Cornell Food Industry Management Program

October 1992

A.E. Ext.92-18

STATE OF NEW YORK/NEW JERSEY FOOD INDUSTRY

WHOLESALE CLUB STORES: THE EMERGING CHALLENGE

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ABSTRACT

The impact of wholesale club stores on food distribution varies greatly by region and market within the U.S. Until recently, the New York/New Jersey region has experienced limited penetration by alternative food retailing store formats. With the entry of Sam's Wholesale Club into the states of New Jersey and New York during the past 18 months the pace of expansion of wholesale club stores into the northeast has accelerated dramatically. Other recent entrants into the two state area include Pace Membership Club (a division of K-Mart), Price Club, and Costco Membership Club.

The rapid expansion plans and long-term investments being made by these firms require strategic responses from traditional food wholesalers and retailers. Although there have been a wide variety of examples of strategic responses throughout the country, the uniqueness of individual firms and markets may prevent a successful strategy in one market from being transferred to other firms or markets.

A mail survey of food wholesaler and retailer executives in New York and New Jersey, augmented by personal interviews with key executives of chain and independent retailers and wholesalers, was conducted to determine the variety and relative success of strategic responses to wholesale membership clubs. Consumer interviews were conducted in supermarkets to attempt to capture the degree to which supermarket shoppers also purchase food at wholesale membership clubs and perceive club stores as alternatives to supermarkets.

Clear distinctions in demographic profiles were found between supermarket shoppers who are also wholesale club members and those who are not. Nearly two thirds of wholesale club members surveyed had been members for less than three years. Wholesale club members rated supermarkets a better value for perishable foods but preferred the wholesale club for dry grocery products, general merchandise and health and beauty care products.

New York and New Jersey supermarket operators' ratings of supermarket value compared with wholesale club value agreed with those of wholesale club members. Supermarket executives also rated most effective those marketing strategies which emphasize supermarkets' strengths relative to club stores -- service, selection, location, etc. A variety of strategic responses concerning pricing although considered not very effective, were considered necessary competitive responses.

ACKNOWLEDGEMENTS

The success of this study of the New York/New Jersey food industry reflects the hard work, support and contributions of a broad coalition of individuals, organizations and agencies. Although the Cornell University Food Industry Management Program research staff is responsible for the contents of this report, we relied heavily on the cooperation of public and private sector sources for information, ideas and feedback.

Foremost, Kraft General Foods' sponsorship of the study is just one indication of its commitment to understanding the needs of the customers they serve in New York and New Jersey. The New York State Food Merchants Association and especially James Rogers, President, provided leadership and support for the study.

The authors also offer their gratitude to the members of the Special Advisory Committee established by the New York State Food Merchants Association to assist in the guidance of the study. We would especially like to thank:

Jim O'Neil, Wegmans Food Markets
Bill Vitulli, The Great A&P Tea Company
Jim Keller, Kraft General Foods

We also express our appreciation to the wholesale and retail executives who contributed their valuable time, information and expertise in completing the executive survey. We would especially like to thank the following New York/New Jersey food industry executives who provided valuable insight on their views and strategies concerning wholesale clubs:

Tom Lowe, Price Chopper
Ron Hodge, Hannaford Brothers
Ralph Kushner, Super Duper
Howard Fruchterman, Wakefern Food Corp.
Michael Stolarz, Twin County Grocers

The authors would also like to acknowledge the important contributions made by David Russo and Michelle Hansmire, Research Support Specialists in Cornell's Food Industry Management Program, in questionnaire development, interviewing and data analysis. Last but certainly not least, we are indebted to Sharon Wyllie, administrative assistant, for her outstanding efforts in preparing this manuscript.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

INTRODUCTION

Over the past decade several significant developments in the formats of U.S. food stores -- limited assortment stores, warehouse stores, super warehouse stores, hypermarkets, etc. -- have threatened traditional supermarkets. In general, supermarkets responded to these competitors by adapting their operations to thwart the advantage each new format presented. These alternate formats initially followed strategies of appealing to limited segments of consumers but ultimately were victims of "the wheel of retailing." That is, by succumbing to the temptation to add more features, they diluted their original strategy and in the process compromised much of their competitive advantage.

The end of the 1980's, however, marked the expansion of still another in the parade of retail store formats: the wholesale club store.[1] The emergence of the wholesale club store has been called "one of a small handful of wholesale or retail concepts developed over the past two decades that economically have the competitive staying power to become a permanent ... part of the American retailing landscape." (Goldman, Sachs Co. in The Discount Merchandiser, November 1988). Wholesale clubs also have been called "a revolution that is shaking traditional notions about the distribution of goods and blurring the distinction between wholesaling and retailing" (Business Horizons, March/April 1987) Although still representing a very small share (about 4%) of total food sales, wholesale clubs began experiencing explosive growth in the late 1980's and appeared by 1992 to be a formidable and likely permanent competitor for supermarkets. Tim Hammonds, Senior Vice President of the Food Marketing Institute (FMI) has stated that the wholesale club phenomenon "is not a temporary change. The club experience is restructuring the consumer" (Progressive Grocer, May 1992).

A "wholesale club" is defined as a retail store format which limits access to businesses and individuals who become members of the club. Membership typically requires consumers to be affiliated with established organizations such as credit unions, labor unions, large employers, government agencies, etc. and to pay a fee or premium to shop in the club. Businesses, too, pay annual membership fees and utilize the club as their wholesale supplier. In fact, initially, wholesale clubs were developed to service the needs of small businesses which are often too small to be serviced completely by traditional wholesale distributors. Small business operators are attracted to wholesale clubs for the economy and convenience of the club's "cash and carry" nature, enabling them to get products desired in quantities required at convenient times.

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[1]Wholesale clubs are also interchangeably referred to in retailing circles as "warehouse clubs" and "membership clubs". Throughout this report, for clarity we use the convention of "wholesale clubs."

METHODOLOGY

The research approach for this study consisted of four distinct but interrelated phases:

1) A review of existing research, trade literature, consulting and newsletter publications.

2) Personal interviews were conducted with 460 supermarket shoppers in New York and New Jersey. Shoppers were intercepted outside of supermarkets and interviewed regarding their shopping behavior and perceptions of wholesale clubs. Supermarkets were chosen from major market areas where wholesale clubs were already present. Shoppers were interviewed at five different supermarket chains. Three locations in New York State were used; Syracuse, Albany, Rochester and one in Elizabeth, New Jersey.

3) A survey questionnaire (see Appendix) was mailed to every retail company and every wholesale company serving independent supermarkets in New York and New Jersey. The purpose of the questionnaire was to gauge current and anticipated strategies adopted by retailers in response to the emergence and expansion of wholesale clubs in New York and New Jersey.

4) Personal interviews with New York and New Jersey supermarket industry executives were undertaken to assist in the interpretation of the written survey and trade information. This interaction served to reinforce and validate the trends, challenges and suggestions that emerged from the other components of the study.

EVOLUTION OF WHOLESALE CLUBS

WHOLESALE CLUBS VS. SUPERMARKETS

Although young and still growing, the wholesale club format has not been static. The format has evolved, changing as consumer acceptance, membership, and geographic coverage have expanded. One of the most important strategic advantages of wholesale clubs over traditional food stores is that club stores can be built in any suitable market without considering the logistics of an existing distribution system. Since, typically, a wholesale club will receive "drop shipments" directly from manufacturers, there is often no need for central warehouses, distribution centers, or transportation fleets. Whereas, most traditional supermarkets are tightly clustered in the proximity of their central wholesale distribution center, a wholesale club operator can open a store on the West Coast and another on the East Coast with comparable ease.

