The Changing Models of Inner City Grocery Retailing
Initiative for a Competitive Inner City (ICIC)  
www.icic.org

The Initiative for a Competitive Inner City (ICIC) is a national, non-partisan, not-for-profit organization founded in 1994 by Harvard Business School Professor Michael E. Porter, following several years of pioneering research on inner-city business and economic development. With affiliates in three cities and significant on-the-ground activities in many others, ICIC has rapidly established itself as a national force in inner city economic development. By identifying the competitive potential of inner cities: strategic location, local market demand, growth opportunities via integration with the regional economy and availability of labor, ICIC aims to build the business case for doing business in America’s inner cities. ICIC’s mission is to spark new thinking about the business potential of inner cities, thereby creating jobs and wealth for inner-city residents.

Garfield Foundation

The Garfield Foundation is a private grantmaking foundation, whose mission is to stimulate systemic-level solutions to progress toward a more equitable, economically prosperous and environmentally sustainable global society. Grantmaking priorities focus on community revitalization and the environment. The Community Revitalization program explores opportunities to strengthen commercial development in economically distressed urban neighborhoods that will bring reasonable priced goods and services to areas under-served by the market, provide jobs to neighborhood residents, and stimulate additional economic development. In addition to commercial development, the Foundation has a small subsidiary fund supporting innovative youth development initiatives.

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The Changing Models of Inner City Grocery Retailing

Funded by the Garfield Foundation

“Businesses are discovering that when they carefully tailor their operations to urban areas, the results are often lucrative.” —Washington Post
Over the past several years, retailers in America have begun to recognize and respond to the enormous untapped potential of inner-city markets. While low-income communities, inner cities are the last large domestic frontier for retail, characterized by high concentrations of income and limited competition. The grocery industry has been at the forefront in responding to this opportunity, spurred on by the profit potential of inner cities and the hyper-competition of their suburban base.

In 1998, the Initiative for a Competitive Inner City (ICIC) and the Boston Consulting Group conservatively estimated that America’s inner cities represent over $85 billion in annual retail spending power, equal to the total purchasing power of Mexico. In 1999 and 2000, ICIC and PricewaterhouseCoopers conducted the first national survey of 1,159 inner-city households, which showed that inner-city residents are attractive customers. The question that remained unanswered was what kind of operating models are necessary to successfully serve heterogeneous inner-city markets? For the last 50 years, retail has evolved and prospered in homogeneous, largely suburban markets. The future of America’s retailers, however, is dependent on their ability to better understand increasingly diverse customers, employees and shareholders. This report seeks to uncover key principles for grocery retailers to operate profitably in inner-city communities.

1. Flexibility is Essential.

Grocery retailers have been highly innovative in developing new formats for suburban stores. Some aspects of their suburban business models, however, do not match inner-city characteristics, such as restricted site configurations and diverse populations. Grocery retailers who are serious about taking on these promising but highly variable markets must be willing to “bend the rules” of their suburban models while also accepting greater store-level variability. In other words, flexibility itself must become part of the inner-city model.

Inner-city entrants are recognizing this and experimenting with all aspects of retailing, including smaller store formats, use of renovated buildings, new forms of local consumer research, increased use of local and “micro” suppliers, store-level exemptions from national product promotions, buyers specializing in ethnic markets, and increased local control.

While some grocery retailers have experienced tremendous success early on with their inner-city stores, others have required significant time, patience, and flexibility before they have gotten their model to work—only to discover that their next urban location requires adjustments yet again. As in the case of any “emerging market,” there is a learning curve for early entrants to the inner city. Embodied in the various experiences of inner city grocery retailers are important lessons that can inform and shape industry practice.

2. Community Relationships Are Key.

For many inner cities, a new supermarket represents one of the most significant investments to occur in years. While these stores hold out the promise of new jobs and high quality goods, residents sometimes view them with some wariness due, in part, to the checkered history of corporate behavior in low-income communities. In order to address neighborhood concerns and build support and loyalty, all of the grocery retailers in this report consider community involvement an essential part of their urban strategies. This can include engaging the community around development decisions, product selection, hiring, and security. Beyond this, it involves a demonstrated commitment to improving the quality of life in the community.

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1 By inner city, we mean economically distressed urban communities characterized by high unemployment and lower household income.
The profiles in this study reveal over and over again the critical role that community-based organizations (CBOs), particularly community development corporations (CDCs), can play as strategic partners with inner city grocery retailers. In some inner cities, CDCs comprise the only viable economic entity within the community and function as the neighborhood’s strongest institution. In the development phase, CDCs are often critical players because of their ability to attract subsidies, their patience and determination in assembling and preparing sites, and their community political knowledge. CDCs and other CBOs can also play an important role in understanding the community’s needs before and after the store is in place; building community enthusiasm for new retail developments; and recruiting, screening, and training new employees.

3. Independents and Large Chains Can Coexist.

Vibrant inner-city markets can accommodate a number of players. Large supermarket chains will have an advantage on price and range of products. As the diversity of America increases, there will always be a role for independent and ethnic grocery retailers who have an intimate understanding of targeted market segments and have the flexibility to provide their customers with highly specialized products and services.

4. Inner Cities Represent the Markets of the Future.

Grocery retailers can carry the lessons they learn in inner cities back to America’s suburbs, where minorities and immigrants represent the fastest growing portion of the population.2 “Cross-cultural” and “micro-ethnic marketing” have become grocery industry buzzwords as grocery retailers recognize the significance of America’s growing diversity. Grocery retailers can also leverage the knowledge gleaned from inner-city markets into their global operations where the integration of highly efficient operating systems and local specialization is critical to success. Grocery retailers who compete successfully in America’s inner cities will gain a level of dexterity that will enhance their abilities to increase their national and global market share. Understanding how to serve ethnically diverse markets will become one of the most important competitive advantages for grocery retailers.

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2 Richard Judy and Carol D’Amico, “Workforce 2020: Work and Workers in the 21st Century,” Hudson Institute August 1999. The white population is expected to grow at a rate of only 0.3% per year from 2000 to 2020. Over the same period of time, the African-American population is expected to grow three times faster, and the Hispanic and Asian/Pacific Islander populations ten times faster.
The post World War II era was characterized by a dramatic migration of the American middle class to the suburbs, creating a new booming market for grocery retailers who followed their migratory path. Between 1940 and 1970, the suburban population grew from 24.2 million to 75.6 million. The growth of suburban grocery stores followed suit.

By 1970, however, suburban grocery retailers began to face market saturation. Intensifying competition and increased consumer mobility forced grocery retailers to close older and smaller stores and replace them with bigger, more competitive “super store” formats. These trends resulted in a decline in the number of suburban stores from 208,300 in 1970 to 127,980 in 2000. However, the square-foot growth of suburban supermarkets dramatically outpaced demand, resulting in increasing over-capacity and “hyper-competition.”

Today, in addition to competition with each other, traditional supermarket chains are struggling to defend themselves against persistent competitive encroachment by non-traditional rivals.

■ Wal-Mart: Wal-Mart has become a dominant force in the supermarket arena and, according to market analysts, poses the most serious competitive threat to traditional grocery retailers due to its favorable supply chain economics. Wal-Mart has made food a major focus of its overall growth strategy in the belief that offering grocery items is one of the best ways to lure customers to its stores. Wal-Mart plans to continue its growth through the addition of new supercenter stores that are typically 180,000 square feet or larger. At the same time, Wal-Mart is ramping up its Neighborhood Markets chain of

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3 U.S. Census Bureau data (1940-1970) trended by Todd Gardner. Definition applied to the data in effect at the time of enumeration for each census.

smaller grocery stores (generally about 40,000 square feet), a format that has the potential to extend the company’s reach in urban communities. In 2001, Wal-Mart commanded a 3 percent share of the U.S. food market with the potential to accelerate over the next few years.\(^5\)

**Specialty Food Retailers:** Consumers face a growing array of options for purchasing food. A variety of specialty food retailers are growing in prominence including natural food purveyors such as Whole Foods, “gourmet discounters” such as Trader Joe’s, “category killers” such as PETsMART, and the list goes on. Additional competition comes from warehouse stores that offer narrow product lines and limited service in return for low prices.

**Convenience Stores:** Progressive Grocer reported in 2001 that there were 58,000 “traditional” convenience stores accounting for six percent of grocery store sales. These stores have traditionally competed indirectly with supermarkets by focusing on beer, cigarettes, snack foods, and high-priced convenience foods. But the magazine reports that a new generation of convenience stores, including 7-Eleven, is competing more directly and effectively with supermarkets by offering more attractive environments and more competitively priced food.\(^6\)

**Non-Food Retailers:** A number of new participants, including drug stores, office supply chains, gas stations, “dollar stores,” and video stores, have added grocery items to stimulate traffic and broaden their appeal. Although they may seem innocuous, they continue to siphon off sales from the traditional grocery retailers.

To survive in this intensely competitive environment, grocery retailers are taking a variety of steps. First, the industry is undergoing significant consolidation through mergers and acquisitions as grocery retailers pursue greater economies of scale. At the same time, the industry is becoming increasingly global in nature, as grocery retailers seek out new opportunities for expansion and acquisition. AC Nielsen predicts that global grocery retailers will own most food stores by 2005, and fewer than half of today’s major chains will be in existence.\(^7\)

Growth through consolidation and global expansion will not be enough, however, for the major supermarket chains to survive. To maintain and gain “stomach share” among consumers in their core markets, supermarket chains are in a desperate battle to distinguish themselves from the competition. Grocery retailers are struggling to provide greater value to consumers while also cutting costs. They are being forced to break traditional economic paradigms that typically required a trade off between costs and service and selection. Information technology can help reduce these trade-offs, but technology alone is insufficient.

Our research found that grocery retailers operating in the inner city are in many ways on the cutting edge of this paradigm shift. Inner cities represent not only a rare under-served domestic market, but also, and just as important, an opportunity to test new, more flexible models for retailing that could ultimately be applied in America’s increasingly diverse suburbs and global markets in general.

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Despite lower household incomes, inner-city areas concentrate more buying power into a square mile than many affluent suburbs. In a study completed in 1998, the Initiative for a Competitive Inner City (ICIC) and The Boston Consulting Group (BCG) conservatively estimated that America’s inner cities possess over $85 billion in annual retail spending power, equal to the total purchasing power of Mexico. More importantly, the study found that $21 billion of this demand went unmet within the inner city, representing a tremendous urban retailing gap. The study also found that inner city sales volume is a function of income density, not average household income. With a highly concentrated consumer base of shoppers, inner-city markets offer enormous buying power per square mile – two to six times as much as surrounding metro areas – despite lower household incomes.

Inner-city supermarkets are not a new concept. Some stores, particularly independents, have served inner-city communities for decades. In general, however, inner-city residents have less access to shopping centers and supermarkets than do their suburban counterparts. Inner-city shoppers typically pay higher prices for goods and services and have fewer locally available products from which to choose. A recent report in the American Journal of Preventive Medicine reinforced the findings of ICIC and BCG, pointing out that the relative lack of grocery store options is greatest in low-wealth black neighborhoods. The report goes on to say that this may disadvantage residents seeking to achieve healthy diets.

Distribution of the $85 Billion Inner City Consumer Demand ($ Billions)


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In addition to unmet demand, ICIC and BCG found that some supermarkets that have located in inner cities are actually more profitable than their suburban counterparts. Limited competition means that inner-city supermarkets have the potential for high sales per square foot and sales per employee. Another factor contributing to renewed interest in inner city supermarket development is a growing appreciation among community groups and local governments for the many ways that supermarkets can strengthen neighborhoods. Strong supermarkets provide a wide variety of competitively priced goods and services, physical rehabilitation and blight reduction, jobs for local residents, and catalysts for further retail and other commercial development. Retail is often the first visible signal of economic viability and a community’s connection to the wider economy. As such, supermarkets can represent an important engine for local economic development.

At the same time, inner-city retailing presents some unique challenges, and while some grocery retailers have successfully seized inner-city opportunities, others struggle and sometimes fail in their efforts to develop a successful urban business model.

### Inner City Grocery Stores Outperform Regional Competitors in Major Cities

<table>
<thead>
<tr>
<th>Store Averages</th>
<th>Atlanta</th>
<th>Boston</th>
<th>Chicago</th>
<th>Miami</th>
<th>New York City</th>
<th>Oakland</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales ($M)</td>
<td>IC Region</td>
<td>IC Region</td>
<td>IC Region</td>
<td>IC Region</td>
<td>IC Region</td>
<td>IC Region</td>
</tr>
<tr>
<td>Selling sq. feet (K)</td>
<td>12.0</td>
<td>30.9</td>
<td>22.7</td>
<td>23.8</td>
<td>17.8</td>
<td>26.8</td>
</tr>
<tr>
<td>Sales/sq.feet ($)</td>
<td>15.4</td>
<td>22.8</td>
<td>21.7</td>
<td>20.3</td>
<td>19.0</td>
<td>17.3</td>
</tr>
<tr>
<td>Employees</td>
<td>31.7</td>
<td>37.3</td>
<td>39.6</td>
<td>31.5</td>
<td>20.8</td>
<td>55.0</td>
</tr>
<tr>
<td>Sales/employee($K)</td>
<td>41.0</td>
<td>39.4</td>
<td>39.6</td>
<td>36.6</td>
<td>31.0</td>
<td>31.8</td>
</tr>
<tr>
<td>Sq.ft/household</td>
<td>377</td>
<td>829</td>
<td>579</td>
<td>553</td>
<td>856</td>
<td>487</td>
</tr>
<tr>
<td>Sample size</td>
<td>374</td>
<td>579</td>
<td>548</td>
<td>567</td>
<td>614</td>
<td>544</td>
</tr>
</tbody>
</table>

(1) Manhattan only; does not include Fairway (estimated sales $35M, 35K sq. ft.)

