

## 2.16: Advantages and Disadvantages of Retailer Types

### Learning Objectives

- Match a retailer with its advantages and disadvantages based on its classification

Consider the number of formats within the retail industry selling food:

- club and warehouse
- mass merchandisers / supercenters / superstores
- convenience and drug
- dollar and discount
- natural and organic
- specialty
- .com and at-home delivery
- traditional grocers

Each of these formats and the retailers within them are targeting a distinct consumer or shopping occasion. They've developed their retail environment to reflect that, in order to provide value. Consider the differences described below.

### Club and Warehouse Stores



At a club store, product is handled in-bulk, meaning on pallets and in large case packs.

Club and warehouse stores like BJ's, Costco, and Sam's Club offer the lowest price per unit, or the lowest sales price for the number of pieces in a package. Club and warehouse stores accomplish this by offering a limited assortment of products and offering them in bulk sizes, passing savings from the manufacturing and logistical efficiency to their shoppers.

Think about the can of soup we discussed earlier in this module. If the soup is a popular flavor from a leading manufacturer, it might be offered at a club or warehouse store. However, each can won't be available as a single unit. Instead, the soup will be sold in a multipack, with several cans in the same package. By doing this, the retailer helps the manufacturer by selling products that can be manufactured in the most efficient way, i.e. selling the most popular items in large quantities. By selling in high-count multipacks, the manufacturer reduces its manufacturing and packing costs. These savings are passed through to the retailer and on to the consumer.

Thus, warehouse and club stores are able to offer the lowest "cost per piece," though they usually have high prices for individual items because they're selling in bulk. Consider granola bars for example:

- \$14.79: Retail price for granola bars
- 49 individual packages
- \$0.302 per individual unit

Compare to a grocery store:

- \$2.79 retail price for granola bars
- 6 individual packages
- \$0.465 per individual unit

That is, each individual granola bar at a warehouse and club store is cheaper than what can generally be found in other channels, but the price for the total multipack is relatively high.

Generally, club and warehouse stores carry only about 10% of the total number of products available in a typical grocery store (~4,000 vs. ~40,000).<sup>[1]</sup> However, they prioritize the strongest brands and best-selling items. Furthermore, club and warehouse

stores also rotate new products into distribution frequently to create a treasure-hunt-like experience for shoppers, rewarding their loyalty.

Members pay an annual membership fee for the opportunity to shop in warehouse and club stores. In fact, most club and warehouse stores do *not* earn any profit from the sale of products. Instead, they generate profit through the sale of memberships. Costco is an example of this. Their leadership requires that the profit margin on all products be capped at 14%, covering only the cost of operations. Memberships provide all profits for the company.

## Mass Merchandisers / Supercenters



Mass merchandisers compete by offering a wide assortment of products to support a one-stop shop for consumers.

Mass merchandise retailers, or supercenters like Wal-Mart, Target, and Kmart, provide shoppers with a one-stop shop by offering multiple categories, a broad selection, and deep inventory. This creates contact efficiency, allowing shoppers to buy what they want with a smaller number of store visits and transactions. This contact efficiency reflects adaptations to consumer behavior and the resulting market forces. Consumers want to maximize their time and minimize their work. Historically, mass merchandisers have benefited from higher shopping traffic due to the breadth of the categories and services they offer. However, this traffic has slowed since 2014. We will discuss this trend in greater depth in a coming section.

The scale of mass merchandisers allows them to negotiate aggressively with suppliers, passing discounts to shoppers through promotions and lower everyday prices. Please note, however, that the Federal Trade Commission requires that manufacturers be “fair and equitable” in their pricing across all channels. They cannot pass discounts to specific retailers, in the form of favorable pricing, unless there are real efficiencies realized in doing business with that retailer.

Thus, the everyday low pricing (EDLP) many mass merchandisers offer is not a reflection of better pricing from the manufacturer. Instead, mass merchandisers have adopted a strategy where they bundle all discounts and apply them across the projected annual sales volume so they can discount each item everyday. Consider the following:

- \$2.40/unit—wholesale price of item X
- \$2.00/unit—wholesale price of item X when on sale
- \$0.40/unit—wholesale discount of unit when item X when on sale
- 40/60 Mix—percent of total manufacturer volume sold when item X is not on sale (“Off-Promotion”) or on sale (“On-Promotion”)

Thus, a mass merchandiser with an EDLP strategy would likely be offered item X at \$2.16 per unit on every order:

- $\$0.40 \text{ discount per unit} \times 60\% \text{ of volume sold "On-Promotion"} = \$0.24 \text{ discount per unit}$
- $\$2.40 - \$0.24 = \$2.16 \text{ per unit}$

This means that the mass merchandiser is buying the product at \$2.16/unit and potentially pricing it on-shelf at \$2.99 with 27.8% margins.

- $\$2.99 - \$2.16 = \$0.83$
- $\$0.83 / \$2.99 = 27.8\%$

By comparison, a competitor in another channel will purchase the product at \$2.40, which means that their shelf price, assuming a 27.1% margin, will be \$3.29. However, the \$0.30 difference in price ( $\$3.29 - \$2.99$ ) is made up when the competitor is able to put the item on sale. Then, the mass merchandiser might offer the item at \$2.79 at a better 28.3% margin.

