22 percent of sales last year. Profit leaders — those companies in the top 25th percentile that had profits of at least 2.16 percent — better controlled operating expenses and more than tripled the average industry profit figure. They show lower-than-average costs in nearly all cost areas, whether salaries and benefits, utilities or supplies.

Healthcare costs continue to be a major concern for retailers, ranking second on the FMI Worry Index. Two-thirds of retailers reported higher healthcare costs in 2010 compared with 2009 with an average increase of 8.7 percent. While 33.8 percent managed to reduce costs in 2010, this share drops to 19.7 percent in 2011. Healthcare costs already make up 1.5 percent of total sales. In order to cope with the rising costs of providing healthcare, 71.9 percent of retailers whose cost increased passed along all the additional expenses and 23.4 percent absorbed at least some of the cost. Their most common way of passing along cost increases was through raising premiums and deductibles. Fully 97.1 percent of retailers expect that healthcare reform will increase healthcare expenses. Retailers point at the higher dependent age and the 30-hour per week eligibility rules as two areas that will contribute to this increase.

HR executives agree that in the current economic environment it is easier to recruit for hard-to-fill positions and that they're receiving resumes from better-qualified candidates when posting job openings. Relative to corporate or headquarter employees, slightly more companies decreased staffing levels than added employees in 2010. Among those reporting staff reductions, 52.9 percent resorted to layoffs and 47.1 percent implemented hiring freezes. For 2011, the outlook is much brighter with half as many retailers expecting to reduce staffing levels. At the store level, 38.1 percent of retailers resorted to staffing reductions, of which more than one-third had layoffs. For 2011, 23.0 percent expect further staff reductions.

Total 2010 payroll increased among 37.7 percent of retailers, but decreased among a roughly equal share. Limiting overtime availability was the most popular measure taken to reduce payroll, followed by freezing or reducing bonuses, and corporate salary freezes. For 2011, about twice as many retailers are planning on limiting bonus eligibility, but more retailers are planning on paying out bonuses.

On a positive note, the economy has led to improvements in employee productivity, inventory turns, employee turnover and fresh-item shrink.

- Sales per labor hour reached a high of $166.55 across departments and inventory turns improved to 14.4 turns for the total store.
- Turnover averaged 11.2 percent for full-time store employees and 44.1 percent for those working part time. Headquarter turnover was much lower at 8.4 percent.
- Fresh-item shrink also declined to 2.3 percent across categories.

On the other hand, transactions and the average basket size took a hit and dropped to 11,680 transactions per store per week at $26.78 per transaction.

Speaks respondents point at supercenters as their main competitive threat, followed closely by competition from existing full-service supermarkets and ones that are being added to their market areas. In order to differentiate themselves, retailers turn to an emphasis on perishables as their most frequently used strategy, but also the most successful one. Creating a unique shopping environment, store design or product selection is the second-most successful retailing strategy. Compared with prior years, significantly more retailers have added quick-stop areas to their stores —one-stop destinations where shoppers can find all items for one

dinner occasion. High numbers of stores are also increasing their prepared food assortment, and with it, their meal solution sales. Private brands continue to soar. Seven in 10 retailers noted an increase in private-label sales over the past year and eight in 10 added own-brand items to their assortment. Private brands now make up 12.7 percent of total SKUs and 16.1 percent of sales.

Locally-grown products continue to be shopper favorites with two-thirds of operators noting sales increases. Focusing predominantly on produce, examples of top-selling local products are corn, apples, tomatoes and strawberries. Most retailers define locally-sourced products as coming from the same state as the store location, followed by a certain mile radius.

In order of importance, the hot grocery trends of 2011 are social media, mobile marketing, value shopping, health and wellness and natural/organic food.

- Advertising budgets received a big boost in 2011 with 1.5 percent of sales set aside for advertising purposes. While newspaper advertising took up nearly half the budget in 2011, social media jumped to 2.7 percent, with an additional 3.0 percent spent on email and website advertising. Social media experience levels vary widely with 18.8 percent just getting started and another 18.8 percent having implemented social media initiatives years ago. Typically, larger chains are ahead of independent operators, but the latter are starting to catch up. Facebook, Twitter, blogs and YouTube are the most-commonly used social media tools, with Facebook being the vehicle of choice for social media novices. Cited as the top two benefits of social media are building relationships with customers and generating exposure for the company.
- Half of retailers are active in mobile marketing, with website optimization and mobile advertising being the most commonly implemented techniques. To date, only 14.9 percent of food retailers have developed custom smartphone apps.

- Price differentiation is the third-most popular strategy for differentiation among food retailers.
- Health and wellness will have a greater focus in 2011. Even though retailers recognize that nutritious eating is of lesser importance to shoppers in the midst of the economic downturn, retailer merchandising, promotional and private-label development efforts remain strong. Additionally, nearly half of retailers have implemented nutritional labeling guidance programs.
- Retailers are expecting growth in the natural and organic product category in 2011. Roughly two-thirds have added SKUs and equally many already noted a rise in sales.

For the first quarter of 2011, economic growth slowed more than expected as higher food and gasoline prices dampened consumer spending in other areas. A broader measure of inflation, the personal consumption expenditures price index, rose at a 3.8 percent rate — its fastest pace since the third quarter of 2008. Growth in the U.S. gross domestic product braked to a lower-than-expected 1.8 percent annual rate after a 3.1 percent fourth-quarter pace. Consumer spending over the remainder of 2011 will much depend on whether gas and food prices continue to rise or whether they will plateau. As seen throughout the study, economic woes benefit some retailers, while others struggle to maintain sales and profit levels. Overall, retailers are less optimistic about the current environment as they are facing tough decisions on whether to pass along cost increases to the customer, and if so, to what extent. Retailers are predicting a drop in trips, but a rise in the average transaction size. Customer loyalty will be key to success in growing sales, identical-store sales and profits in 2011.