### Average Retail Demand Per Square Mile ($M)

<table>
<thead>
<tr>
<th></th>
<th>Chicago</th>
<th>Atlanta</th>
<th>Oakland</th>
<th>Detroit</th>
<th>Boston</th>
<th>Harlem</th>
</tr>
</thead>
<tbody>
<tr>
<td>Metro:</td>
<td>27</td>
<td>4</td>
<td>11</td>
<td>4</td>
<td>12</td>
<td>53</td>
</tr>
<tr>
<td>IC:</td>
<td>57</td>
<td>10</td>
<td>35</td>
<td>26</td>
<td>71</td>
<td>297</td>
</tr>
<tr>
<td>2x</td>
<td>2x</td>
<td>3x</td>
<td>6x</td>
<td>6x</td>
<td>6x</td>
<td></td>
</tr>
</tbody>
</table>


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III. Unique Challenges and Solutions of Meeting Inner City Grocery Demand

The unique challenges to developing and operating successful inner-city supermarkets are derived from four primary characteristics of inner-city neighborhoods:

■ Densely Built Environment (with limited available land) and High Development Costs
■ Higher Operating Costs
■ Diverse Populations (with a wide range of preferences)
■ Community Relationships

These factors challenge traditional supermarket chains to adjust their standard suburban business models. But as this report’s case studies illustrate, these same factors can also result in unique opportunities. Addressing these challenges and tapping these opportunities requires grocery retailers to experiment with a variety of tools and approaches. It also requires grocery retailers to allow greater business model variation across different types of inner-city markets.

Densely Built Environment and High Development Costs

Assembling, cleaning, and preparing sites for large-scale development in urban areas can be expensive and time consuming, particularly in the older and densely concentrated cities of the Midwest and Northeast. Unlike most suburban development projects in which large parcels of land typically have one owner, urban sites usually have multiple owners and may face demolition regulations that make clear-cut development impossible.

Assembly of a sizeable site can take years and require extensive litigation and municipal intervention to gain clear title. Cleaning and preparing sites then requires additional investment. As a result, the cost of urban development is typically higher.

The number of sites that can accommodate supermarkets, especially of the size typical of today’s suburban developments, is very small. As Jim Keefe, President of Trinity Financial and the developer of a Shaw’s Supermarkets in Boston, puts it, “In the inner city, you don’t select the site; the site selects you.”

In the Inner City, the Site Selects You

Opening a prototypical suburban store in the inner city can sometimes become difficult, if not impossible, if the food retailer is unwilling to adapt to the environment. However, if store developers approach city neighborhoods with some sensitivity to neighborhood concerns and if they can demonstrate a modest level of flexibility in store configuration and operations, significant progress can be made. A good example is a new Shaw’s store being developed by Trinity Financial, Inc., in the Lower Mills Section of Dorchester, Mass. The 40,000-square-foot store (Shaw’s typical store size is 58,000 sq. ft.) is being fit into a renovated warehouse that was once an integral part of the historic Walter Baker Chocolate Factory Complex. According to Jim Keefe, President of Trinity Financial, “In the inner city, you don’t select the site; the site selects you.” After another large retailer failed after two years to get community approval for the design of a 65,000-square-foot clear-cut suburban model store, Keefe and Shaw’s representatives met with community leaders and redesigned a smaller store with structured parking, largely within the existing shell of the original historic structure. Although the need to work within an existing structure presented some design and engineering issues for store planners, the majority of the community endorsed the new plan, enabling Shaw’s to succeed where others had failed.
Obtaining development financing can also be difficult. A number of financing methods to assemble investment capital are often necessary to advance such a project. The method chosen for development financing may differ depending on what entity is taking the lead in the development. Public and private-sector programs can both be used as supermarket development financing options. The Retail Initiative is an example of a private sector community investment program.

Major supermarket chains have responded to these challenges in a variety of ways. Some supermarket chains have relied on public support, often channeled through community development corporations (CDCs), to help level the costs for urban sites. In conjunction with city governments, CDCs often play a critical role in the arduous task of assembling, cleaning, and preparing sites. Local government may also offer support in terms of infrastructure investment, a situation that is not entirely different from the suburbs where developers often entice potential anchor tenants with offers to cover some infrastructure costs. As Henry Edwards, Vice President of Organizational Effectiveness of Ahold USA, Inc., the parent company of Stop & Shop and Giant Food Stores, points out, “City governments increasingly realize that they need to act more like suburban developers in supporting deals.” Edwards also notes, however, that grocery retailers are increasingly willing to enter urban markets without significant public support because of a greater appreciation of the potential of these trade areas.

Grocery retailers have also responded in a variety of ways to the dearth of large urban sites. Some grocery retailers have chosen to simply stay out of urban markets except in those rare instances when large tracts become available for development. Others, however, have begun to experiment with smaller formats and even the renovation of existing structures. Shaw’s and Trinity Financial, for example, are currently developing a 40,000-square-foot supermarket in a historic warehouse building in the Dorchester neighborhood of Boston. In locations with heavy foot traffic and good public transportation, grocery retailers are reducing their traditional parking requirements, aligning their thinking with urban planners who advocate transit-oriented development. Grocery retailers have also been increasingly willing to consider standalone urban stores, foregoing a suburban norm of having supermarkets anchor larger developments.

These examples illustrate the need for grocery retailers to be flexible, “bending the rules” of traditional suburban formats and financing models.

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The Retail Initiative (TRI) – Development Financing for Inner City Grocery Development

Founded in 1992 by the Local Initiative Support Corporation (LISC), TRI is a unique equity fund that provides venture capital and technical assistance to bring supermarkets and supermarket-anchored retail centers to low income urban areas. Ten institutional investors capitalized TRI in 1994 at $24,000,000. TRI investments range from $1 million to $3.5 million per development project and cannot exceed 30 percent of the project’s total cost. In addition, eligible projects must have a debt to capitalization ratio below 80 percent. Between 1994 and 2001, TRI committed $20.6 million to bring 740,000 square feet of much-needed retail space to inner cities across America. Typically, TRI’s investment in a project provides the leverage necessary to convince other investors to follow. In each development, TRI helps to create cooperative arrangements between community development corporations (CDCs) and supermarket operators, resulting in successful retail center developments that address identified inner city development needs – especially the need for easy access to quality affordable food and other basic goods.

TRI has made equity commitments to Pathmark Harlem (New York), Dominick’s Lawndale Plaza (Chicago), Shaw’s New Haven (Connecticut), Albertson’s West Cliff Plaza (Dallas), and many others. TRI has also co-sponsored conferences on inner city retail development and has organized panel discussions at the annual convention of the International Council of Shopping Centers.
Higher Operating Costs

While the relative costs for suburban and inner-city stores will vary by city and location, grocery retailers in many urban locations confront higher operating costs. Higher costs in the urban core include security, shrinkage, workers compensation, general liability insurance, and real estate taxes. Several grocery retailers cited a smaller average purchase size in urban stores as another key driver of higher operating costs. Another factor is lower rates of car ownership, particularly in the Northeast, resulting in small, frequent shopping trips conducted on foot or public transportation. For grocery retailers, smaller purchases result in higher transaction costs, due, in particular, to the need to hire additional cashiers.

Grocery retailers have responded to higher operating costs in a variety of ways. As with development costs, some simply count on higher sales per square foot to make up the difference. For example, in St. Louis, Schnuck Markets, Inc., (Schnucks) uses an inner city store model that relies on smaller, tighter stores to generate higher sales per square foot.

Grocery retailers are finding that, beyond higher sales per square foot, other factors can help offset the higher costs of inner-city stores. For example,

**Inner City Monthly Grocery Spending Per Capita by Household Income**

*Percent of households*

<table>
<thead>
<tr>
<th>Household income</th>
<th>Per Capita Monthly Spending</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>&lt; $75</td>
</tr>
<tr>
<td>&lt; $15,000</td>
<td>50.7</td>
</tr>
<tr>
<td>$15,000 to $24,999</td>
<td>19.7</td>
</tr>
<tr>
<td>$25,000 to $34,999</td>
<td>10.4</td>
</tr>
<tr>
<td>$35,000 to $49,999</td>
<td>10.7</td>
</tr>
<tr>
<td>&gt; $50,000</td>
<td>8.4</td>
</tr>
</tbody>
</table>


**Inner-City Residents’ Vehicle Ownership by Region**

*Percent of households*

<table>
<thead>
<tr>
<th>Region¹</th>
<th>Total IC</th>
<th>North</th>
<th>Midwest</th>
<th>South</th>
<th>West</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zero</td>
<td>37</td>
<td>68</td>
<td>28</td>
<td>27</td>
<td>26</td>
</tr>
<tr>
<td>One</td>
<td>40</td>
<td>21</td>
<td>49</td>
<td>43</td>
<td>45</td>
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<tr>
<td>Two</td>
<td>17</td>
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<td>4</td>
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<td>4</td>
<td>6</td>
<td>7</td>
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<tr>
<td>Four or more</td>
<td>2</td>
<td>0</td>
<td>2</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Mean # of cars</td>
<td>1.0</td>
<td>0.4</td>
<td>1.1</td>
<td>1.1</td>
<td>1.2</td>
</tr>
</tbody>
</table>

¹ Columns may not add to 100 due to rounding error

some grocery retailers report lower labor costs result from the inner city’s abundant supply of labor and lower turnover rate. However, this depends on local labor markets and is not universally true.

More commonly, grocery retailers report certain inner city ethnic and minority groups are heavy purchasers of high-margin perishable foods, such as produce, baked goods, meats, seafood, and freshly prepared foods. This is consistent with the ICIC/PricewaterhouseCoopers survey of shopping behavior, which shows inner-city shoppers, particularly Latinos, purchase certain perishable categories more frequently than the general population. Perishable items are more complex to manage than non-perishable packaged goods, but their substantially higher gross margins can generate significant profits for the grocery retailer.

As discussed later in this report, grocery retailers are also finding opportunities to generate incremental profits in inner-city stores by providing non-grocery goods and services that are not readily available in many under-served areas.

Finally, grocery retailers have addressed high operating costs more directly. New Community Corporation (NCC)’s Central Ward Pathmark, for example, has responded to the specific issue of small purchase sizes by successfully offering pricing incentives and return transportation to encourage shoppers to consolidate their shopping trips. Grocery retailers also report experimenting with various staffing configurations designed to minimize costs.

### Diverse Populations

The diversity of inner-city populations represents the greatest challenge faced by several of the grocery retailers profiled in this report. Inner cities are not monolithic. While some inner cities have fairly homogeneous minority populations, others are highly diverse in terms of race, ethnicity, and income.

The challenge of serving diverse populations begins with data. Inner city market research usually relies on widely available reports based on the U.S. census, typically broken down by ZIP Code. Inner city grocery retailers in multi-ethnic communities have come to realize, however, that official statistics do not capture the vibrancy and diversity of inner-city populations.

First, inner-city minorities are typically undercounted. In New York City, for example, 4.8 percent of the black population and 5.2 percent of the Latino population were missing in the 1990 census. Thus, in many neighborhoods, the number of potential shoppers is under-represented. New in-fill housing and immigration have recently expanded the minority population of many inner-city neighborhoods, making it likely that the inner-city undercount was even more significant in the 2000 census.

### Percent of Households Purchasing Perishable Items Over 30-Day Period

<table>
<thead>
<tr>
<th></th>
<th>Total U.S. Shopper Sample</th>
<th>Total Inner City</th>
<th>Primary Inner-City Shopper Sample</th>
<th></th>
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<tbody>
<tr>
<td></td>
<td>(%)</td>
<td>(%)</td>
<td>Latino</td>
<td>African-American</td>
<td>White</td>
<td></td>
<td></td>
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<tr>
<td>Produce</td>
<td>96</td>
<td>97</td>
<td>99</td>
<td>95</td>
<td>97</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Meat</td>
<td>93</td>
<td>94</td>
<td>98</td>
<td>95</td>
<td>91</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Seafood</td>
<td>48</td>
<td>57</td>
<td>50</td>
<td>70</td>
<td>48</td>
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<td></td>
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<tr>
<td>Dairy</td>
<td>97</td>
<td>95</td>
<td>96</td>
<td>94</td>
<td>96</td>
<td></td>
<td></td>
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<tr>
<td>Delicatessen Foods¹</td>
<td>66</td>
<td>67</td>
<td>64</td>
<td>69</td>
<td>67</td>
<td></td>
<td></td>
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<tr>
<td>Fresh Prepared Main Courses</td>
<td>21</td>
<td>23</td>
<td>27</td>
<td>24</td>
<td>19</td>
<td></td>
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<tr>
<td>Fresh Bakery Items</td>
<td>65</td>
<td>65</td>
<td>73</td>
<td>57</td>
<td>68</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

¹ Sliced meats and cheeses, specialty salads, etc.

III. Unique Challenges and Solutions of Meeting Inner City Grocery Demand

Second, census data uses ethnic categories that are too broadly generalized for food marketing purposes. Although broad ethnic categories, such as African American, Latino, and Asian, are adequate for many other categories of retail, eating habits can vary significantly, particularly based on country of origin. As in the late 19th century, inner cities are usually the points of entry for many new immigrant groups into the United States. Thus, under the category of Latino, for example, there are numerous nationalities, many of which coexist within single communities, but which have distinct food preferences. The Shaw’s store in East Boston sells seven different types of tortillas to meet the needs of a highly diverse Latino community. A survey of 112 random customers at America’s Food Basket in Dorchester, Mass., for example, identified 25 countries of origin.

Finally, the ethnic make-up of many inner-city communities is constantly changing. Ten-year census data is hardly adequate to keep up with the dynamic nature of many inner-city populations. In addition to ethnic and racial groups, grocery retailers need to pay attention to income groups. Many inner-city stores aim to appeal to a mix of low-, middle-, and even upper-income shoppers. In doing so, they need to account not only for diverse tastes, but also for psychological barriers that may keep different socio-economic groups from shopping at the same store.

As the case studies reveal, grocery retailers are learning to analyze, attract, and serve very diverse customer bases. While no two stores follow precisely the same approach, there are some general lessons that can be taken away related to Trade Area Assessment and Merchandizing, Supply Chain Management, Marketing and Customer Service.

Trade Area Assessment and Merchandizing: As a result of the inadequacy of traditional trade area assessments, grocery retailers are commissioning more detailed demographic reports that generate new data around such things as customer country of origin. These costly reports become quickly outdated, however, as some neighborhood demographics may experience dramatic shifts in a relatively short period of time. Getting out into the neighborhood is critical to understanding not only the demographics of the local consumers, but also the nature of the competition. Diverse inner-city communities are often homes to a variety of ethnic grocers, take-out shops, and specialty retailers. New entrants need to understand this competition in order to merchandize and price appropriately and
realistically and to assess the potential for leakage – food retail demand not satisfied by supermarkets.