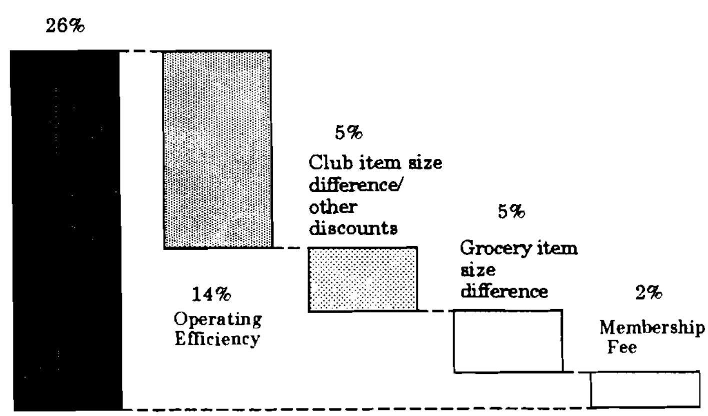
In fact, this flexibility in store site location allows clubs to enjoy other key operating and marketing advantages over supermarkets. By receiving "drop shipments" directly from manufacturers, the product mix in each club location can be tailored to suit local market demand.

Club stores are also able to adjust prices according to local market conditions without concern about a unified pricing program. By contrast, most supermarket operators with multiple store locations in a market area must offer a consistent pricing program in all those stores. One of the competitive advantages that wholesale clubs offer consumers is everyday low prices (EDLP). When adjusted to a comparable product mix offered in both formats, the average wholesale club price level is 26 percent lower than the average supermarket (Figure 1).

FIGURE 1

Source of Price Per Unit Advantage
Wholesale Clubs vs. Supermarkets

Total Price Difference in Market Baskets = 26%*



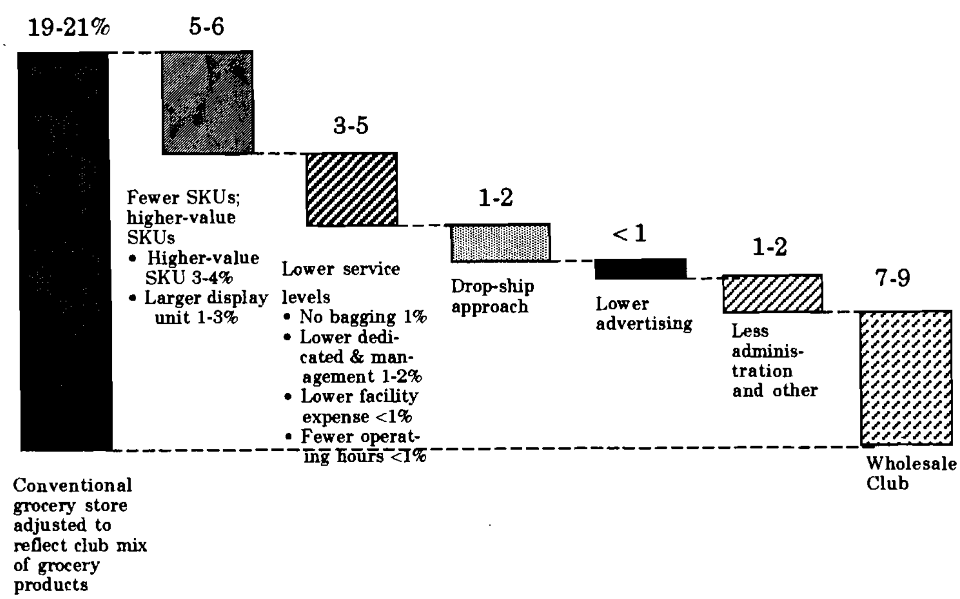
* Average supermarket price is 26% higher than average wholesale club prices

Source: FMI, 1992

The broad components from which the club's 26 percent price advantage accrues are operating efficiencies, item size differences, and membership fees. Operating efficiencies account for more than half (14%) of the 26 percent price difference between clubs and supermarkets. A closer look at the elements of club stores operating efficiencies reveals that typical supermarkets would have total operating expense ratios in the range of 19-21 percent of sales when their product mix is adjusted to reflect products also carried by wholesale clubs (Figure 2). Club stores, on the other hand, have total operating expense ratios in the range of 7-9 percent of sales. Therefore, wholesale clubs have an operating efficiency advantage over supermarkets in the range of 10-11 percent of sales.

FIGURE 2

Operating Expense Differences between Wholesale Clubs and Supermarkets



Source: FMI, 1992

Most of the operating efficiencies of wholesale clubs are traceable to the nature of the way club stores do business. Typically, wholesale clubs stock around 5,000 stock keeping units (SKU's) while supermarkets carry from around 14,000 SKU's for a "conventional" supermarket to as many as 60,000 SKU's in the larger "super combo" stores. In addition to handling fewer products, the SKU's themselves are large sizes and multi-pack sizes which have higher value per SKU than typical supermarket items. In addition, the receiving and merchandising aspects of club stores are often designed to utilize full pallets to minimize handling of individual packages. To further reduce operating costs, wholesale clubs rely on shelf price cards rather than individually pricing each package. These SKU efficiencies combined account almost half (5-6 percent) of the operating expense difference between club stores and supermarkets. The second largest efficiency difference reflects the lower customer service levels offered in the wholesale clubs. Club stores do not offer shopping bags or bagging. Store labor and management staffing requirements are much lower for club stores due to lower service levels and shorter operating hours than supermarkets. These operating characteristics also allow club stores to reduce expenses for equipment and rent.