## Convenience and Drug Stores

Convenience and drug stores are opportunistic food retailers, offering single-serve portions, smaller package sizes, and high velocity items for fill-in shopping trips. Generally, they stock very limited items and quantities, predominantly sticking to staples like milk or shelf-stable snacks, meal replacements, and beverages. Shoppers in these formats pay higher prices for convenience.

Thinking back to our soup example, it's very likely that our item might be replaced on-shelf with a comparable item with more convenience, such as a product that can be microwaved or a product that is a full meal replacement.

### Discount and Dollar Stores



Dollar and discount retail formats offset low prices by offering a no-frills shopping experience.

Discount and dollar stores, such as Aldi's, Dollar General, and Dollar Tree, are no-frills value formats that primarily stock shelf-stable, packaged foods. Because their shoppers are particularly value-oriented, discount and dollar stores typically offer private label products or items from secondary and tertiary brands. When offering products from leading national brands, these items are generally "close-dated," meaning that they're approaching their expiration date and were likely purchased at a significant discount. Staffing is minimal at these stores, and units on shelf are frequently presented in their shipping case, unlike the cleaner and more attractive presentation at other retailers.

### Natural and Organic Stores

Natural and organic Stores, e.g. Whole Foods, Sprouts and Trader Joe's, cater to health-conscious shoppers. While all-natural and organic foods have become more mainstream, they are generally priced at a significant premium to traditional grocery products. Some retailers in this space do offer traditional items, such as Cheerios at Whole Foods, while others limit their assortment exclusively to items certified as organic or all-natural. Again, thinking of our soup example, it is possible that the soup would be shelved in some natural or organic stores. However, it would not likely have the same shelf presence or focus that it warrants in other channels, especially traditional grocery.

### Specialty Retailers



Specialty retailers focus on high levels of service and customization.

Specialty retailers are on the rise as an alternative to mass merchandisers and online retailers. Their focus is on customization and customer service. Examples of this are butchers and bakers. Ethnic grocers, which shelve unique products not generally found in other outlets, are also specialty retailers. Generally, these retailers command higher prices to offset high input and labor costs.

### Online Retailers

There are many retailers who have developed their .com capabilities to complement their brick and mortar stores. Wal-Mart, for example, is in the midst of expanding at-home delivery for orders through their website, sending the product from their nearest location. There has also been an emergence of direct-to-consumer at-home delivery services like Boxed.com, Graze, and NatureBox. These companies have similar models, sending an assortment of products to the shopper's home at a set interval. Similarly, companies like Blue Apron, Hello Fresh, Sun Basket and Plated send meal preparation kits to their subscribers. These players are particularly noteworthy because they reflect a new trend within retail, fulfilling a consumer need for convenience by skipping the shopping trip entirely.

### Traditional Grocers

Traditional Grocers are the primary retail outlet for food sales, including grocery stores and supermarkets. Many of these stores are undergoing change to increase perimeter departments, reflecting consumer interest in fresh and specialty items. These areas have

higher labor costs, but are potentially areas of differentiation for the retailer.

Typically, grocery stores operate with a high-low promotional model, meaning that they advertise weekly specials to drive traffic. They pulse discounts on and off to encourage consumers to take advantage of the offer now, making consumers increase their number of purchases. As we showed earlier, a typical item may have a cost structure like this:

- \$2.40/unit—wholesale price of item X
- \$2.00/unit—wholesale price of item X when on sale
- \$0.40/unit—wholesale discount of unit when item X when on sale
- 40/60 Mix—percent of total manufacturer volume sold when item X is not on sale (“Off-Promotion”) or on sale (“On-Promotion”)

Thus, a traditional grocer will purchase ~40% of their annual inventory at \$2.40, while buying ~60% at \$2.00. This means that their weighted average cost of goods is \$2.16. (You should note that this is the same price as the discounted rate the mass merchandise retailers receive “everyday.”)

- $\$2.40 \times 40\% = \$0.96$
- $\$2.00 \times 60\% = \$1.20$
- Weighted cost = \$2.16

As such, a traditional grocer will likely offer the item on-shelf at \$3.29, assuming a 27.1% margin, every day UNLESS they have a sale promotion. During the sale period, they’ll offer the item at \$2.79 with 28.3% margins. Given the scope of products offered in a traditional grocery store (approximately 40,000 products), these retailers are able to consistently pulse promotions weekly to drive traffic to their stores.

As you can see, each of these formats provides unique value to the consumer. For example:

- Warehouse and club stores offer the greatest value, but they require annual memberships and have relatively high item prices.
- Mass merchandisers offer everyday low prices, but the breadth of items they carry, up to 150,000, make their stores busy and difficult to shop at. Furthermore, traditional grocery stores will offer better prices on promoted items during sales.
- Convenience and drug Stores offer convenience, but have very limited selection.
- Discount and dollar stores offer low prices, but generally offer no-frills shopping environments and less well-known brands.
- Natural/organic and specialty retailers offer an array of unique items, though they generally have higher prices.
- Traditional grocers carry a wide assortment of foodstuffs and have competitive pricing. But, they do not offer the lowest prices (like club and warehouse stores) or most convenience (like mass merchandisers).

Thus, each format targets specific consumers and types of shopping trips. In order to provide value, their retail environments and strategies reflect this.

### ? Practice Questions

<https://assessments.lumenlearning.co...essments/9138>

1. <https://www.fool.com/investing/general/2015/04/26/why-does-costco-have-less-merchandise-on-its-shelv.aspx> ↩

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