As the case studies show, some grocery retailers have gone even further to get input on merchandizing from their customer bases. Shaw’s, for example, has used community meetings to solicit input on products to carry in new or renovated stores. Pathmark worked with NCC, its local community partner, to conduct focus groups with Newark’s burgeoning Latino population. In this environment, a number of grocery retailers report that store-level customer surveys are growing in popularity. Another key to successful merchandizing is finding a way to allow more store-level input into merchandizing decisions. For independents such as Boston’s Americas’ Food Basket, a two-store chain with its origins in ethnic marketing, the store-based owners, Andre Medina and Eduardo Cruz, are able to solicit input directly from customers. Americas’ Food Basket will carry a new item based on a single customer request on a test basis. If the item proves profitable, it is reordered. The owners have also empowered department heads to make merchandizing decisions, treating each department of the supermarket as a separate profit center in order to encourage financially responsible experimentation.

For large supermarket chains with elaborate systems for category management, the approach to getting local customization and input is more complex. Some chains have installed special regional buyers to support stores in diverse markets. Shaw’s, for example, has a buyer who specializes in ethnic and international foods. He spends 90 percent of his time studying the market complexities of individual stores and

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**NCC Pathmark – Recognizing a CDC’s Market Research Capability**

Like many northeastern cities that experienced significant depopulation during the last four decades, Newark, in recent years, has become the destination for significant numbers of new, particularly Latino immigrants, many of whom have settled within the trade area of NCC Pathmark. Between 1990 and 2000, Latino immigrants from 30 different countries made up two-thirds of the population of the Western Ward, which abuts the New Communities Corporation (NCC) Shopping Center. According to Monsignor William J. Linder, the Founder of NCC, “We have not done well penetrating the Latino market. The smaller ‘bodegas’ have found a profitable niche within our trade area and the leakage is significant.” Pathmark was also concerned about this issue in many of their inner-city locations. In a unique arrangement, NCC and Pathmark teamed up to study this issue.

Capitalizing on its community presence, NCC enlisted the services of its own Hispanic Development Corporation (HDC), one of the 40 companies under the NCC banner. Incorporated in 1996, the HDC is a multi-service organization providing education, job training, and housing and legal services to the Central Ward’s Latino community. In cooperation with Pathmark, the HDC conducted focus groups comprised of Latino residents to identify Latino consumer needs and ways that Pathmark could improve its services to the community at large. From these focus groups, HDC drew critical lessons on serving Newark’s Latino consumers. The primary messages include the following:

- Low food prices are important to the consumers but not at the expense of quality and freshness.
- A shopping experience that encourages social interactions is preferred.
- Store selection is often decided by certain key members of a household.
- Available transportation plays a critical role in store selection.

NCC Pathmark used the results of the HDC focus groups to inform the store layout, merchandizing, and floor-space allocation in its 2000 $1.1 million store renovation. According to Rich Savner, Pathmark’s Director of Government Relations, “Pathmark began to expand its ethnic specialty food offerings both in Newark and chain-wide.” Both NCC and Pathmark acknowledge that they have a long way to go toward seizing the new micro-market opportunities, but NCC and the HDC’s neighborhood presence can provide Pathmark with important access to the pulse of new immigrant communities.
III. Unique Challenges and Solutions of Meeting Inner City Grocery Demand

Shaw’s Ethnic Merchandising

Many of the large supermarket chains now have on-staff Ethnic Merchandising Specialists, like George Gates of Shaw’s, to address the issue of ethnic merchandising. According to Gates, Shaw’s primary goal is to have the right product offering based on demographic reports and neighborhood visits. “Whether it’s a new store or a store undergoing major remodeling, we start by looking at the demographics from the Shaw’s market research department. But it should not be your only source of information.” Gates stated that the key component, after looking at the numbers, is to go to the community and travel around to see what is in the neighborhood, who lives there, and what is the competition. It is equally important to update this process to monitor changes in the neighborhood demographics. “In our store in Ashland, Mass., we became aware of a significant new Brazilian population that suddenly emerged within the store’s trade area. Either it was recent growth or we simply missed their presence in our previous surveys. We recently added an 8-food Brazilian section to the store.”
expensive IT systems, paying high slotting fees, or undertaking significant consumer marketing, large chains have had to adjust their expectations accordingly.

Purchasing from small, local, or regional vendors is not as efficient for individual stores as purchasing from large suppliers. One supermarket chain is exploring the idea of having large suppliers take over some distribution responsibilities for smaller suppliers. Chains are also realizing, however, that the inefficiencies of smaller suppliers are at least somewhat offset by benefits. Purchasing from local vendors can help build goodwill in the community and differentiate supermarket chains that get exclusive contracts. Schnucks went so far as to provide technical assistance to a local supplier with a popular product in order to accelerate their growth. Even without such assistance, supermarket contracts have allowed some small vendors to grow and supply more of the chain. This benefits the grocery retailer, the supplier, and the community.

Even with greater flexibility, there are limits to what the large supermarket chains can economically undertake in terms of product and supplier diversity. While these limits are not clearly defined and can change as a result of IT and new approaches, industry members agree that there will continue to be a role for independent inner city grocery retailers focused on specialty products. Americas’ Food Basket, for example, successfully competes within the trade area of two large chain stores. Americas’ Food Basket’s strategy is to offer the hard-to-find items that customers will travel to purchase. The owners’ in-store presence, coupled with a willingness to test a new product

**Schnucks, St. Louis – Helping to Bring a Micro-Supplier to Scale**

In 1998, when Schnucks opened its 62,000-square-foot City Plaza superstore, it was the first full-service supermarket to open in North St. Louis since 1945. Ed Ferguson, Schnucks’ Urban Administrator of Merchandising and Community Relations, was a 30-year industry veteran with extensive inner-city experience. His first challenge was to team up with Schnucks category managers to establish a product mix at the City Plaza store that met the needs of its African American customer base. A major challenge was finding a supply source for high quality sweet potato pie. Ferguson located a good pie at Hooper’s Better Bakery on the north side of the city. The owner, Samuel Ansari, agreed to supply the City Market store. Demand for the pies grew quickly, and Schnucks successfully introduced the pies at some of its other inner-city and non-inner-city stores.

The orders soon exceeded Hooper’s production capacity, so CEO Craig Schnuck sent the Schnucks industrial engineer to review the Hooper’s production process and help develop a more efficient workflow. Schnucks then donated capital equipment to improve output. The production improvements were such a success that Hooper’s closed its retail operation and devoted its resources to supplying over 15 Schnucks supermarkets with a growing variety of pies.
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SUPERVERVALU – A Supplier Learns from its Inner-City Independents

SUPERVERVALU is one of the largest companies in the United States grocery channel. With annual revenues in excess of $20 billion, SUPERVERVALU holds leading market share positions with its 1,260 retail grocery locations and the number one market position in the extreme value grocery retailing. In addition, through SUPERVERVALU’s geographically diverse distribution centers, the company provides distribution and related logistics support services across the nation’s grocery channel, including Americas’ Food Basket (AFB) in Dorchester, Mass. While the company recognizes the largely untapped market potential of America’s inner cities, SUPERVERVALU acknowledges that it has a lot to learn about supplying this complex marketplace. The company believes that the independents’ ability to be flexible gives them a competitive advantage over the larger chains when it comes to reacting to the shifting demands of dynamic inner city ethnic communities.

SUPERVERVALU provides its independent retailers with an array of operational, marketing, and, sometimes, financial support. In its eagerness to get a handle on inner-city markets, the company is continuing to work collaboratively with its inner city independent retailers to create a two-way learning process that can be shared company-wide to be promulgated to its inner-city customers around the country. This has definitely been the case with SUPERVERVALU’s relationship with Americas’ Food Basket. According to David Klein, Area Marketing Director – New England Region, “Americas’ Food Basket is a wonderful opportunity for us. We have developed a strong relationship based on mutual trust and respect. SUPERVERVALU does not mandate how the independents operate their stores; they suggest different methods, marketing practices, and broad industry and marketplace trends.” Klein acknowledges that “we (SUPERVERVALU) cannot force the independents to do anything we want; instead, we counsel them on business information and operations. The independent retailers are in control of their business and ultimately have greater familiarity and flexibility necessary to serve the local markets.” The company’s long-term goal, relative to serving inner-city markets, is to benchmark its more successful inner-city customers, such as Americas’ Food Basket, to develop an array of replicable inner-city practices. This will be accomplished through the use of expanded ethnic product availability driven by enhanced relationships with ethnic, direct store distribution suppliers and by creating closer ties to inner city supermarket operators on a national level.

based on a single customer’s request, enables Americas’ Food Basket to rapidly respond to subtle demographic shifts and tastes missed by larger grocery retailers. Americas’ Food Basket’s largest supplier, SUPERVERVALU, supplies less than 50 percent of its stock. Beyond SUPERVERVALU, Americas’ Food Basket has relationships with 70 vendors and micro-suppliers that provide Americas’ Food Basket’s wide variety of ethnic food products. While transaction costs are typically higher with this practice, they are offset by pricing and lower, non-unionized labor costs.

Marketing and Customer Service: The grocery retailers profiled in this report recognize that inner-city residents have expectations for service that are at least as high as those of the general population. The grocery retailers we profiled have often gone beyond the norm, implementing innovative programs to attract and better serve these diverse markets. Their efforts have ranged from small things like decorating the store with flags from customers’ home countries to more significant undertakings such as hiring multilingual staff and cashing welfare and government checks at no charge. Another service offered by many stores is return transportation for customers who purchase above a set amount in a single trip. This provides customers with a valued service as well as an incentive to increase per trip purchases.
Ahold USA’s Identification of an “URBANIC” Market

For Henry Edwards, Vice President of Organizational Effectiveness for Ahold USA, one of the largest grocery retailers in the world, urban and inner-city markets represent a golden business opportunity to expand the company’s competitive advantage. According to Edwards’ research, many inner-city markets historically populated by ethnic minorities, such as Washington, D.C., are experiencing an influx of a sizeable middle class white population. Baby boomers and Generation “Xers” have been returning to some cities and demanding more convenient access to quality retail. Edwards has coined the term “URBANIC” to describe these new mixed inner-city markets. In fact, he believes that while these URBANIC markets are today considered niche markets by the grocery industry, given the population trends and shifting consumer tastes, they represent an early indicator of the core mixed markets of the near future. To capture this market opportunity, Ahold USA is directing its “global thinking and regional acting philosophy” to develop a strategy that extracts knowledge from the company’s worldwide scale and influences the entire supply chain. Through its corporate ethnic merchandising team, comprised of representatives from all of Ahold’s operating companies, Ahold has designed a cross-functional approach to merchandizing, human resources, and operations in its inner-city stores.

The Changing Models of Inner City Grocery Retailing
III. Unique Challenges and Solutions of Meeting Inner City Grocery Demand

Community Relationships

For many inner cities, a new supermarket represents one of the most significant investments to occur in years. These stores bring the promise of new jobs and improved access to high quality goods and services at better prices. But the introduction of a large supermarket chain can also present a threat to local independent grocery retailers who are used to operating in a relatively non-competitive environment. In order to address neighborhood concerns and build support and loyalty, all of the grocery retailers in this report consider community involvement an essential part of their urban strategies.

The nature of this involvement takes many forms and varies by retailer and by location. But five areas of particular interest stand out:

- Workforce Development
- Security
- Community Involvement
- Partnering with Community-Based Organizations
- Offering Needed Community Services

Workforce Development: All of the grocery retailers profiled are committed to hiring from within the community. This benefits them in several ways. It builds their image as good community citizens, allows them to tap into a large pool of workers, and, in the case of multilingual communities, ensures that their non-English-speaking customers feel welcome. At the same time, local hiring contributes to the overall economic health of the neighborhood. Grocery retailers are often able to leverage the resources, connections, and expertise of local organizations to find job-ready workers from the community. Even with such assistance, some grocery retail operators we profiled have found more time and training is required to prepare employees to meet store and customer expectations. But none have found this to be a significant barrier to operating in inner-city areas. In fact, Pathmark notes that it has below-average recruiting and training costs in its Newark store (NCC Pathmark) because of higher retention rates. This may be partially due to the fact that some entry-level employees at the Newark store are recruited directly from New Community Corporation’s workforce development training programs.

Security: As with finding qualified employees, security is another aspect of inner-city retailing that has often been incorrectly perceived as a barrier to entry. Our cases reveal that increased inner city security needs can be effectively managed. Grocery retailers have learned to make simple adjustments to the layout and design of stores and parking areas to increase security. At several of the profiled stores, access to the parking lot was limited to a single gated entrance. In addition, barriers against cart theft were incorporated into the store's exterior design.

Many grocery retailers stated that it is critical to actively engage the community in determining how to address the stores’ and consumers’ security concerns. Shaw’s, for example, began an early dialogue with the local development corporation, community representatives, New Haven Police, and security experts, to devise an effective and yet inoffensive security plan to physically protect the New Haven store and ensure the safety of customers and store employees. Americas’ Food Basket’s Andre Medina implemented a “zero tolerance” policy regarding misbehavior on the streets surrounding his store. In the early years, Medina called police several times a day, demanding that they enforce even minor infractions of the law. Eventually, the police simply increased their patrols of the entire area, creating what is today a safe inner city commercial corridor.

Community Involvement: Several of the profiled stores have gone beyond their roles as grocery retailers in an effort to support the community. The owners of Americas’ Food Basket, for example, donate to a variety of community and civic events from ethnic festivals to youth groups. The store manager of Shaw’s in New Haven serves as a commissioner on the board of the local Special Services District, which is dedicated to improving the local business environment. Schnucks CEO Craig Schnuck is the Co-Chairman of the St. Louis Inner City Competitive Alliance and the Chairman of the St. Louis Initiative for Racial Economic Progress. “Being active in the community and seeking a workforce in balance with the
community is simply the right way to do business,” Schnuck states. As operators of an important community institution, these grocery retailers consider it critical that they demonstrate their commitment to the community and support efforts to strengthen the community – efforts that, if successful, will likely help companies’ bottom lines as well.