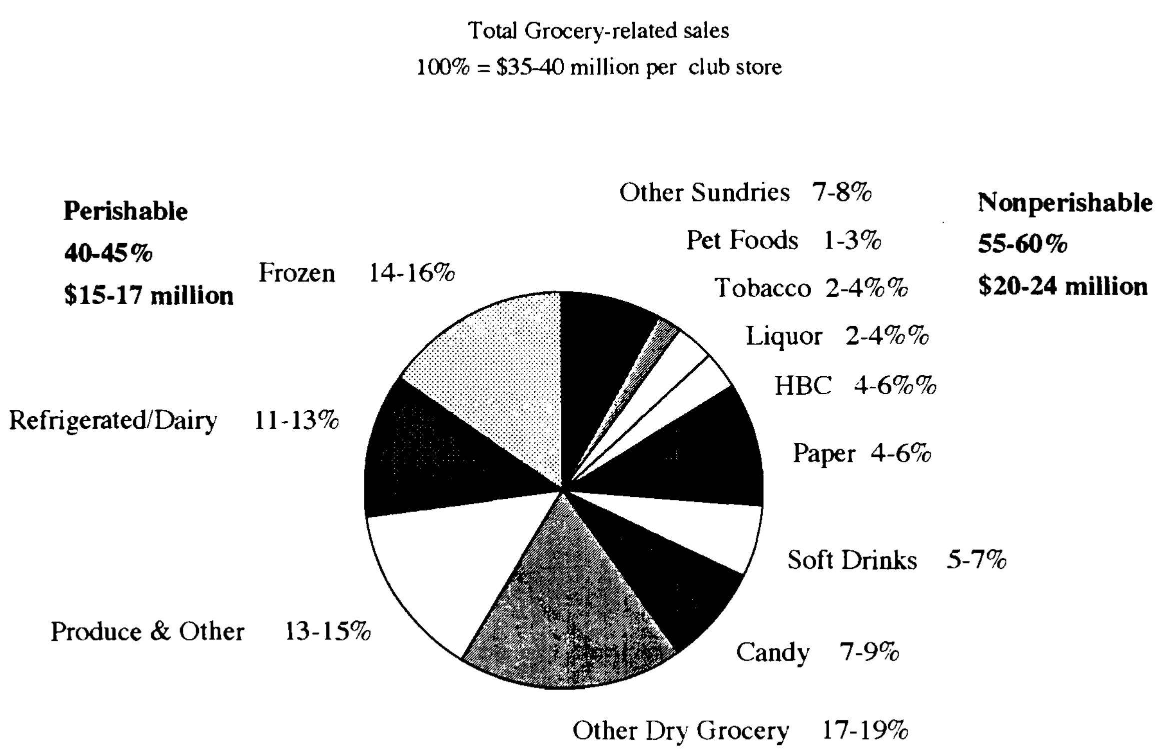
The drop-ship approach mentioned earlier eliminates the warehousing and transportation expense which costs typical supermarkets 1-2 percent of sales. Part of the club store formula is minimal advertising and promotion. This approach flows from its "everyday low price" strategy and membership requirements. Club stores do not require high visibility or high traffic locations, two conditions that tend to command the higher rents which supermarkets typically must pay.

Moreover, club store operations require less administrative and general expense due to the simplicity of their operations: fewer levels of management, less staff training needed and less maintenance and repair. One key operating efficiency arises from the merchandising philosophy of club stores. In most cases, club stores have a negative net inventory investment; this greatly reduces working capital needs. In other words, club stores stock only items with high turnover so they literally sell product through their stores before they pay for it. Supermarket operators typically offer consumers enough variety and selection to achieve "one-stop" shopping. Hence they must stock many slow moving products and thus may have millions of dollars invested in each store's inventory at any time.

Wholesale club stores operated by the major club operators averaged $58 million per store in 1991. FMI estimates that 55-65 percent or about $32-$38 million of each club store's sales are from grocery-related products. Of these grocery related sales, approximately 40-45 percent are perishable products including produce, refrigerated and frozen foods products (Figure 3).

FIGURE 3

Distribution of Grocery-Related Sales at Wholesale Clubs



Source: FMI, 1992

The remainder of grocery-related wholesale club sales are non-perishable, dry grocery product. In New York state, wholesale clubs can sell liquor, wine and beer while supermarkets can sell only beer. Likewise, in New Jersey where supermarkets can only sell wine and beer, wholesale clubs may also sell liquor.

HISTORY

Sol Price introduced the concept of the wholesale club to the U.S. when he opened the first Price Club in San Diego in 1976. The original Price Club was targeted at small business operators and, accordingly, the product mix and merchandising reflected this focus. As consumers became exposed to the concept, the product mix and merchandising were adjusted to meet consumer needs as well.

Since 1976, the wholesale club industry has grown dramatically, especially in the last ten years (Table 1). From 1985 to 1990, for example, total food store sales increased at an annual rate of just under 5 percent while wholesale club sales increased by 41 percent per year (Progressive Grocer, May 92). Further, over the period 1987 to 1992, despite the 1990-1992 recession, wholesale club sales still increased by an impressive rate of over 25 percent per year.

TABLE 1
Ten Years of Wholesale Club Industry Growth,
1983 to 1992*

YEAR	STORES	SALES ($ BIL)
1983	21	0.9
1984	65	2.0
1985	118	4.2
1986	209	7.3
1987	257	10.7
1988	306	13.9
1989	367	17.5
1990	407	22.1
1991	495	27.8
1992*	588	34.7

* Projected.

Sources: The Discount Merchandiser, June 1992
Progressive Grocer, May 1992
The Discount Merchandiser, June 1990
The Appraisal Journal, April 1990

By 1992, the size of the industry in both stores and sales, as well as the continuing high growth rate exceeded all prior expectations of retailing analysts. For example, Oppenheimer & Co. predicted that the total U.S. market could support a maximum of approximately 500 wholesale clubs (The Appraisal Journal, April 1990). By the end of 1991, however, there were already 495 wholesale clubs with total annual sales of $27.8 billion. However, sales were projected to grow to almost $35 billion in 1992 with over 90 new stores expected by year's end.

However, the largest number of wholesale club stores have been developed on the West Coast (Table 2). The New England states experienced the highest growth rates in wholesale club stores and sales in 1991 (Table 3). Still, the 1991 growth rates in the Middle Atlantic states for both sales and stores were more than double the average rates for the other seven regions of the country. National projections for wholesale club sales and stores in 1992 are for gains of 19 percent and 18 percent, respectively, over 1991 levels. The Middle Atlantic states of New York, New Jersey, and Pennsylvania registered the second fastest growth rates in wholesale club stores (31%) and sales (35%) between 1990 and 1991.

TABLE 2
Wholesale Club Growth by Region, 1988-1991

	NO. OF STORES				SALES ($ BIL.)			
REGION	**1991**	**1990**	**1989**	**1988**	**1991**	**1990**	**1989**	**1988**
New England	26	16	10	8	1.3	0.7	0.5	0.3
Middle Atlantic	38	29	20	17	2.0	1.5	0.9	0.7
East North Central	78	67	59	41	3.3	2.7	2.1	1.2
West North Central	27	23	24	16	1.2	1.0	0.9	0.5
South Atlantic	85	74	64	56	4.5	4.1	3.1	2.6
East South Central	21	19	18	19	1.0	0.8	0.7	0.7
West South Central	62	52	51	51	2.8	2.3	2.0	1.9
Mountain	33	30	25	26	2.0	1.9	1.5	1.4
Pacific	105	97	86	79	7.1	6.8	5.8	4.7

Source: The Discount Merchandiser, June 1992

TABLE 3
Wholesale Club Growth Rates by Region, 1991

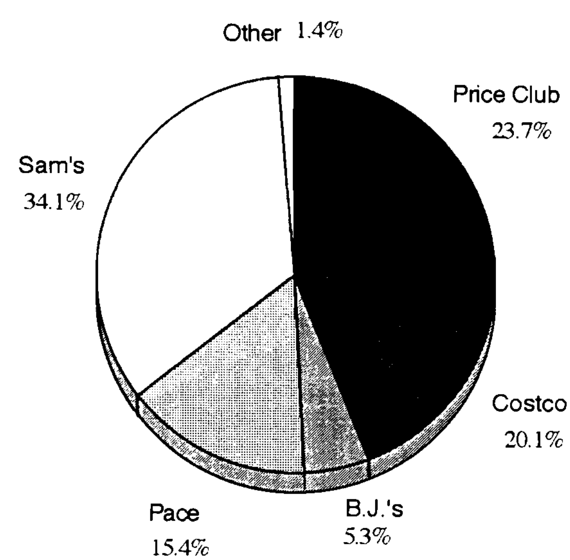
REGION	NO. OF STORES	SALES	SQUARE FEET
	%	%	%
Total U.S.	+17	+16	+21
New England	+63	+84	+64
Middle Atlantic	+31	+35	+38
Average of other Regions	+14	+15	+19

Source: The Discount Merchandiser, June 1992

While still in its growth stage, the wholesale club industry has already experienced considerable consolidation. The industry is highly concentrated with four major firms controlling over 93 percent of industry sales (Figure 4). As recently as 1985, there were at least 16 major players in the industry; by 1992, however, there were just seven (Progressive Grocer, May 92). Despite this very high level of "concentration", entry of new firms continues and appears to be constrained primarily by the availability of suitable store sites.