Partnering with Community-Based Organizations: Over and over again, the profiles in this study reveal the critical role that community-based organizations (CBOs), particularly community development corporations (CDCs), can play as strategic partners with inner city grocery retailers. In some inner cities, CDCs function as the neighborhood’s strongest institution. In the development phase, CDCs are often critical players because of their ability to attract subsidies, their patience and determination in assembling and preparing sites, and their political knowledge and connections. CDCs and other CBOs can also play an important role in understanding the community’s needs before and after the store is in place; building community enthusiasm for new retail developments; and recruiting, screening, and training new employees. In the unusual case of Pathmark, NCC is a majority owner of the store exercising significant input into operating decisions. This is an unusual model, one that goes further than many grocery retailers and CDCs would choose. Nonetheless, CBOs are often indispensable partners to supermarkets operating in these complex environments.

A common theme among the stores profiled is that community involvement – of all kinds – is a security measure in and of itself because it gives community residents a sense that the store is a community asset and should be protected. Successful grocery retailers often effectively create a community center. Residents are drawn to the stores not only as places to shop, but also as safe, pleasant community gathering places for neighbors.

Offering Needed Community Services: Supermarkets in inner-city neighborhoods may find skepticism and distrust from the community due to a history of under-investment by grocery retailers. As a result, supermarkets are held to the highest expectations for quality and range of services. While this can mean special efforts are needed for grocery retailers to build trust and support from residents, it can also enhance the business opportunity for grocery retailers. As noted above, grocery retailers are finding opportunities to generate incremental profits in inner-city stores by providing non-grocery goods and services that are not readily available in these under-served areas. For example, some supermarkets have begun acting as neighborhood financial centers, offering needed services such as check cashing, money orders, wire transfers, and bill payments. In addition, some financial institutions, including banks and insurance companies, are beginning to work with supermarket chains to develop in-store mini-branches in order to serve low-income populations in a cost effective, comfortable setting. For grocery retailers, this can provide an additional source of income and increase foot traffic, thereby helping to offset higher operating costs.
IV. In Conclusion: Creating Competitive Advantage Through Flexibility

While the challenges of developing and operating supermarkets in inner cities can be substantial, grocery retailers are demonstrating that challenges can be addressed and inner-city markets served profitably. What is required for success is an “emerging market” operating model characterized by flexibility, innovation, and patience. While some inner-city stores have made above average returns from day one, many grocery retailers have struggled before finding an operating model that works, only to discover that replicating the model in another urban market requires further adjustments. Thus, flexibility and experimentation are themselves becoming essential components of inner city store performance.

For grocery retailers who rise to this challenge, the potential for profit is great. America’s cities, even those hardest hit by de-industrialization, are rebounding. As urban populations and markets grow, fueled by the current wave of immigration and, in some cases, gentrification, grocery retailers who first understand these new mixed markets will be well positioned to grow with them.

Furthermore, the lessons grocery retailers learn about serving diverse markets will be applicable in other increasingly diverse domestic and global markets. Domestically, the suburbs are themselves becoming more complex to serve due to growing immigrant and minority populations, the broadening tastes of America’s “mainstream” consumers, and the increasingly diverse nature of competition. A recent Brookings Institution study found that racial and ethnic minorities make up more than a quarter (27 percent) of the suburban population in America’s 100 largest cities, up from 19 percent in 1990. In addition, as grocery retailers extend their global reach, they will be confronted time and again with new local market conditions that require them to innovate. Inner cities represent not only a rare under-served domestic market, but also, and just as important, an opportunity to test new, more flexible models for retailing that could ultimately be applied in America’s increasingly diverse suburbs and global markets in general.

In closing, it is important to note that vibrant inner-city marketplaces can accommodate a number of players. Even with greater flexibility on the part of large supermarket chains in the inner city, there will always be limits to what they can economically undertake in terms of product diversity and customized service. As the diversity of America increases, there will always be a role for independent and niche grocery retailers who have an intimate understanding of targeted market segments and are, therefore, able to provide their customers with highly specialized products and services.

Case 1
Americas’ Food Basket: An Independent Finds its Ethnic Niche

“Congratulations! Boy, are you crazy!”

On April 21, 1992, Andre Medina and Eduardo Cruz signed their first store lease and drove to the site of their future Americas’ Food Basket (AFB) supermarket in the Upham’s Corner section of Dorchester, Massachusetts. “The area was like one of those old western movies where you’re waiting for the bad guy at the other end of the street swinging revolvers on his fingers,” Medina recalled. There were no pedestrians and no cars parked on the street. The vacant just-leased store had solid grates over its windows and doors. Upon seeing the site, Medina’s uncle said, “Congratulations! Boy, are you crazy!”

Over the last 10 years, the AFB store in Upham’s Corner has become an anchor for what is now a thriving inner city commercial district. AFB is recognized as a principal catalyst for the neighborhood’s commercial revitalization. Although the store is near two large chain supermarkets (Stop & Shop and Shaw’s), AFB is now one of the premier independent chains in the Boston area, catering to a predominantly Latino and Afro-Caribbean clientele. Based on their success in Upham’s Corner, Medina and Cruz opened a second AFB store in 1997 in Hyde Park, a new ethnically diverse inner-ring suburb.

This is the story of how Medina and Cruz identified an under-served demand by following their three strategic objectives:

- To operate efficiently and profitably
- To provide the largest variety of ethnic foods at reasonable prices to a diverse clientele
- To employ inner-city residents and be a strong part of the community’s development

They have achieved these objectives by understanding their market and developing innovative store merchandising and supplier relationship models.
Experience Counts

Andre Medina grew up in the ethnic food business. Before immigrating to the United States with his family, his father operated a neighborhood grocery store in Cuba. Once resettled in Boston, the elder Medina worked at Tropical Foods, then owned by Medina’s uncle, in Roxbury (an inner-city neighborhood of Boston). The Roxbury Tropical Foods was the largest ethnic food store chain in the Boston area with annual sales over $2 million, primarily serving an African-American, Afro-Caribbean, and Latino consumer base. Andre worked at Tropical Foods throughout high school, gaining first-hand experience at the operating and merchandising challenges presented by a multi-ethnic clientele. He learned that respect for the customers and their ethnicities is key to running a successful ethnic food retailing business. He learned that even though people may speak the same language, their dietary demands and brand preferences can be quite different – a lesson he calls the “rice lesson.” Although Tropical Foods sold several brands of rice, people from different countries were constantly asking his uncle to supply their individual national brands. Medina saw the difficulty that his uncle and father faced in profitably supplying the needs of such a diverse market. When a wave of Nigerian immigrants moved into Roxbury in the 1970s, Medina’s uncle had to travel to Africa to find a supplier of a particular brand of palm oil that his new customers requested.

Return to the Family Business – The Birth of Americas’ Food Basket

In 1992, Medina saw a newspaper advertisement listing a 10,000 square foot grocery store site for lease at the corner of Dudley Street and Ramsey Street in Dorchester. Medina immediately recognized the address because several other markets had failed at the same location. The most recent failure was owned by a fellow Cuban immigrant. “You’ll never get financing,” friends and family members warned. His friends had a point as the Upham’s Corner neighborhood had been “red-lined” for years. Nevertheless, Medina was hooked; where his friends saw obstacles, Medina saw opportunity. Medina also saw the limitations of a store focused on what was then a small ethnic niche. In particular, he recognized the stark contrast between the overall selection and quality of goods offered at various stores in inner-city Roxbury and those offered at the gleaming supermarkets in Boston’s suburbs. As a teenager, Medina made a mental note: “If I ever go into the grocery business, I will do things differently.” He saw a need for a clean, well-lit inner-city store that provided both a wide variety of ethnic merchandise and a broad selection of competitively priced standard merchandise.

As a young adult, becoming a grocer was not high on Medina’s list of career preferences. “At 22, the last thing I ever want to do is work in a supermarket,” Medina said. After completing an architecture degree at Boston’s Wentworth Institute, he worked in real estate and automobile sales. Both careers gave him hands-on marketing and finance experience. But an inner compass led him back to the business that he knew best – the food retail industry. In 1982, Medina worked at Roxbury Wholesale, a Boston area food wholesaler, as a sales representative. There, he gained exposure to the wholesale and supplier side of the grocery business, daily affirming his desire to open his own grocery store to serve the demands of Boston’s growing immigrant population.

Getting financing was, in fact, a challenge. Medina contributed $37,500 of his own money and received $12,500 from his cousin Eduardo. He then put his experience as an automobile salesman to work and convinced his employer, Tomas Dominguez, to become his partner and contribute the remaining $50,000 he needed to pull together $100,000 of seed money. Medina then set out to assemble the additional $250,000 needed to launch the new store from the commercial banking community, which proved to an arduous endeavor. Medina presented several area banks with his business plan, which projected first year sales at $5.2 million. But the banks barely returned his calls. Frustrated, Medina contacted
officials from the city of Boston, who, in conjunction with State Street Bank, guaranteed a $250,000 bank loan. In turn, Medina and his partners had to guarantee the loan with personal assets in the event of venture failure.

**Americas’ Food Basket – A Bumpy Start**

On December 14, 1992, AFB opened its doors for business. Medina (the President) and Eduardo Cruz (the Chief Operating Officer) were responsible for the market’s operation. Although SUPERVALU was AFB's primary supplier, Medina followed his uncle’s example and developed supplier relationships with a number of smaller ethnic merchandisers. He hired a multi-lingual staff and placed his then semi-retired father at the front of the store to greet new customers. Business was so brisk (first week sales were $180,000 – double the $90,000 projection outlined in the business plan) that the store ran out of merchandise. Medina and his partners seemed to be making money hand over fist with goods flying off the shelves. However, back-office accounting and inventory control were problems. Eleven weeks after the opening, Medina was shocked to discover that the store had lost over $100,000. Despite the collective food retail experience of Medina and his partners, their management experience was running the store aground. There were cost over-runs, a lack of inventory control, and no tracking of sales. While the new AFB store was meeting the community’s unmet demand, it was not making a profit.

Given the mounting losses and invoices, SUPERVALU, the 10th largest supermarket supply company in the United States, would have been justified in pulling the plug on the AFB venture. But SUPERVALU admired the energy of Medina and Cruz, saw AFB as a laboratory for gaining an understanding of the growing potential of the inner-city market, and saw working with AFB as a good opportunity to build market share. In exchange for not canceling its supplier contract, Medina and Cruz agreed to attend a weekly crash tutorial in Supermarket Management and Operations offered by senior managers at SUPERVALU’s regional offices in Andover, Mass. The weekly tutorial sessions turned out to be a mutual learning experience for both SUPERVALU and Medina and Cruz. While SUPERVALU had a lot to teach about the mechanics of store management, operations, and finance, SUPERVALU’s expertise was in serving a homogenous suburban customer base rather than AFB’s diverse inner city customer base. For example, a SUPERVALU-sponsored in-store bakery popular at suburban locations failed at AFB as customers preferred to purchase baked goods from independent bakeries, as many had done in their home countries.

After five months of tutoring, Medina and Cruz managed to turn a profit in the second year of operation. “The golden kids,” so nicknamed by SUPERVALU, tightened their labor usage, increased margins in certain areas, and curtailed expenditures for items such as display racks. At the same time, Medina followed his uncle’s example by listening to the needs of his customers while incrementally taking more control of the operation to meet those needs. Thus, AFB began to evolve into a standard bearer for running profitable independent inner-city supermarkets. SUPERVALU was so satisfied with Medina and Cruz that, in 1997, it helped them open a second store in the Hyde Park section of Boston.

**Surviving in the Face of Competition**

About a year after opening AFB, a Super Stop & Shop store opened in 1993 in nearby South Bay Plaza, one of the first and most successful inner city mall developments in the United States and less than a mile away from AFB’s Dorchester store. This was potentially a bad omen for Medina and Cruz because the new supermarket was targeting the same ethnically diverse customer base. This was particularly threatening because less than a mile away in the opposite direction stood an older 35,000-square-foot Star Market (now Shaw's). Not surprisingly, customer surveys done at the time revealed that the new Stop & Shop and Star Supermarkets were AFB’s main rivals. With suburban saturation, supermarket chains began a renewed move into urban areas in the 1990s in order to generate growth. Despite the immediate threat, in retrospect, Medina concluded, “They may have stopped our growth, but they didn’t take sales away.” Medina credits AFB’s survival to what he calls the “ignorance” of the large chains and the fact that they have difficulty reacting to change:

15 Wetterau, Inc., a St. Louis, MO-based wholesaler and retailer, was AFB’s first primary supplier. In 1992, SUPERVALU, Inc., acquired Wetterau.
In 1997, under the encouragement of Jeff Levine, landlord of the Upham's Corner building, Andre Medina and Eduardo Cruz purchased the lease on a vacant 14,700-square-foot store in Boston's Hyde Park neighborhood. Compared to the Upham's Corner store, the AFB Hyde Park was a more suburban layout, located in a plaza that included a CVS, a Radio Shack, and a video store, and less than 5 percent of Hyde Park's grocery business was walk-in traffic, compared to more than 65 percent for Upham's Corner. Hyde Park had historically been a white, working-class, inner-ring suburb, but, in recent years, it had become a neighborhood in transition, with a steady influx of working class Latino and Afro-Caribbean immigrants – AFB's target population.

SUPERVALU provided AFB with a trade-area analysis. SUPERVALU estimated a weekly sales potential of $1.3 million for the total trade area, estimating that the AFB site would generate $130,000 in weekly sales. The report projected the store's main consumer base as primarily white (the same customer base as the previous store operator). AFB based this estimate on 1990 census data and 1995 projections, which identified the trade area's population as two-thirds white, one-third black, with a “spattering” of Latinos. Skeptical of the complete accuracy of the trade area demographics, Medina and Cruz believed their ethnic market model could garner more revenue than the projected $130,000 weekly. On somewhat of a “gut feel,” they decided to open their second location. AFB enlisted SUPERVALU to help in store merchandising and layout.

SUPERVALU recommended the use of a traditional suburban model that was different from the Upham's Corner Store.

The Hyde Park store opened in August of 1997. In its earliest incarnation, the store had a single aisle devoted to ethnic products, an aisle placed in the middle of the market surrounded by others stocked with merchandise that were SUPERVALU's best movers. That ethnic aisle aside, the store was, according to Hyde Park store manager John Sittig, “essentially an American supermarket.” First week sales were an astonishing $207,000. But, by February 1998, SUPERVALU's financial statements (SUPERVALU was providing accounting services to the store) identified a $300,000 year-to-date loss caused by overly competitive pricing. For the second time in its five-year history, AFB was in jeopardy.