FIGURE 4
Wholesale Club Market Share, 1991

Total Sales Volume = $27.8 billion



Source: James M. Degen & Co., Inc., 1992

INDUSTRY LEADERS

The most powerful force in the wholesale club industry is Sam's Club, a division of Wal-Mart, the nation's largest retailer. In 1991, Sam's 204 clubs generated sales of $9.5 billion, an average of almost $46 million per club (Table 4). Sam's Club takes advantage of the volume buying, operating efficiencies and employee relations program for which Wal-Mart is renown as well as its enormous financial resources to fuel its rapid expansion.

A second major player, Price Club, was first in the market and was the industry sales leader until the recent aggressive expansion of Sam's Club. Second in sales in 1992, Price Club remains an influential force with $6.6 billion in total 1991 revenue from just 77 club locations. Price Club's average sales of over $85 million per club location in 1991 was the industry's highest by a considerable margin.

TABLE 4
Major Wholesale Club Operators, Number of Stores and Annual Sales
1991 and 1992*

	# OF STORES			SALES ($ Bil.)		
Company	**1991**	**1992***	**Percent Change (1991-92)**	**1991**	**1992***	**Percent Change (1991-92)**
Sam's	208	240	15	9.45	11.53	22
Price	77	90	17	6.60	7.90	20
Costco	80	95	19	5.30	6.09	15
Pace	87	105	21	3.65	4.30	18
BJ's	29	39	35	1.43	1.65	15
Warehouse Club	10	10	--	.24	.26	5
Wholesale Depot	4	7	75	.08	.12	50
Source Club	--	2	n.a.	--	.05	n.a.

*Projected

Source: The Discount Merchandiser, June 1992.

Costco was the third largest wholesale club operator in 1991, with sales of $5.3 billion generated by 80 club stores, for the second highest per store sales average of $66 million.

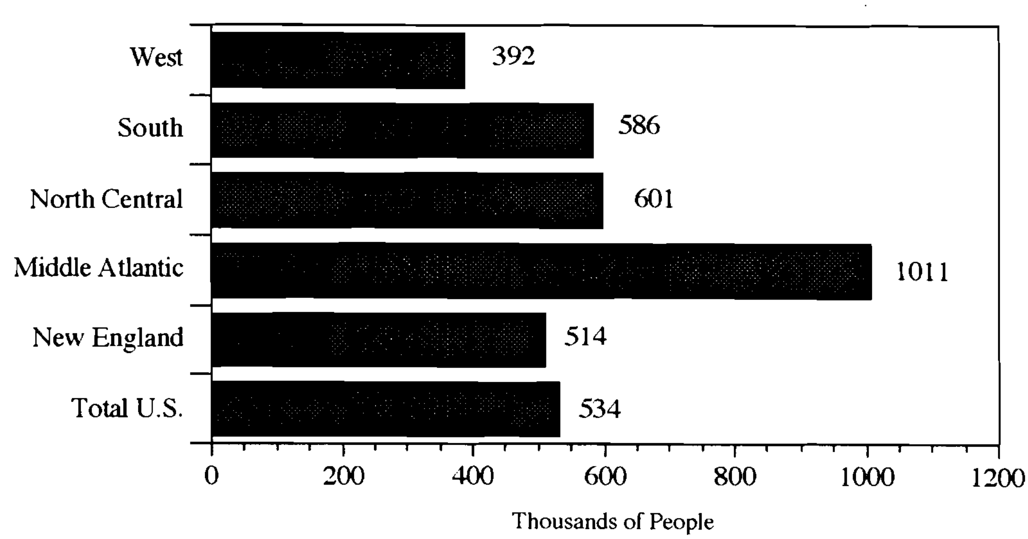
Pace Membership Club was founded in Denver in 1983 and, in 1989, was acquired by K-Mart Corp. and merged with K-Marts 9 Makro Clubs under the Pace banner. In 1990, K-Mart acquired Price Savers Wholesale Club and converted its 17 wholesale clubs to Pace units. K-Mart's enormous financial resources have continued to fuel Pace's rapid expansion. Pace controlled over 15 percent of industry sales with 1991 volume of $3.65 billion from 87 locations for an average of almost $42 million per store.

BJ's Wholesale Club began as a division of the Zayre discount store chain in 1984 and by 1992 was a part of the Waban Corporation which had been spun off from Zayre. Although BJ's is the smallest of the top five wholesale club operators, in 1991, it has a large presence in the Middle Atlantic states and was the first wholesale club to operate in the region. BJ's 29 stores averaged over $49 million for total 1991 sales of $1.4 billion.

Finally, The Warehouse Club operates 10 club locations in the Midwest and appears to have leveled off after its initial rapid expansion in the last part of the 1980's. The smallest and newest firm in the wholesale club industry is Wholesale Depot. It is characterized by a unique strategy of operating smaller clubs in market areas which appear too small to support a typical club's large format. Wholesale Depot was founded in 1989 by the former BJ's president. Wholesale Depot's stores tend to be about 60,000 square feet, approximately 60 percent the size of a typical wholesale club store.

Considering their population base, the Middle Atlantic states appear to represent the greatest potential market area for further wholesale club expansion. When population per wholesale club is examined, for example, the Middle Atlantic states have by far the fewest wholesale clubs per capita of any region in the U.S. (Figure 5). In 1991, Middle Atlantic states averaged over 1 million residents per wholesale club while Pacific states averaged just over 389,000 people per club location. In other words, the Pacific states had about three times as many wholesale clubs per capita in 1991 as did the Middle Atlantic states.

FIGURE 5
Population Per Wholesale Club (000's), 1991



Source: Discount Merchandiser, June 1992 and Progressive Grocer, April 1992

The conventional wisdom suggests that a typical wholesale club operation requires a population base of about 400,000 people (Progressive Grocer, May 1992 and Discount Merchandiser, November 1991) within its drawing radius to reach its operational and financial objectives. If this notion is true then we can conclude that the Pacific, Mountain, and West South Central states are just about saturated with wholesale clubs.