SUPERVALU, AFB's largest vendor, stood behind the company despite AFB being four to five weeks in arrears – at about $100,000 per week. Medina and Cruz turned to the city of Boston's Department of Neighborhood Development for help. The city considered AFB's viability important to the communities it served. In March of 2000, the city loaned AFB $837,000 to pay off its bank obligation and its vendor debt. By this time, the Hyde Park store had begun to turn around. Returning to their competitive advantage, the store began to carry more ethnic products, some which were solid sellers in Dorchester, others brought in by new vendors. Ethnic goods, as a percent of total product mix, went from 20 percent to 60 percent. The store's essence was transformed: AFB Hyde Park was reborn as an ethnic store. And after losses in years one and two of $400,000 and $160,000, respectively, AFB Hyde Park became a profitable operation. Today, the store's weekly revenues are three times that of the previous operator's and exceed the market study projections by well over 20 percent. Recent customer surveys reveal that two-thirds of Hyde Park’s customers are of Hispanic descent and one-quarter are African Americans. And the Hyde Park store, defying the market study, draws over 20 percent of its customers from outside the projected trade area.
“You can have a yucca – a very ugly looking piece of vegetable, a root favored by people from the Caribbean. If the chain carries the yucca but the produce employee has no idea what it is or where it is, you’ll never have success no matter how big you are or how much stock you have behind you. The people who work in and manage the store have to be sensitive to the people who shop there.”

David Klein, SUPERVALU’s Northeast Regional Marketing Manager, says AFB’s competitive advantage is its ability to be nimble: to swiftly adjust its merchandise selection to shifts in consumer demand. This is particularly true in the case of shifting populations of immigrants. Medina is able to make these rapid adjustments because:

■ Medina is physically in his store every day and sees who shops there.

■ He is actively involved in the community and keeps track of changes in the demographics.

■ The store is staffed with people from the community, speaking the community’s variety of languages.

■ In what some would consider a bold, non-traditional move, department managers at AFB are given full autonomy in running their own departments. Medina thinks of each manager as running his/her own little company, making independent decisions about products and pricing, labor issues, and other non-quantifiable metrics such as department cleanliness.

■ He develops strong relationships with small specialty food suppliers.

Medina acknowledges the advantage of supermarket chains in moving large quantities of commodity grocery items, and he realizes that he cannot compete with them in their space. However, by focusing on a niche, highly personalized merchandising approach and providing the friendly, clean atmosphere of a neighborhood store, AFB has managed to carve out a niche that the large supermarket chains have difficulty filling.

The Upham’s Corner store is more than a supermarket. It is a place where neighborhood residents come not only to shop but also to exchange greetings, news, and gossip. The store’s smells, languages, and food selection remind people of their home countries. The front exterior of the store is lined with flags from AFB customers’ native countries. Some regular customers drive down from as far away as New Hampshire for the specialized products and the experience.

Focusing on the Ethnic Niche – Avoiding the “Goya” Trap

Medina and Cruz believe that inner-city demand is, at best, misunderstood by industry experts and, at worst, overlooked. AFB’s primary trade area (identified by seven ZIP Codes surrounding the stores where about 80 percent of its customers reside) is ethnically diverse. According to 2000 census data, the trade area’s population is 44 percent black, 28 percent white, 16 percent Hispanic, and 12 percent other. AFB differentiates itself from its large chain competition by:

■ Recognizing that preferences differ by country of origin, and

■ Responding quickly to shifts in customer demand resulting from subtle demographic changes.

AFB understands that, within its primary trade area, the Hispanic population originates from over 20 countries within Central and South America, Mexico, Puerto Rico, and the Caribbean, and, therefore, has subtly different dietary preferences. For example, though Haitians and Dominicans are both categorized as Hispanics at the macro-ethnic level, AFB recognizes that their food preferences are not monolithic. AFB’s Haitian customer prefers more produce and some slight differences in rice and pork cuts than does the average Dominican. AFB responds by stocking its shelves
accordingly. Many large chains respond to Hispanic specific grocery demand by simply adding a “Goya” aisle. Medina suggests that Latinos will not go out of their way to buy Goya products. They will go out of their way to purchase other specialty cuts of meat and rice and pick up Goya and other products while they are in the store. Medina believes that “the primary market for Goya products in large chain stores is non-Hispanics who want to cook a novelty Latin meal and Latinos who have no other choices available.”

Although SUPERVALU is AFB’s major supplier, it only provides 50 percent of its stock. AFB has relationships with 70 vendors and small food suppliers, which provide AFB’s wide variety of ethnic food products. Unfortunately, the more vendors used, the greater the variety of transactions, costs, and likelihood of errors. For example, AFB enters between 200-300 invoices each week. To mitigate this, AFB is working with partners like SUPERVALU to bring in more ethnic products through fewer suppliers. SUPERVALU, for its part, is looking to expand its ethnic product SKUs, establishing a national ethnic supplier network.

The “Rice Shack” Concept

Over two-thirds of AFB’s merchandise is ethnic focused. Medina likes to say, “AFB has flavor.” At AFB, you’ll find non-traditional items representing the dietary needs of many nationalities. AFB acknowledges that it cannot compete with the volume discount prices that the large chains offer on standard items such as toilet paper and soap. However, customers come to AFB to purchase goods not available at the large chains, such as Trinidadian coconut water and chicken feet. They might pick up standard items while they are there.

Nothing exemplifies this marketing principle better than the “Rice Shack.” AFB has an entire aisle dedicated to selling over 10 brands of rice from around the world. Rice is available from standard small boxes to restaurant size 25-pound bags. At the Rice Shack, you’ll find Tai jasmine rice, Mila Grossa, and China farm long grain enriched at extremely competitive prices. AFB is the only store carrying several of the brands in the Boston area. The Rice Shack is one example of how AFB extends its trade area for some goods to the entire metro-Boston area.

Listening to the Customer

AFB offers its customers a highly personal level of service that begins with Medina and Cruz. Most customers know them by name. Store employees are encouraged to develop first name relationships with the customers. Medina and Cruz state that this practice comes from a single lesson passed on by their fathers: Listen to the customer.

By granting a degree of autonomy to aisle managers, AFB has the ability to respond to the new product request of a single patron. AFB’s philosophy is to “try a product at least once if asked.” Ultimately, the new product’s movement – its sales volume – will determine how long it is carried. At times, finding a new ethnic product can be a challenge. Customers sometimes simply bring in a label or a jar of a foreign brand. AFB then scouts the supplier

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16 SKU stands for Stock Keeping Unit and is a number associated with a product for inventory purposes. As this number is used to identify an individual product, each product must have a SKU, and each SKU must be unique.
base to locate the product. AFB often has to source product from specialized vendors in the metropolitan New York area where there is a higher ethnic population density. “A customer will say ‘I don’t want to go to Stop & Shop to buy this box of Parmelat milk, so you bring it in for me….’ So, I find it, bring it to the store, and battle to find shelf space. Customers really appreciate that,” Medina says.

AFB’s customers purchase a high quantity of meats, often in bulk, making the meat department a vital source of revenue and profitability. Beyond variety, AFB cuts meats to customer specification. While most large chains offer this service, it is often burdensome for the customer to locate the department manager to make the request. At AFB, a customer can ring a bell at the meat window and request a certain cut and, much like at a neighborhood butcher shop from their country, wait a few minutes while the pork shoulder, for example, is chopped to their liking.

**Workforce**

AFB’s employee base represents the ethnic diversity of its customer base. Because half of AFB’s customers speak little to no English, AFB recruits multilingual employees. Despite industry wide labor issues of employment retention, especially in front-end operations, AFB’s community-based hiring approach has provided a steady stream of qualified candidates. In addition, all of AFB’s 18 managers, many of whom have been with the company since its start, have been promoted from within.

As in the rest of the grocery industry, labor is AFB’s second largest expense after cost of goods sold. However, AFB’s labor costs, as a percent of revenue and as a percent of total operating expense, are approximately 10 percent below industry averages. This is due to lower employee turnover and the fact that AFB’s employees are not unionized, which, in turn, allows AFB greater latitude in setting competitive wages and employee benefits in accordance with the local labor supply. The lower labor costs also enable the company to keep prices competitive despite the fact that AFB cannot get the same volume discounts as large chains.

**Strong Commitment to the Community**

Andre Medina considers community involvement and hiring from the neighborhood critical to the success of any inner-city business. He attempts to build a symbiotic relationship with AFB’s surrounding community. Over the last 10 years, AFB has played an instrumental role in cleaning up and rejuvenating the neighborhood. Medina exercises a one-man “zero tolerance” policy on the streets surrounding his store. In the early years when the neighborhood was still in transition, Medina called the police several times a day, demanding that they enforce even minor infractions of the law. Eventually, the police simply increased their patrols of the entire Upham’s Corner Commercial corridor and created what is today a safe commercial space.

The company sponsors and donates to a variety of community and civic events from ethnic festivals to youth groups. By using the neighborhood as its primary labor pool and using local vendors for some ethnic merchandise, AFB keeps much of its profits in the community and anchors the local area’s revitalization. Medina has also emerged as a commercial spokesperson for the community. In 2001, he and AFB were featured in a television commercial for the national insurer Liberty Mutual.

**Conclusion**

Medina and Cruz see great potential for their company. Medina believes that the ethnic consumer in Massachusetts will continue to be under-served by the grocery industry. In 1992, when AFB first opened, he estimated that the state could profitably support 10 AFB-like stores. Today, with the growth of a new immigrant population, Medina thinks that there is an opportunity for many more stores. Medina has a 20-year plan for replicating his ethnically focused neighborhood grocery model to other under-served markets in New England.

In Medina’s opinion, poverty and crime are not the inner city’s greatest problems. Instead, he believes that the perception of poverty and crime creates “far more detrimental defeatist attitudes about inner city business potential.” Medina is confident that the future will bring a new open-mindedness within the food industry. AFB has become a standard bearer for successful inner city independent grocery retailers. Its greatest competitive advantages are systems that create flexibility to adjust to heterogeneous and changing customer markets.

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17 Estimated based on late 1990s company financials and industry averages.
Case 2
Shaw’s Supermarkets: A Large Chain in Search of an Inner-City Model

An Inner-City Laboratory

In 1994, for the first time in the company’s history, Shaw’s Supermarkets (Shaw’s) closed a relatively new store because of failed revenue. Opened in 1991, the store was located in a predominantly Latino section of South Lawrence, Mass. In theory, the South Lawrence store should have been a success because it served the unmet demand of a large, diverse population including the affluent community of North Andover. The chain also had a long history of serving urban markets.

In practice, however, the store failed to build an adequate customer base and provided the company with a humbling lesson on the complexities of the modern inner city grocery market. Rather than cause a company-wide retreat from communities such as South Lawrence, the failed store taught the company critical lessons about serving such communities. Shaw’s realized that meeting the needs of diverse, non-suburban populations would require modification of its standard store development and operating models. More importantly, it realized America’s changing demographics means that a shift in consumer shopping patterns and attitudes is inevitable. Lessons from inner-city markets, which are the most ethnically diverse markets, will have chain-wide implications as the rest of the country changes.

Since 1996, Shaw’s has opened and acquired several successful inner-city stores that serve ethnically and economically diverse populations. Shaw’s inner city grocery strategy is, in essence, an incremental learning process. The company’s goal is to increase the chain’s urban presence through expansion and acquisition. With each new store, Shaw’s gains useful experience and knowledge that it applies to the next. This is the story of the incremental development of the Shaw’s inner city store model derived from its experiences in three stores: East Boston, opened in 1997; New Haven, opened in 1998; and a new store in Dorchester, Mass., due to open in 2002.

Shaw’s Urban Past

Shaw’s was founded nearly 150 years ago with a single store in downtown Portland, Maine, by George C. Shaw. Maynard A. Davis, founder of Brockton Public Market (BPM), purchased George C. Shaw Company in 1919. After many years of operating as separate entities, the two companies merged and became Shaw’s Supermar-

V. Case Studies

J Sainsbury expanded the Shaw's chain by acquiring several New England food retailers between 1987 and 2000. The company identified urban and inner-city neighborhoods as key areas for future market expansion in New England. The series of acquisitions significantly increased Shaw's urban and inner-city market share in the greater Boston area, particularly after the 1999 FTC-approved acquisition of the Star Market Company’s 37 stores. Shaw’s also opened several new urban stores, notably in South Lawrence, East Boston, and New Haven.

Shaw’s urban and inner-city expansion strategy seemed like a good fit for the company. During its first 100 years, Shaw’s and BPM stores were located in densely populated urban areas of New England, serving the various ethnic populations of the day. Then, as now, new immigrants gravitated toward urban areas along the East Coast. Shaw’s became adept at adjusting store inventories to meet the needs of these large, pre-War, ethnic (mostly European) communities. The Shaw’s store in New Bedford, Mass., stocked the sweetbreads and Linguica favored by the city’s large Portuguese population. According to Bernie Rogan, Shaw’s spokesperson:

“We [Shaw’s] always catered to some ethnicity in New England, whether it was the Franco-American population in Maine, our Portuguese communities in Fall River and New Bedford, or the Italian communities in Boston. We were aware of these consumers because they shopped and worked in our stores and they requested their native products. You didn’t want them to go down the road to someone else so you made an all-out effort. But it was easier back then because the number of communities was fewer, easily identifiable, and more densely populated than they are today.”

Like most chains, Shaw’s followed these groups in their post-War suburban migration, developing a suburban store model to meet their increasingly homogeneous tastes. In the process, Shaw’s and other chains lost touch with the urban pulse and the ability to gauge and adjust to shifts in ethnic preferences.

The Lessons of South Lawrence

In 1991, Shaw’s opened a new 52,000-square-foot store in South Lawrence, Mass. The store followed the chain’s standard suburban model that it had evolved and successfully replicated over the previous 30 years. In 1991, 42 percent of South Lawrence’s population was Latino. Although South Lawrence was considered an inner-city community, the store’s trade area included portions of the 90 percent white upper-middle-class community of North Andover, Mass. In order to be successful, Shaw’s needed to meet the needs of and create a comfortable environment for consumers of distinctly different ethnic backgrounds and income levels.