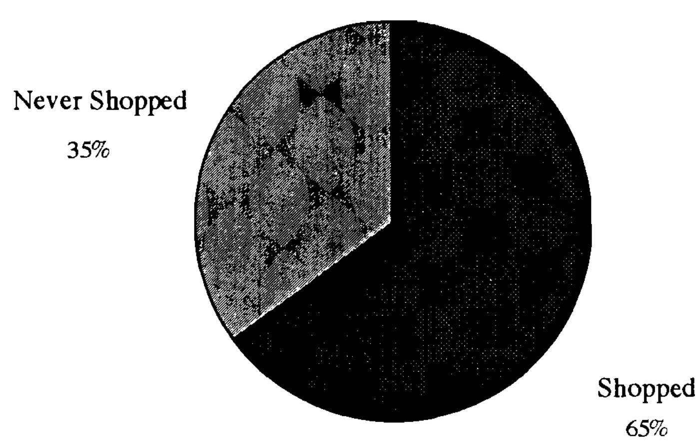
CONSUMERS RESPOND

Since the Middle Atlantic states, particularly New York and New Jersey, offer the greatest untapped potential for wholesale club expansion, the research focused on consumer and supermarket operator reactions to wholesale clubs in the two state area. The consumer survey probed differences among wholesale club members and non-members in demographics, perceptions, shopping habits and spending. The results of these investigations are reported in this section of the report.

WHOLESALE CLUB MEMBERSHIP

Each of 460 New York/New Jersey shoppers was asked to respond to a series of questions regarding wholesale club store shopping. Approximately, two thirds of the shoppers surveyed indicated that they had shopped at a wholesale club at some time in the past (Figure 6).

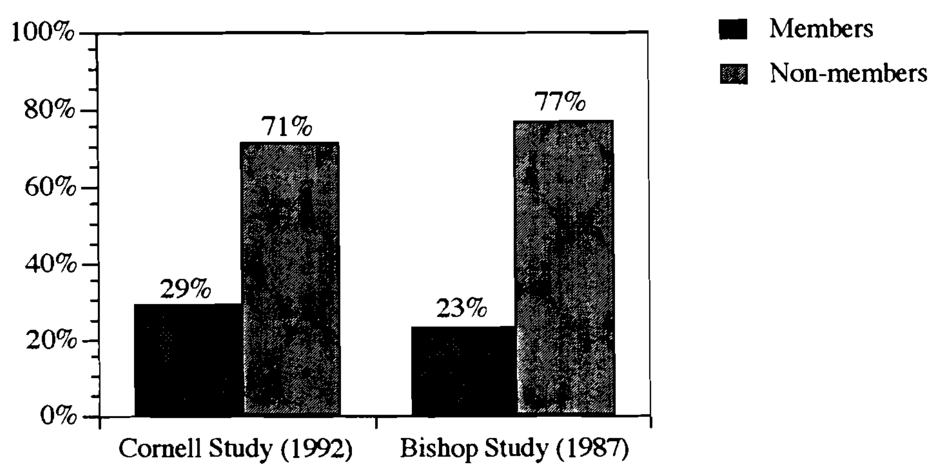
FIGURE 6
Shopping at Wholesale Clubs



Source: Cornell University, 1992

However, of those who reported having shopped at a wholesale club, slightly less than half (or 29 percent of all shoppers) actually became members of a club. This result is quite similar to another study of shopping habits at wholesale clubs conducted in Oklahoma (Bishop 1987) where 23 percent of shoppers were found to be club members (Figure 7).

FIGURE 7
Consumer Membership at Wholesale Clubs



Thus, although the majority of respondents have at one time shopped at a wholesale club, less than one third of New York/New Jersey shoppers, as represented by our sample, have chosen to make a formal commitment to wholesale club shopping by paying the required membership fee. It appears that many consumers who shop at wholesale clubs do so by shopping with a friend or relative who has a membership, thus avoiding the fee. Further, it is possible that shopping in groups also permits individuals to split up large package sizes or bulk packs into more manageable quantities thus benefiting from volume discounts without being burdened with quantities too large for individual needs.

DEMOGRAPHIC PROFILE OF MEMBERS AND NON-MEMBERS

This study identified a number of demographic factors which clearly differentiate wholesale club members from non-members (Table 5). Wholesale club members tend to be middle aged women from larger households with children. They are often part of a household with two or more persons employed with total household income between $20,000 and $60,000. In fact, members are twice as likely to be from high income households and less than half as likely to be from low income households as are non-members.

In contrast, non-members tend to come more often from less affluent households with fewer or no children. The proportion of non-members from one or two member households is 1.6 times the proportion of members. Furthermore, non-members are nearly twice as likely to be over 55 years old and retired (see Table 1).

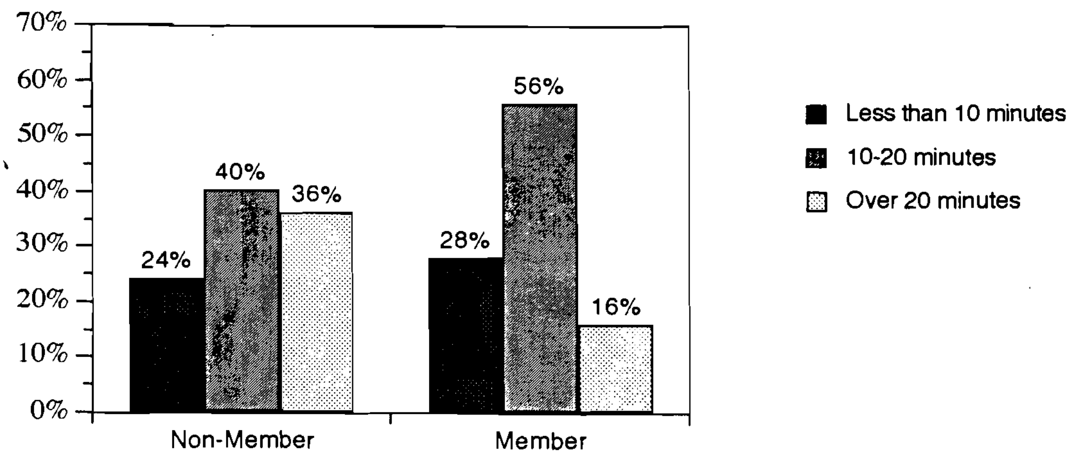
TABLE 5
Demographic Profiles of Wholesale Club Members and Non-Members

	MEMBERS	NON-MEMBERS
	%	%
SEX		
Female	87.2	80.6
Male	12.8	19.4
ANNUAL HOUSEHOLD INCOME		
Less than $20,000	10.4	25.8
Between $20,001-$60,000	62.4	59.8
Over $60,000	27.2	14.4
HOUSEHOLD SIZE		
1-2 persons	26.7	42.9
3-4 persons	50.4	42.5
Over 4 persons	22.9	14.6
NUMBER OF CHILDREN UNDER 18		
No children under 18	40.2	58.5
1-2 children under 18	42.4	30.9
More than 3 children under 18	17.4	10.6
NUMBER OF PERSONS EMPLOYED		
No one employed	8.4	20.3
One person employed	34.4	31.2
2 persons employed	41.2	37.3
3 or more persons employed	16.0	11.2
AGE		
Under 25	3.8	4.7
Between 25 and 55	79.5	63.5
Over 55	16.7	31.8

NON-MEMBERS: A CLOSER LOOK

For those respondents living within 20 minutes of a wholesale club, apparently distance is not a major factor when considering membership (Figure 8). However, as travel time increases to over 20 minutes, a far greater percentage of respondents chose not to be wholesale club members (35.8%). Thus it appears that the "drawing power" of wholesale clubs is less than the popular wisdom often suggests.