Between 1991 and 1996, the store struggled. The store never “caught on” with either target group. According to Gary Bienefeld, Shaw’s Vice President of Market Research,

“In retrospect, we [Shaw’s] opened South Lawrence and didn’t know how to merchandise to the urban customer at all... we didn’t even carry the number one item our Latino customers were looking for.”

This lack of appropriate merchandise mix created a situation where, as Rogan puts it, “the Hispanic community didn’t feel it was their store.” This challenge could have been overcome if the store was able to draw customers from the North Andover portion of its trade area. Ultimately, the South Lawrence store could not convince the residents of North Andover to cross the geographical and, more important, psychological barriers into South Lawrence. Given this Catch-22, the company made the difficult decision to close the South Lawrence store in 1994.

Inspired by the South Lawrence experience, Shaw’s began to re-think the company’s urban growth strategy. In 1996, the company formed a cross-functional team of field and corporate representatives to consider its urban growth strategy. The team looked at issues of diversity across all sectors of
the company, including store operations, purchasing, real estate, and human resources. The mission statement of Shaw’s diversity team was to:

- Promote and support the creation of a company environment that welcomes all people.
- Act in an advisory capacity to senior management regarding matters of diversity in the workplace.
- Provide advice and council to the diversity officers in areas of promoting programs to support a diverse workplace.
- Support the premise that marketing to a diverse customer base is integral to Shaw’s success in urban neighborhoods.
- Assist, if necessary, in the creation and implementation of programs to build a management team that is diverse in all ways at Shaw’s.

An immediate task of the team was to understand why the South Lawrence store had failed and to shape a new approach to serving the urban consumer. The team has identified the keys to successful urban retailing as operational flexibility, community involvement, and micro ethnic marketing and merchandizing. Drafting a diversity mission statement and actually implementing a diversity plan are two different things. Shaw’s distinguished itself from other large chains by its willingness to test its theories and humbly implement an incremental “learn by doing” strategy.

Putting Diversity to the Test in East Boston

With a more focused urban growth strategy, Shaw’s decided to open a store in East Boston, Mass., in 1997. The East Boston neighborhood has long been a magnet for new immigrants to the Boston area and is representative of the increasingly diverse ethnic urban marketplace. For decades, each generation of immigrants has ascended to middle class status, moved to the suburbs, and been replaced by another generation of immigrants from other countries. Once predominantly Irish, East Boston is home to large Italian and extremely diverse Latino populations, which include Salvadorans (27 percent), Colombians (14 percent), as well as significant numbers of Brazilians, and people of Afro-Caribbean extraction.20

Adding to the variety is a growing group of young urban professionals who are creating new gentrified enclaves. Recognizing East Boston’s diversity, Shaw’s put together an internal team to assemble a merchandising mix to meet the needs of the target communities of East Boston. Extensive trade-area market research revealed the African American and Latino ethnic categories included numerous sub-categories with distinct product and brand preferences. The challenge was to merchandise the future store in a manner that hit the key target food preferences, as well as to establish a mechanism for adding merchandise as new product needs emerged. As a result, the Shaw’s East Boston store offers seven different types of tortillas to meet the subtly different preferences of its Colombian, Guatemalan, and Honduran customers, and the store’s deli counter carries goat meat to reflect the preferences of some of its Afro-Caribbean customers. To remain current with existing and shifting customer preferences, the East Boston store manager was given increased autonomy in merchandising. In addition, to keep a hand on the community pulse and avoid the lack of ethnic ownership problem that emerged in South Lawrence, Shaw’s recruited a workforce that reflected the community’s diversity.

After four years of operation, the East Boston store has performed better than expected. The success of the store can be attributed to the company’s willingness to admit what it did not know and adjust its standard model to the specific needs of a multi-ethnic community. The lessons of South Lawrence were transferred to East Boston, as the lessons of East Boston were later transferred to New Haven, Conn.

Shaw’s New Haven

New Haven is an ethnically diverse city with over 123,000 residents. The city’s population is 36 percent white, 36 percent black/African American, and 21 percent Hispanic/Latino, with the remainder being of mostly Asian descent. While 80 percent of the Hispanic/Latino community originates from Puerto Rico and Mexico, the other 20 percent come from more than 20 countries across Central and South America and the Caribbean. Home of Yale University, the city is a well-known and striking contrast between wealth and economic distress.

19 2000 U.S. Census Bureau data.
In 1994, a group of community activists formed a community development corporation (501-C3) called the Greater Dwight Development Corporation (GDDC) principally to improve the economic and social well-being of lower income residents of three New Haven neighborhoods: Dwight, Edgewood, and West River. That same year, a Yale University School of Management study estimated that $150 million of New Haven’s annual food consumption dollars were being exported to the suburbs where food prices were 10 percent-20 percent lower. For 20 years, the communities had been without a full service supermarket. The study reported that 66 percent of inner-city residents left the city to do their grocery shopping. According to Sheila Masterson, GDDC’s co-founder:

“Yale research indicated that the unmet consumer demand was so dense that you could plop three Super Stop & Shops on the New Haven Green and they would all thrive.”

Understandably, the cornerstone of the GDDC’s economic development plan was a full service supermarket, anchoring the Whalley Avenue Shopping Plaza, a small shopping plaza for which GDDC had successfully assembled 6.2 acres of land. The GDDC and The Retail Initiative (TRI) agreed to co-own the future Whalley Avenue Shopping Plaza with 51 percent and 49 percent ownership, respectively. Despite quantifiable data on the neighborhood’s unmet demand and site availability, five chain operators rejected GDDC’s aggressively marketed new store proposals.

With the successful launch of the East Boston store, Shaw’s was willing to take on the challenge offered by the Greater Dwight area. In 1995, Shaw’s signed a 20-year guaranteed lease on a proposed 55,000-square-foot store, which would anchor the new inner city shopping plaza located within three blocks of the Yale University campus.

Shaw’s market research team considered the Greater Dwight location “a bull’s eye.” Particularly appealing was the absence of competition (no supermarkets within two miles) and the “captive” customer base (only 20 percent of the residents owned cars). The GDDC’s leadership and the community’s commitment to making a new store work also impressed Shaw’s. The Shaw’s market research team estimated weekly trade area sales for the new store at 1 mile = $1 million and 2 miles = $3 million.

But New Haven’s Greater Dwight area also presented unique challenges. Besides the community’s ethnic diversi-
ty, the area was also home to some of the most economically distressed households in the city. In addition, as in the case of the South Lawrence store, full trade area sales maximization was dependent upon the store's ability to draw customers from an adjoining but distinct socio-economic community – Yale University students, faculty, and staff. Shaw's realized that bringing Yale to an inner-city store would require addressing psychological barriers that had previously prevented the Yale community from shopping in this community.

Community Level Collaboration

Shaw's management determined that building a successful store would require a more aggressive and innovative approach than the one used in East Boston. Taking the East Boston model to another level, the company engaged community participation in several phases of store preparation and execution, including store security, workforce, merchandising, and ongoing community involvement.

Store Security

The company began a dialogue with the GDDC, community representatives, New Haven Police, and security experts, to devise an effective and yet inoffensive security plan to physically protect the store and its merchandise and ensure the safety of customers and store employees. Shaw's ultimately implemented a security strategy that included an in-store police officer during store hours and a 24-hour manned security car in the parking lot. Beyond these measures, perhaps the greatest deterrent was the community itself. Shaw's credits the GDDC with “getting the word out” that the store belonged to the community and should be treated with respect. Shaw's worked closely with the GDDC to usher the project through the city of New Haven's various planning and zoning boards. In addition, community residents had direct input into the store's exterior appearance. Shaw's was responsible for store security.

Merchandising

The greatest challenge Shaw's faced was merchandising. According to Rogan of Shaw's, you have to begin with a broad product mix because you can't track the sale of items you don't stock. The Shaw's market research team identified 42 different ethnic and religious affiliations in the greater Dwight trade area. In addition to reviewing country of origin demographics, in an innovative merchandising strategy Shaw's collaborated with the GDDC and held a meeting with Greater Dwight's ethnic leadership to discuss product offerings. Held in a former YWCA, Shaw's buyers and category managers, sitting at tables arranged by category (e.g., produce, seafood, etc.), met one-on-one with the community representatives and solicited ideas on what products to carry. From this, the company customized its merchandising approach to fit the community's ethnic mix. As an example, the store chose to stock fresh goat meat to satisfy the needs of consumers from some Caribbean countries.

Thanks to target merchandising and marketing, the store has also been successful at drawing members of the Yale community to the store. Each year, Shaw's prepares a gift pack for new Yale students containing toothpaste, mouthwash, soap, and a redeemable phone card. Last year, Shaw's distributed 500 gift packs during freshman orientation week. The company is currently looking into establishing a credit card purchase program whereby a student's purchases are billed to his/her parent's credit card. Yale is also considering adding a Shaw's stop to the University's shuttle bus route.
On-Going Community Involvement

Shaw’s willingness to engage the community translated into a high level of community “ownership”—a missing link in the failed South Lawrence store. According to Masterson of GDDC, “The community really respects the supermarket because it’s their store; it’s a community gathering place.” The GDDC assumes an important role as a link between the community and Shaw’s. To that end, the GDDC established the Shaw’s Neighborhood Advisory Board. Chaired by a GDDC board member, the Advisory Board meets on the third Monday of every month and is a forum for customers and residents to speak directly with the store manager. Typically, a half dozen community residents attend. Recurrent topics include store cleanliness, bottle returns, and shopping carts. Shaw’s uses this as a vehicle to understand changes in its customers’ food demands.

The Shaw’s store manager is also personally involved in the community, serving as a commissioner on the board of the Whalley Avenue Special Services District. The organization’s mission is to provide a safe and conducive environment in which businesses can successfully operate. It is governed by a 13-member board of commissioners elected from property owners and business people from the community. Shaw’s participation enhances its reputation as a committed neighbor and increases its awareness of the community, its culture, and the dynamic. In New Haven, Shaw’s proactively uses community forums to keep abreast of local interest and subtle demographic shifts.

Competition

Shaw’s New Haven’s main large-chain competition is a Stop & Shop on Dixwell Avenue and another located in the abutting town of Amity. Several smaller independents, which had been serving the community before Shaw’s arrived, continue to prosper because of their niche focus. Shaw’s admits that these competitors are a source of the store’s sales leakage—food retail demand not satisfied by the store.

According to Shaw’s, sales leakage is more difficult to assess for an urban store than a suburban one. Urban residents have many more alternatives to satisfy their consumption needs, including restaurants, convenience stores, and specialty shops. In addition, specialty shops that cater to specific immigrant groups can draw away customers because of their deep knowledge of customer needs, language, and by extending informal credit. In some cases, leakage in an urban location can be two to three times that of a suburban trade area. With more urban Shaw’s stores being launched, Shaw’s is hoping to improve its leakage analysis skills to the point of creating a competitive advantage.

The Evolving Inner-City Model

The South Lawrence experience provided the impetus for Shaw’s to develop an urban approach to serving a heterogeneous trade area. According to Rogan, “We could go back to that store now and blow it away because of what we learned—the birthing that took place.” What the company learned was flexibility, the overriding principle that now informs its urban approach. The company understands that no two urban trade areas are alike and each requires a slightly customized approach. For example, the New Haven ethnic merchandising meeting was repeated in Waterbury, Conn., where attendees included three mullahs—one from Africa, the Middle East, and Eastern Europe. However, the meeting was not replicated in Providence because the neighborhood’s ethnicity was in a sensitive stage of transition—experiencing the disharmony often found when new immigrant groups replace long-standing ones.

As a major food retailing chain, Shaw’s has a traditional grocery presentation format that it utilizes in most of its stores. However, as one member of the market research team put it, “We’re a
supermarket but we can flex to meet any market.” Though store merchandise is determined at headquarters, Shaw’s has a process whereby store managers can request products to meet local customer demand. The corporate office acts on requests on a store-by-store basis; critical mass across the chain isn’t necessary. Once authorized, store managers work directly with specialized vendors, sometimes locally owned and operated. Sourcing locally extends the company’s goodwill and helps stimulate economic growth in the area it is serving. In East Boston, the manager purchases tortillas from a local Guatemalan vendor. New Haven’s manager orders direct from a Caribbean food distributor. Though available across the chain, this process is exercised most often by urban store managers because of the greater demand for specialty products.

As no two markets are alike, neither are the issues that can arise from operating a business within them. Operating in diverse areas requires heightened awareness to socio-economic sensitivities. In East Boston and New Haven, the relationships with and within the community helped Shaw’s handle potentially charged situations.

In New Haven, Shaw’s hired employees from economically challenged inner-city neighborhoods. Many new employees had limited or no work experience or exposure to good customer service. Despite these environmental factors, Shaw’s did not compromise its employee performance standard. The company felt its inner-city customers deserved the same level of service that suburbanites received, so the company took a long-term approach allowing the employee time to learn, through training and observation, good customer service skills. Developing listening skills is one example of the learning required. However, impatient community residents felt some employees were “an embarrassment” and were poorly representing the Greater Dwight area. This was indicative of the affinity between the community and the store. Shaw’s worked with ethnic leadership to inform the community of its position and to reassure its customer base that it was striving to provide the best possible customer service.

“Fitting” into the Inner City

Shaw’s believes that the urban centers of New England are grossly underserved by the food retailing industry. Expansion into these markets is part of the company’s growth strategy. New stores are under way in Providence and Boston. These new stores are testaments to the company’s flexible approach to serving the urban consumer. Shaw’s has, in essence, thrown the cookie cutter into the backroom. Locating a store in a retrofitted chocolate factory warehouse, as will be the case in Boston’s Lower Mills, Shaw’s showed a willingness to work within the constraints of the existing urban environment. Jim Keefe, President of Trinity Financial, the developer of the Lower Mills store, has an expertise in this type of inner-city development. According to Keefe, “In the inner city, you don’t select the site, the site selects you.” Slated for completion in 2003, the project will retrofit the former refrigerated warehouse of the Baker Chocolate factory into a supermarket with indoor parking for approximately 200 cars. Here, Shaw’s ability to be flexible was key as a previous large chain had failed to get community approval for a clear-cut store model that would have torn down the now-landmark structure. The 40,000-square-foot store will be 70 percent of the chain’s average store size and will serve diverse communities – Dorchester, Mattapan and Milton – with diverse populations.