FIGURE 8
Travel Time to Wholesale Clubs
- % of shoppers -



Source: Cornell University, 1992

When asked the major reasons for not joining a membership club, package size/bulk buying and membership fees were the principal responses by non-members (Table 6). For example, when discussing membership fees, several shoppers commented, "Why should I have to pay to shop in a store?" Others mentioned that they did not feel that prices at a wholesale club were "better" than at a supermarket. They indicated, "If I watch the ads and use coupons, I can do just as well at the supermarket as at a wholesale club." Inconvenient location or distance were reasons why some shoppers were not members. Furthermore, lack of awareness and confusion about wholesale clubs also became evident as shoppers indicated they were unaware of club locations and qualifications for membership.

Other reasons mentioned less frequently by shoppers included: "shop at a club with a friend or relative who is a member "and" do not like the selection at wholesale clubs."

Further examination of respondents' reasons for non-membership in wholesale clubs reveals that household size and income level appear to affect an individuals reluctance to buy items in large volumes (Table 7). Almost one third of non-members who do not like to buy in bulk are in the lowest income category (less than $20,000/year) and over half fall into the middle income range. Further, nearly half of non-members are from one to two person households and almost two-thirds are over 55 years old.

TABLE 6
Reasons Given for Non-Membership at Wholesale Clubs

REASON	% OF RESPONDENTS*
Packs too big/don't want to buy in bulk	35.2%
Don't want to pay membership fees	32.9
Prices at wholesale clubs are not better	11.7
Too far/don't like location	11.1
Lack knowledge of clubs	10.7
Don't like product selection at wholesale club	4.4
Shop at wholesale club with friend/relative	4.0
Other	12.0

*Does not total 100 percent since respondents could give multiple answers

Perhaps not surprisingly, small households (1-2 people) account for over 60 percent of those citing their dislike of bulk packs as a reason for not becoming a member of a wholesale club. Since small households make up just over a 40 percent (see Table 5) of all member households, it appears that large packs area a major factor preventing singles, retired couples, couples without children and other small households from pursuing club membership. The proportion of larger non-member households citing bulk sizes is less than that of all non-members from larger households, indicating that large packages are not as big a deterrent to those households as they are to small households.

TABLE 7
Non-Member Discontent With Bulk Volume/Large Packs, By Income and Household Size

INCOME LEVEL	PERCENT	HOUSEHOLD SIZE	PERCENT
Less than $20,000	31%	1-2 people	61%
$20,000-$60,000	53	3-4 people	29
Greater than $60,000	16	Over 4 people	10
TOTAL	**100%**	**TOTAL**	**100%**

Just over 60 percent of non-members citing membership fees as a reason for not joining club stores were from middle income households (Table 8). This percentage is roughly the same as the proportion of all non-members from middle income households (59.8% from Table 5). Lower income households represent over a quarter of all non-member households (see Table 5) but account for just 20 percent of those citing membership fees as a deterrent to club membership. The opposite relationship exists for upper income households which account for a larger proportion of those citing membership fees than they do of total non-member households (15% vs. 19%). Paradoxically, it would seem the membership fee would be relatively more expensive to lower income households than to high income households. It is surprising then that there are proportionately fewer low income households and proportionately more high income households citing membership bees as a deterrent to club membership.

Almost half of non-members citing membership fees as a reason for not joining a wholesale club are from 3-4 person households although such households comprise just under 43 percent of all non-member households). Likewise, 20 percent of the households citing membership fees as a deterrent to membership contained 4 or more members while these larger households represent just under 15 percent (see Table 5) of all non-member households.

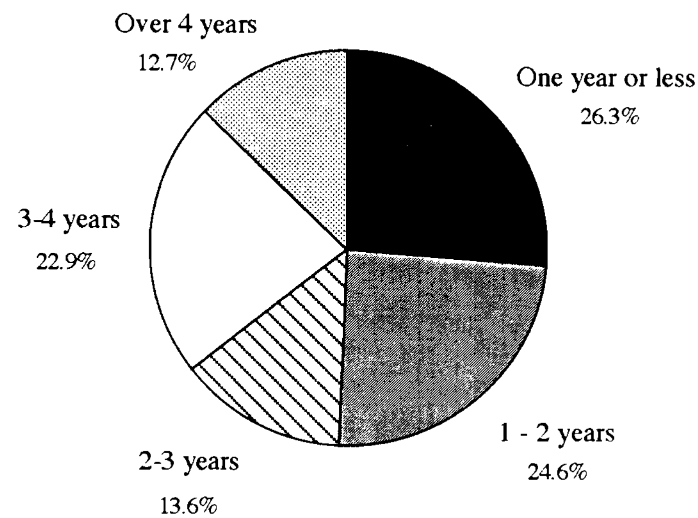
TABLE 8
Non-Members Citing Membership Fees as a Reason for Non-Membership, by Income Level and Household Size

INCOME LEVEL	PERCENT	HOUSEHOLD SIZE	PERCENT
Less than $20,000	20%	1-2 people	31%
$20,000-$60,000	61	3-4 people	49
Greater than $60,000	19	Over 4 people	20
TOTAL	**100%**		**100%**

SHOPPING HABITS OF CLUB MEMBERS

Duration of consumer membership in wholesale clubs appears to be spread almost evenly across membership tenure from "less than one year" to "more than four years" (Figure 9). There were slightly more respondents who have belonged to a wholesale club for one to two years. These findings are quite similar to those of a national study (Alternative Store Formats, FMI, 1992), with only a slightly greater proportion of new members in the FMI study than in the Cornell study (35% vs. 26%). Despite the aforementioned rapid expansion of wholesale clubs in New York/New Jersey, this survey focused on market areas where wholesale clubs have been operating for 5 years or more. This may account for the slightly longer tenure of club members in this survey than in the FMI study.

FIGURE 9
Length of Wholesale Club Membership

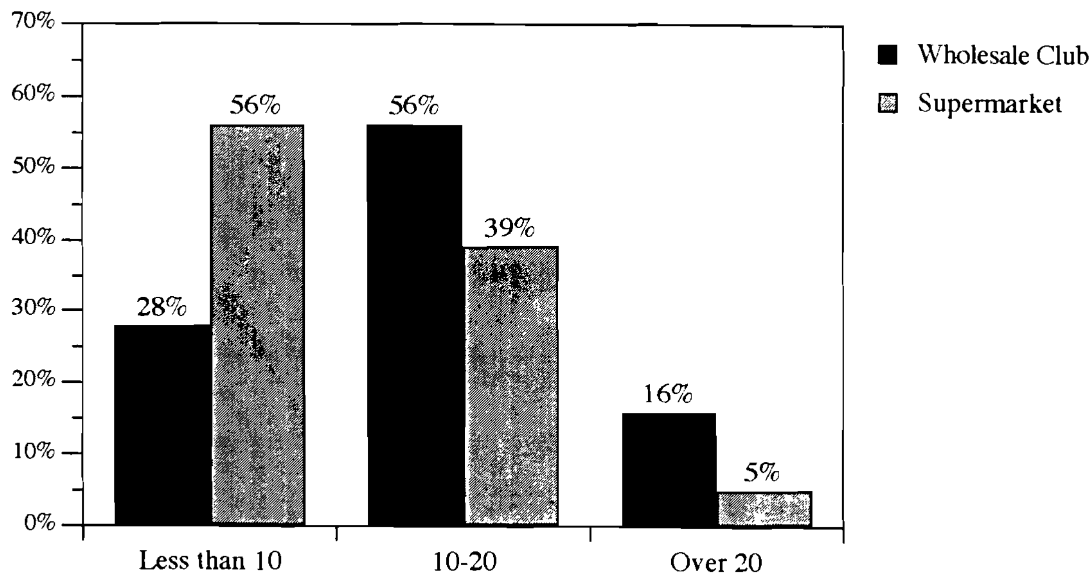


Source: Cornell University, 1992

Travel time would seem to be a critical factor affecting consumers' shopping choices considering the premium value placed on convenience in today's hectic lifestyles. Where wholesale club shopping is concerned though travel time to the club store does not seem to be a negative factor. Accordingly, less than half (44%) of supermarket shoppers who are wholesale club members traveled more than 10 minutes to the supermarket (Figure 10). In contrast, these same shoppers are willing to travel much further to shop at a wholesale club: nearly three-quarters of the wholesale club members surveyed traveled over 10 minutes to the nearest wholesale club.

However, it is likely that this finding resulted in part from the high density of supermarkets in most markets relative to the limited number of wholesale clubs. In fact, for three out of the four markets where the Cornell shopper survey took place, consumers only mentioned one wholesale club were they shop. For the fourth market, two wholesale clubs were mentioned, with one having two locations.

FIGURE 10
Travel Time to Wholesale Clubs & Supermarkets
- % of shoppers -



Source: Cornell University, 1992

Wholesale club members and non-members tend to shop at supermarkets with about the same frequency: a little less than 8 times per month (Table 9). However, shoppers in the Cornell study shop at a supermarkets almost twice as often as shoppers reported doing in the principal earlier studies (Bishop 1987; FMI 1992). This is undoubtedly explained by the high density of supermarkets present in the New York/New Jersey market areas where the Cornell study took place relative to the other studies. By contrast, shopping at wholesale clubs in New York/New Jersey is far less frequent (1.7 times per month) than at supermarkets.

For club members, the combined total of wholesale club shopping trips and supermarket shopping trips equals over nine trips each month to shop for grocery and food needs. However, non-members average less than eight trips per month to purchase grocery and food needs at supermarkets.

TABLE 9
Shopping Trips Per Month, Members vs. Non-Members

	MEMBERS			NON-MEMBERS
	SUPERMARKET	WHOLESALE CLUB	TOTAL	
	Average shopping trips per month			
Cornell study	7.5	1.7	9.2	7.9
Bishop study	4.1	1.8	5.9	4.2
Progressive Grocer*	--	--	--	8.7

*Progressive Grocer, April, June 1992

As expected, members living closer generally shop wholesale clubs more frequently than those living further away (Table 10). However, very few members (less than 17%) shop more than twice a month at wholesale clubs regardless of the proximity to the club.

TABLE 10
Effect of Travel Time on Shopping Frequency at Wholesale Clubs

	TRAVEL TIME IN MINUTES			
SHOPPING TRIPS PER MONTH	UNDER 10	10-20	OVER 20	ALL MEMBERS
	% of member respondents			
Less than 1	27	43	52	43
1 to 2	57	40	43	42
More than 2	16	17	5	15
TOTAL	**100%**	**100%**	**100%**	**100%**

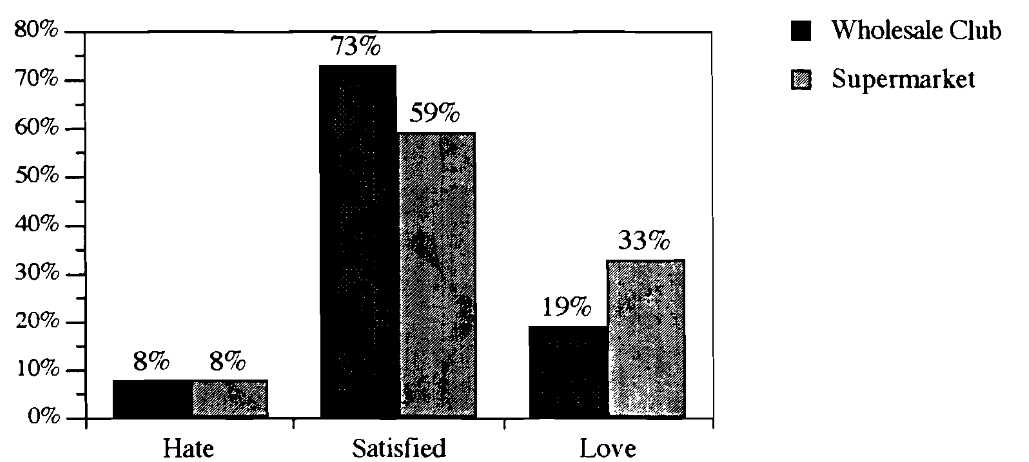
SHOPPING PERCEPTIONS OF CLUB MEMBERS

Generally, club store members enjoy shopping at both wholesale clubs and supermarkets, however, perhaps ironically, nearly twice as many wholesale club members "love" shopping at supermarkets than at the wholesale club where they pay a membership fee. (Figure 11).

FIGURE 11

Wholesale Club Members Rate Their Shopping Experience

- % of shoppers -



Source: Cornell University, 1992

Income level of shoppers appears to affect their satisfaction with shopping at both store formats (Table 11). In fact, as income increases a greater proportion of shoppers report the highest satisfaction level ("love") regarding the overall shopping experience at both supermarkets and club stores. However, for all income groups, shopping at supermarkets is consistently rated more positively than shopping at wholesale clubs.

TABLE 11
Perceptions of Member Shopping Experience, Wholesale Clubs and Supermarkets, by Income Groups

PERCEPTIONS OF **SUPERMARKET SHOPPING**

	Annual Household Income Level ($000's)		
	Below $20	**$20-$60**	**Above $60**
		% of member respondents	
"Hate"	7.7	4.0	14.7
"Satisfied"	46.1	31.6	11.8
"Love"	46.2	64.4	73.5
TOTAL	**100%**	**100%**	**100%**

PERCEPTIONS of **WHOLESALE CLUB SHOPPING**

	Annual Household Income Level ($,000's)		
	Below $20	**$20-$60**	**Above $60**
		% of member respondents	
"Hate"	0.0	6.5	14.7
"Satisfied"	69.2	44.2	35.3
"Love"	30.8	49.3	50.0
TOTAL	**100%**	**100%**	**100%**

OVERALL VALUE EVALUATION

When shoppers were asked to rate the best value, by major department, between the supermarket and the wholesale club, supermarkets were the clear winners in the perishable departments: produce, meat, deli and bakery (Table 12). However, shoppers felt that shopping at wholesale clubs offered them better value in dry groceries, health and beauty care, and general merchandise. There was, however, a high level of confusion and indecision over which format offers the better combined value in all departments. Household size does not appear to effect how respondents rated either format.