Whichever urban market place it goes into, Shaw’s hopes to replicate the admiration it receives from the New Haven community, best summed up by GDDC’s Sheila Masterson:

“Shaw’s has changed the way people do business here. They’ve just been a real good neighbor. That’s got to be the key thing for any business.”
V. Case Studies

Case 3
NCC Pathmark: A Market-Making Partnership

Background

Founded by Father William Linder, a parish priest, and a group of community residents in the wake of the 1967 riots, Newark's New Community Corporation (NCC) is one of the largest and most successful community development corporations (CDCs) in America. There are currently more than 40 companies under the NCC banner. Through its programs of low income housing construction, education, workforce development, and business development, NCC is largely credited for rejuvenating Newark's Central Ward.

In 1980, Father Linder directed his significant energy and political savvy to attracting a major supermarket chain to the Central Ward. Nine years of hard work produced NCC Pathmark, the first supermarket store in the Central Ward in a generation.

NCC Pathmark is the story of a unique joint venture between a faith-based CDC and a publicly traded retail grocery chain. Pathmark's need for new markets, coupled with NCC's need to stimulate business development in Newark's Central Ward, enabled these unlikely partners to successfully navigate significant development and operational obstacles to create a Pathmark-anchored inner city shopping center. Since opening for business in 1990, the 47,000-square-foot NCC Pathmark has become one of the most profitable stores in the Pathmark chain, drawing over 50,000 customers per week. The partnership continues to evolve and generate challenges and opportunities, functioning as a laboratory for Pathmark to extract and replicate critical lessons about inner city store development and operations.

NCC – Born out of “the Riots”

The city of Newark is divided into five wards. In the 1960s, the Central Ward was a vibrant, predominantly African-American community with a mixture of small and medium-sized businesses. The summer of 1967 riots changed everything. Bill Linder, then a progressive young priest assigned to a Central Ward parish, stated: “Over five days, I (helplessly) watched the Central Ward's entire commercial sector go up in smoke.” In its wake, the ensuing middle-class flight left behind a neighborhood of low-income households, vacant lots, and virtually no commercial activity.

With strong neighborhood support, Father Linder and a core group of community leaders founded NCC in 1968. Its mission is to help Central Ward residents “improve the quality of their lives to reflect individual God-given dignity and personal achievement.” Although rooted in the development of affordable...
housing, NCC programs expanded over the last 35 years to meet the needs of the city of Newark and surrounding urban areas. NCC programs include health care, workforce development, educational programs, childcare, healthcare services, and economic and commercial development.

**Grocery Market Conditions – A Disappearing Supply**

Before the riots, there were four supermarkets within a five-block area of the Central Ward. By 1980, none remained. Central Ward consumers were forced to rely on poorly stocked and pricey convenience stores and bodegas. According to a 1980 NCC commissioned food retail study:

- Food costs were 38 percent higher in the Central Ward than in surrounding Newark suburbs.
- The quality of locally available produce, meats, and fish was generally substandard.
- Few grocery retailers were Women, Infants, and Children (WIC) program eligible. Those that were did not carry the full range of program-endorsed products.
- Ninety percent of the Central Ward’s residents did their food shopping outside the city limits. However, only one in three residents owned an automobile; thus, savings were absorbed by high transportation costs.
- Neighborhood grocery jobs in the Central Ward were mostly held by non-Ward residents.

“**The Three Ps**” – Perseverance, Patience, and Pathmark

In 1980, Bill Linder envisioned an entire NCC shopping center anchored by a supermarket. A 3.3-acre site (one square city block) at the corner of Bergen Street and South Orange Avenue was ideal. The site could draw customers from the 93,000 people who lived and worked within ½ mile of the site including workers at the University Hospital (across the street) and 10,000 residents from nearby NCC housing developments.

Unfortunately, the potential site consisted of 61 individual properties, half of which were either vacant or abandoned. Undaunted by the complicated dynamics of inner city land assembly, Linder persevered in the face of landowners who refused to sell their vacant lots. For seven years Linder lobbied the state of New Jersey to exercise its condemnation authority. His patience ultimately paid off, and with backing from the state, NCC received final approval for the acquisition for all lots in 1987. NCC then asked Central Ward residents what kind of store they wanted. Residents unanimously requested a full service “suburban style” store. They also wanted to retain a high level of community control over the future store’s hiring, pricing, and merchandising. When asked to list their preference for desired chains, the store operator of choice was Pathmark – a chain with a well-publicized expanding inner-city presence.

Founded in 1968, Pathmark pioneered urban grocery store operation in several Northeastern cities. Contrary to suburban expansion trends of other large chains in the 1970s, Pathmark opened new stores in Camden, NJ, and the Bronx, NY. The 1979 opening of Pathmark’s Bedford-Stuyvesant store garnered significant media coverage and caught the attention of Central Ward residents. In Bedford-Stuyvesant, Pathmark not only shared store ownership with the local CDC, the Bedford Stuyvesant Restoration Corporation (BSRC), but, more importantly, Pathmark allowed the BSRC to retain majority ownership.

In the early 80s, NCC and Pathmark began negotiations based on the BSRC’s joint-ownership model. In 1987, NCC and Supermarket General Holdings (parent company of Pathmark) ironed out ownership and lease arrangements. Pathmark ended up being the ideal partner for NCC. Pathmark had experience working with CDCs, and they did not have a rigid minimum store size threshold for new stores. The Central Ward’s population density, the absence of major supermarket competitors, and the participation of NCC, a reputable community partner, made the project enticing for Pathmark. In addition, NCC’s plans for a supermarket-anchored shopping center added particular value to the location.

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A Multi-Faceted Partnership at Work

After nine years of planning and development, the 47,000-square-foot NCC Pathmark supermarket opened in 1990. The store anchors the NCC Community Shopping Center, which consists of Nathan’s; Pizza Hut; World of Foods Bakery; Mailboxes, Etc.; Dunkin’ Donuts; the NCC Print and Copy Shop; and other New Community managed businesses.

The Community Supermarkets Corporation, one of 40 corporations under the NCC banner, owns the NCC Community Shopping Center. In a unique arrangement, Community Supermarkets also owns a majority 67 percent of the Newark Pathmark store, and Pathmark owns the minority 33 percent share. Ownership stakes were based proportionally on the initial investments made in the project: NCC put up $800,000 and Pathmark $400,000 of the $1.2 million needed to capitalize store operations. NCC owns the $19 million shopping plaza and rents to the partnership. In addition to one-third of the store’s profits, Pathmark makes concerted efforts to ensure that the close ties with the community continue beyond the development processes.

Despite the legal ownership arrangement, it is more important to Pathmark that residents of inner-city communities, such as the Central Ward, take psychological ownership of the store. To this end, Pathmark made significant operational concessions to the specific needs of NCC and Central Ward residents. In an industry that seeks economies of scale through standardization, Pathmark made operational concessions in the interest of taking full advantage of the special synergies created by its unique partnership with NCC.

Workforce

Prior to the 1990 store opening, NCC prescreened job candidates, minimizing hiring costs for Pathmark, and, importantly for NCC, provided a mechanism for tapping the Central Ward’s significant labor supply. When the store first opened, all but 18 of the store’s 206 employees were local residents. NCC continues to play a critical staffing role by sourcing job candidates from a separate NCC workforce development training program. Today, Pathmark credits NCC involvement with increased employee retention and lower training and recruitment costs.

Security

Security is a primary concern for all inner city grocery retailers. Central Ward residents demanded not only a clean, well-stocked supermarket, but they also wanted a safe commercial space. In another example of the NCC-Pathmark partnership at work, the NCC shopping plaza was designed with the security of customer and employee in mind. The entire plaza, including its 280-capacity parking lot, is a fenced site with a single entrance/exit. NCC’s own unarmed security force, composed of Central Ward residents, monitors the incoming and outgoing traffic and patrols the store’s exterior. In-store security, managed by NCC, is staffed by off-duty Newark police officers. The resulting safe commercial space has made the NCC Shopping Center into the “Main Street” of the Central Ward, providing residents with a place to meet. Pathmark and NCC nurture this image by providing additional social services.
services at the location, such as health care screenings and tables for community events.

The Community Takes Stock of Needs

Pathmark’s strategic goal is to serve all customers within a store’s primary trade area. Its ability to modify a store’s strategy to better serve customers is determined by a realistic assessment of the psychological and cultural influences on purchasing behavior. Pathmark’s success in neighborhoods like the Central Ward is dependent on its ability to monitor changes in consumer demand and behaviors. Based on its experiences in other inner-city locations, Pathmark used the NCC store as a test case for a new inner city store merchandising model in 1989. With NCC assistance, Pathmark conducted an on-the-ground customer survey of the Central Ward trade area. To augment the survey’s results, representatives from NCC and Pathmark jointly conducted customer surveys outside smaller neighborhood convenience stores and bodegas, collecting detailed information about customer purchasing habits and price preferences.

Armed with new data from the Central Ward, Pathmark revised its chain-wide inner city merchandising formula in 1990. Pathmark’s revised inner city store model provides staple products at competitive prices, and, where possible, specific items and services are inserted to satisfy specific local demand. Based on NCC customer surveys, a full service interactive deli and a fresh fish department replaced prepackaged prepared meats and frozen fish. Strong customer preferences for red meats and fresh produce, items that produced higher margins for Pathmark, resulted in the expansion of the selection and aisle space allocation. Tightly positioned store aisles and minimal backroom space help maximize floor-selling space and provide the greatest number of items possible, thereby maximizing the store’s sales potential.

The Pathmark market research of the Central Ward revealed a problem common to other inner city store locations. Customers were making frequent trips and smaller purchases, averaging $8 purchases per visit or about 65 percent of the average across the Pathmark chain. Market research found that, because many residents lack access to cars, the quantity of grocery purchases was limited to what could be carried home by foot or on public transportation. The smaller the purchases, the higher the transaction costs for the NCC store.

In the first year of operation, NCC and Pathmark campaigned to change customer purchase patterns by offering $2-off coupons on future purchases of $20.00 or more. In addition, given the relationship between transportation and per-trip purchasing, NCC provides subsidized return transportation service (at a nominal fee) to the customer as well as a grocery delivery service for homebound customers. Within a 12-month period, the average customer purchase increased by an estimated 50 percent, lowering transaction costs and increasing the store’s bottom line. These programs were so successful in the Central Ward that they are now standard practice at other Pathmark inner city store locations.

The Changing Customer

Between 1990 and 2000, in addition to increased employment and income levels, Newark experienced a gradual demographic shift. Although the Central Ward remained predominantly African-American, there was a significant influx of Latinos from 30 different countries, as well as a growing immigrant African and Afro-Caribbean presence. In the neighboring West Ward within NCC Pathmark’s trade area, Latinos made up two thirds of the population in 2000. Like other large chains operating in urban markets, reaching new immigrant markets has become a primary challenge for Pathmark.

Pathmark and NCC successfully teamed up again to address the issue by enlisting the services of NCC’s Hispanic Development Corporation (HDC). Incorporated in 1996 as one of 40 companies under the NCC banner, HDC is a multi-service organization providing educational, job preparation and referral, housing, and legal services to Newark’s low-income Latino community. The HDC organized Pathmark-sponsored focus groups to identify the needs of the growing Latino community. The HDC focus groups illuminated critical factors in meeting the broad grocery needs of new immigrant groups in general.
In Newark, many low-wage-earning immigrants financially support families in their countries of origin. Although low food prices are critical, quality, freshness and ethnic product variety hold equal weight, as well as social and interactive market experience. In addition, Pathmark recognized the need to develop a company-wide micro-merchandising strategy to satisfy the demand of new immigrant groups. Like other large grocery chains, Pathmark realizes that there is no simple short-term solution. According to Savner, Pathmark is taking a “trial and error” approach as they struggle “to extend ethnic specialty food items beyond the Goya Foods product line.”

To mark the store’s 10th anniversary in 2000, the store underwent a $1.6-million-dollar renovation and redesign. In addition to an increase in the store’s square footage, the store was upgraded and modernized and a new pharmacy was added. The store modifications reflected significant changes in Central Ward demographics over the last 20 years. For example, in response to ethnic customer demands, the fresh produce floor space was increased to 12 percent.

The Newark store serves as a launching pad for several small locally owned food manufacturers. Forfeiting the industry-standard slotting fees, the Pathmark Newark allocated shelf space to locally made food products. (Within the industry, stores generate as much as 5 percent of their revenue from slotting fees and trade allowances.) One local food manufacturer, Texera's Bakery, now sells its goods across the Pathmark chain. Two other smaller scale companies placed products at stores in Newark and Irvington.

Pathmark applies the same retailing fundamentals in the inner city as it does elsewhere with the exception of community involvement. Elevated above the typical suburban store sponsorship of Little League or youth soccer, community involvement in the city requires a grocery retailer to be visibly active and interested in the community and its welfare. The community’s trust has to be earned early on.

Pathmark continues to invest in inner-city opportunities, and Monsignor Linder continues to advise others trying to bring supermarkets to diverse urban neighborhoods. Each year, the store celebrates its birthday with cake and ceremony. To the people of the Central Ward, the Pathmark store isn’t simply brick and mortar, but a member of the community, like a person, deserving of celebration.

For Pathmark, community involvement is a key element of successful inner city store operation and development. According to Rich Savner, Pathmark’s Director of Public Affairs and Government Relations:

“In inner-city neighborhoods like the Central Ward, if you have a community group that supports your efforts and is willing to fund some of the project and share the risk, the store has a significantly greater likelihood of success.”

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23 Typically, grocery retailers collect a fee from food manufacturers for the placement of products on grocery shelves.
Case 4
Schnucks: A Responsible, Strong Regional Player

A Balancing Act

Schnucks is the 31st largest food retailer in the United States and is a dominant grocery player in the St. Louis market where it is headquartered, operating nine stores within the city of St. Louis, five of which serve inner-city neighborhoods. According to Craig Schnuck, Chairman and CEO of the family business founded by his grandmother:

“Proximity and ease of access from the population centers is the number one determining factor for us. People tend to shop where it’s most convenient, and we try to position our stores to serve the largest number of people conveniently.”

Schnucks’ dominant regional position gives Craig Schnuck unique insight into the differences between suburban and inner city store operations. He says that, in general, his inner-city stores have higher costs due to lower inner city St. Louis household income and lower dollars spent per transaction. To succeed, therefore, Schnucks must generate a higher dollar volume per square foot for its inner-city stores.

While Schnucks can expertly map the ideal location for new stores based on consumption patterns, Craig Schnuck’s greatest challenges in the inner city has been developing an optimum inner city store model and changing shopper behavior to maximize sales per square foot. This is the story of how Craig Schnuck balances community expectations with the reality of operating profitable stores in inner city St. Louis.

Schnucks – A Community Anchor

Founded in 1939 with a single store in north St. Louis, privately held Schnucks has over 100 stores in Illinois, Indiana, Mississippi, Missouri, Tennessee, and Wisconsin. Over the last 20 years, the company has introduced and developed its super store model: combination food and drug stores, many offering ancillary services, such as video rental, banking, and some ticket vending to events, such as St. Louis Cardinals baseball games. Stores sell seasonal goods, liquor, flowers and other general merchandise, such as cookware and stationary. While its prototypical store is 61,000 gross square feet, the company has operated stores as large as 75,000 square feet over the years and recently experimented with a 13,000-square-foot market designed to compete with new encroaching convenience stores.
Schnucks has 36 supermarkets in St. Louis County and six in both St. Charles and Jefferson counties. The company also operates two thrift bakeries in St. Louis County.

The city of St. Louis is composed of 79 neighborhoods and has 348,189 people dispersed over 61 square miles. In contrast, Newark, NJ, has double St. Louis’s number of people per square mile. With some public housing developments and high-rise apartment exceptions, St. Louis is primarily a mix of single and multi-family dwellings. Slightly more than 50 percent of the city is black/African American, 43 percent white, 2 percent Asian, and 2 percent Hispanic/Latino. St. Louis’s black population is made up of mostly African Americans who are concentrated in the northern half of the city, while the white population is concentrated in the southern half.

ICIC’s research reports that the median household income level of St. Louis urban residents is 50 percent lower than the remainder of the metropolitan statistical areas – $22,145 in the inner city as opposed to $44,548 in the remainder of the region.24 Also, car ownership among St. Louis inner-city residents is higher than average, making them more able to shop outside of their inner city.

In Search of the Optimum Inner City Store Size

For Schnucks, lower income levels in inner city St. Louis mean smaller weekly food expenditures per capita – it takes more customers in the inner city to generate a corresponding amount of county revenue. Compounded by higher operating costs in the inner city, Schnucks’ inner-city stores have a 20 percent higher breakeven compared to their county stores. According to Schnuck:

“The difficult balance is to create an inner-city store that is large enough to supply the needs of the trade area but small enough to minimize fixed and operating costs that are comparatively higher than in the county.”

Schnucks’ inner city St. Louis stores average 51,400 gross square feet or about 85 percent of the size of its latest prototypical county supermarket. However, the company does operate the City Plaza store, a replica in size of a county store, and the even larger 74,000-square-foot superstore at 3430 South Grand Boulevard. With these two exceptions, the company now estimates its ideal inner city store size to be roughly 50,000 gross square feet. In the end, urban land availability is one of the factors that influences store size and store positioning.

**Higher Costs in the Inner City**

For Schnucks, fixed and variable costs are higher in cities than in suburbs. On an activity basis, checkout operation is more expensive. Inner-city stores experience more variation in payment form (e.g., government subsidies) which drives longer transaction time and higher costs. When coupled with smaller total purchases per customer, the cost of checkout operations as percent of revenue is higher in the inner city than in a county store.

The presence of one or two armed security personnel at all times also makes security costs higher at inner-city stores. According to Craig Schnuck, the visible security personnel are less to protect the store than to “make our customers feel safe and comfortable.” Schnucks City Plaza store’s security and safety setup were modeled after the NCC Pathmark Shopping Center in Newark, NJ. A black iron fence encloses the property with a single entrance to and from the street. For Schnucks, city shrinkage is 20 percent higher than the county store averages. Inside, security cameras monitor every register and aisle. Because of the investment in security, the company reduces shrinkage to a manageable level. Low-height shelves in the drug, personal hygiene, and liquor departments also aid shrinkage prevention.

To mitigate costly shopping cart losses, Schnucks installed cart-locking systems that prevent carts from being removed from store premises. The company also advertises a toll-free number for residents to phone in cart retrieval information. In four of its inner city St. Louis stores, cart theft was reduced by as much as 90 percent. Other higher inner-city costs for Schnucks are bad check expense, workers compensation and general liability insurance, real estate taxes, and construction costs for added safety.

**Balancing Schnucks Inner-City Presence – City Plaza**

In 1993, Schnucks recognized a gap in its coverage of north St. Louis. Two years later, Schnucks purchased its rival National Supermarkets, adding five new St. Louis stores and increasing its total number of stores in the city of St. Louis to 11. After the National acquisition in 1995, the company evaluated its aggregate square foot per capita and decided to consolidate its St. Louis locations, which resulted in the closing of one of its original inner-city stores.

With approval from the city, Schnucks announced its plan to close an aging 28,000-square-foot store acquired from National Supermarkets in 1997 and open a new full-service supercenter one mile away on a 10-acre site. This supercenter would anchor the future City Plaza Shopping Center. The site, on Union Boulevard, was ideally located: accessible to highway routes and public transportation.

Like many large inner city retail development projects, the opening of the City Plaza Shopping Center was delayed by local politics and litigation. The city of St. Louis’s Economic Development Agency (EDA) ultimately acquired the land and deeded it to Schnucks. The savings on the land through EDA offset higher construction costs causing Schnucks City Plaza’s rent to be competitive with a county store of similar size. After five years, Schnucks City Plaza opened in 1998 – the first new full-service supermarket to open in north St. Louis since the end of World War II. The 62,000-square-foot City Plaza store was a crowning achievement and has solidified Schnucks market share and inner-city presence in St. Louis. Upon its opening, the City Plaza store became Schnucks’ fourth store located in north St. Louis, in addition to the five stores already located in the south.
Resistance to Further Consolidation – Delmar

In 2000, due to the success of the City Plaza store, Schnucks announced its intent to close one other inner-city store – National’s 41,000-square-foot Delmar store at 710 North Kings Highway, which had $800,000 in annual losses. Customers’ average purchases were between $14 and $15; the store needed average purchases of $18-$20 – or to draw 5,000 more than the 16,000 patrons the store was attracting weekly – just to breakeven. The store imperative for profitability was to grow revenue by 25 percent to 30 percent by some combination of increased patronage and purchase values. The store, however, was problematic on two fronts. Difficulty attracting non-African-American customers from southern parts of the trade area, and several low-price competitors, selling off-brand or warehouse-displayed merchandise, directly competed for the area’s other residents. Undoubtedly, the store suffered from psychological barriers. “The neighborhood just doesn’t relate to the store... With many customers already going to the nearby Lindell store, it made economic sense to close the Delmar market.”

The development of the City Plaza store and the planned closing of Delmar were pieces of Craig Schnuck’s urban strategy for St. Louis. “Access is key. Proximity and ease of access from the population centers is the number one determining factor for us.” Many of the city stores are located off major routes that connect the city’s commercial district on the east side with the counties to the north, south, and west. Schnucks’ nine St. Louis city stores are open for business an average of 21 hours a day, with five of them open 24 hours a day.

The announcement of the Delmar closing spurred a wave of community resistance and newspaper stories. Schnucks’ decision to close the store was viewed as swift and unexpected. To appease the community, Craig Schnuck agreed to delay the closing for six months to see if the operation could be turned around to profitability. Though the store was bleeding profuse monthly losses, Schnuck felt the decision was the right balance of community sensitivity and economic sensibility.

Schnuck recognized the importance of corporate citizenship and the responsibility that comes with the company’s dominant regional presence. In an attempt to balance the need for company profitability with a sense of social responsibility, the Delmar store is still open for business.

Merchandising Inner-City Stores

“Our goal at each store is to provide our customers with the products they need for a complete shopping trip,” Schnuck says. This is particularly important in inner-city areas because of higher leakage or shopping-out potential. St. Louis has had less of an influx of new immigrant populations than many northeastern cities. Thus, in both inner-city and county supermarkets, about 80 percent of store merchandise is identical across the chain. In some regions as much as 90 percent of store assortments are consistent with one another. As such, between 10 percent and 20 percent of a store’s product offerings are adjusted to meet its local demand.

Nevertheless, finding the right product mix can be challenging. In response, Schnuck tapped Ed Ferguson, a 30-year industry veteran with extensive inner city store management experience, to be the Urban Administrator of Merchandising & Community Relations. Ferguson teamed up with the company’s category managers to establish the City Plaza superstore’s product mix that was sensitive to the needs of African
Americans who comprised 95 percent of the store’s trade area. The store’s produce mix was adjusted to include such items as fresh greens (e.g., collard, turnip, and mustard), corn dogs, pork chitterlings, package smoked jowl, catfish, and locally produced seasoning sauces. The store stocks a wide variety of national brands because, in the company’s experience, inner-city consumers are loyal to well-known brands. A dedicated counter area also was established to serve ready-made foods, which Ferguson considered essential.

In the course of establishing the City Plaza product assortment, Ferguson and his colleagues bumped into a prevalent micro-merchandising challenge: supply source for specific African-American-preferred items. The team needed a quality sweet potato pie but the company did not have a supplier on its vendor list. Undeterred, Mr. Ferguson took to the streets and located Hooper’s Better Bakery in the city’s north section. The owner agreed to supply the City Plaza supermarket, and sales quickly grew. Because of the customer response at City Plaza, the pies were successfully introduced at other Schnucks stores, ultimately exceeding the new vendor’s production capacity. Schnuck sent his industrial engineer to review the bakery’s production process and help develop a more efficient workflow. Subsequently, Schnucks donated capital equipment to improve output. Hooper’s closed its retail operation to devote its resources to supplying over 15 Schnucks supermarkets with a variety of pies. In addition to supplying consumers with items they want, the partnership is a competitive advantage for Schnucks. The product is only available at Schnucks supermarkets, and, by collaborating with a local vendor, Schnucks generates goodwill within the community it serves.

Although input regarding merchandising is solicited from store managers, Schnucks category managers control item decisions. Store managers once
had more discretion but the company found that they were subject to vendor influence or lacked information on all available product options. According to Schnuck, “Category managers are in the best position to identify the vendors; store managers are in the best position to identify what the customers need.”

In recent years, St. Louis has increasingly attracted its share of new immigrants. Two of the Schnucks-St. Louis trade areas have experienced an influx of Latinos, and the company adjusted its merchandise as best it could. Like most food retailers, Schnucks depends on U.S. Census data, but he compares U.S. Census data to a store’s produce: “It’s good while fresh but has a quick expiration date.” To keep abreast of demographic shifts in its trade areas, the company conducts annual customer surveys for each of its stores. The company asks 70 customers of every store to grade the supermarket on friendliness, cleanliness, and merchandise variety for each department. Survey results help to inform store management and category managers of changes in customer demand locally and across the chain, respectively.

Workforce Diversity

Schnucks holds a long-standing belief in workforce diversity and seeks to hire, develop, and promote African Americans and other minorities. In 2001, the United Food and Commercial Workers Union honored Schnucks for its workforce practices. Schnucks became only the second supermarket to be named “Company of the Year” for its efforts in diversity. “If we are to succeed with a diverse customer base, we have to have a diverse organization that understands those customers and can respond to the needs of those customers,” Schnuck explains.

Craig Schnuck is a member of Civic Progress, a group of CEOs from the 30 largest companies headquartered in St. Louis. As the chairman for the group’s Initiative for Racial Economic Progress, Schnuck presided over the creation of the St. Louis Business Diversity Initiative: 115 companies committed to increasing employment and promotion of African Americans, as well as trade with African-American-owned businesses. On an annual basis, each company reports its results so the Initiative can report in aggregate to the greater St. Louis community. “Being active in the community and seeking a workforce in balance with the community is simply the right way to do business,” Schnuck says.

Commitment to the Inner City

Schnucks approaches inner-city retailing by balancing community sensitivity with economic sensibility. “We are aware of and sensitive to inner-city conditions that influence and shape consumer perceptions,” Schnuck states. “We strive to provide the same level of service and quality to all of our customers regardless of where they live.”

In 2000, the company spent $1.1 million to expand and upgrade its South City inner-city store located at 3430 South Grand Boulevard. The South City store underwent extensive interior and exterior remodeling to expand services and product offerings. The store’s ethnic food categories were expanded to serve Vietnamese, Chinese, Mexican, and Bosnian consumers. After remodeling, the store measured 74,000 gross square feet, achieving a supercenter designation and status as one of the chain’s largest stores anywhere. “These two stores require a fairly good dollar volume to support them and, therefore, require a good size population base,” Schnuck explains.

Schnuck admits that operating in the inner city does present challenges but calls any obstacles “surmountable.” Schnuck believes that striking the right balance of retail square feet per capita, cost control, workforce diversity, merchandising, and community collaboration are the keys to being a successful inner city food retailer. Schnuck considers his company’s inner city retail strategy a work in progress and, as such, he and his team continually seek to improve it.
Case Study Selected Data Summary

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<th>Store Information</th>
<th>Americas’ Food Basket</th>
<th>Shaw’s New Haven</th>
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<td>Poverty Rate*</td>
<td>19.9%</td>
<td>25.0%</td>
<td>40.9%</td>
<td>34.0%</td>
</tr>
<tr>
<td>Accessible by Public Transportation</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

**Projected 2004 ZIP Code Data**

| Number of Households | 10,307 | 20,037 | 11,383 | 8,913 |
| Median Household Income | $43,894 | $40,446 | $24,299 | $26,568 |

* Poverty Rate is the percentage of households with less than $15,000 income.

Source: 1999 CACI Sourcebook America, ICIC analysis
Selected Bibliography


The Initiative for a Competitive Inner City (ICIC) and Price-waterhouseCoopers (PwC). “Second Annual Inner-City Shopper Survey: Inner-City Shoppers Make Cents (and Dollars).” ICIC/PwC October 2000.