TABLE 12
Members Rate Overall Value of Major Departments:
Supermarkets vs. Wholesale Clubs

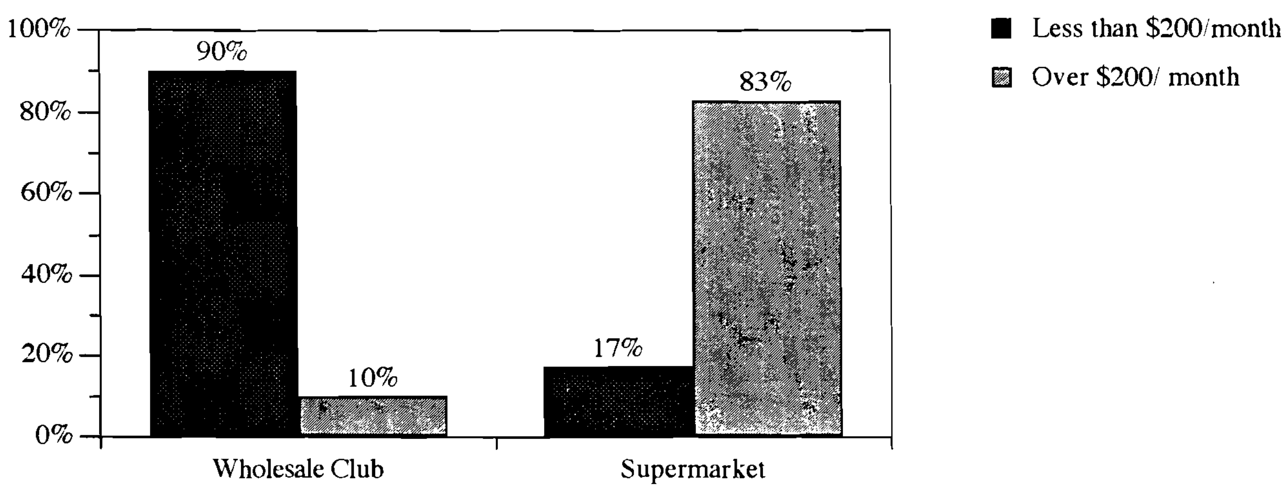
	SUPERMARKET	WHOLESALE CLUB	SAME/DON'T KNOW	TOTAL
	% of member respondents rating the format a better value			
Produce	68.8	10.9	20.3	100%
Meat	59.8	10.2	29.9	100%
Deli	62.5	5.5	32.0	100%
Bakery	54.7	12.5	32.8	100%
Dry goods	29.5	48.4	22.5	100%
HBC	28.1	43.0	28.9	100%
General merchandise	18.1	55.9	26.0	100%

SPENDING PATTERNS OF CLUB MEMBERS

In general, wholesale club members spend considerably less for food and grocery items at the wholesale club than at the supermarket (Figure 12). Only 10 percent of members spend over $200 per month at clubs, whereas 83 percent of members spend over $200 each month at supermarkets. Thus, it appears that members continue to use supermarkets as their primary shopping source for food related items, especially perishables and service-oriented food but may be "stocking up" at wholesale clubs.

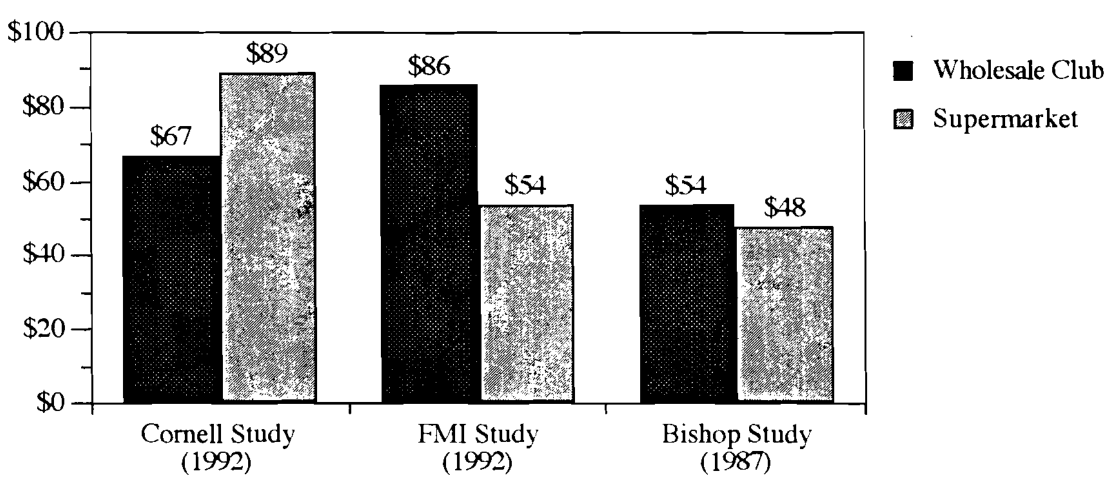
On average, wholesale club members report spending $89 per shopping trip at the supermarket and $67 per trip at the wholesale club. This finding of spending somewhat less at the wholesale club than at the supermarket is the opposite pattern of those found in the Bishop study and FMI study (Figure 13).

FIGURE 12
Member Spending at Wholesale Clubs & Supermarkets



Source: Cornell University, 1992

FIGURE 13
Spending at Wholesale Clubs and Supermarkets
- $ per shopping trip -



Although lower income club members spend about the same amount per trip to wholesale clubs than other members (Table 13), these shoppers shop more frequently. Higher income members are the biggest spenders at supermarkets, spending more per trip and shopping more frequently than other club members. While it appears that lower income shoppers are the greatest spenders in wholesale clubs, high income shoppers remain loyal to supermarket shopping.

TABLE 13
Club Member Spending and Shopping Frequency at Wholesale Clubs and Supermarkets, by Income Level

	Annual Income Level ($000's)			
	Below $20	**$20-$60**	**Above $60**	**All Club Members**
WHOLESALE CLUB:				
Average $ spent per trip	$ 71.25	$ 63.45	$ 71.45	$ 66.74
Average # trips per month	1.94	1.62	1.04	1.70
SUPERMARKET:				
Average $ spent per trip	$ 60.67	$ 89.40	$102.27	$ 89.66
Average # trips per month	7.46	7.36	7.94	7.50

Although their spending per trip is not much greater, larger households tend to spend twice as much at wholesale clubs than smaller households because they shop at club stores almost twice as frequently (Table 14). Furthermore, members from large households shop at wholesale clubs almost twice as often as members from small households. Similarly, these same large households shop more frequently and spend more at the supermarket than do their smaller counterparts.

TABLE 14
Influence of Household Size on Club Member Spending and Shopping Frequency at Wholesale Clubs and Supermarkets

	NUMBER OF PEOPLE IN HOUSEHOLD			
	1-2	**3-4**	**5+**	**All Club Members**
WHOLESALE CLUB:				
Average $ spent per trip	$ 64.48	$ 64.60	$ 72.86	$ 66.74
Average # trips per month	1.17	1.34	2.14	1.70
SUPERMARKETS:				
Average $ spent per trip	$ 65.45	$ 95.11	$102.41	$ 89.66
Average # trips per month	6.14	7.96	7.89	7.50

When asked if they were now spending more, less, or the same, compared to when they first began shopping at a wholesale club, 40 percent of members indicated that they were spending the same at wholesale clubs (Table 15). Approximately 20 percent felt they were spending more, while 15 percent indicated spending less. However, almost a quarter of club members indicated that they did not know if their spending had changed over time.

Lower income members indicated spending less now then when they first started shopping at wholesale clubs (Table 16). Although the majority of middle and high income members felt they were spending more or the same as they were initially, it is significant that a sizeable minority (31%) of upper income shoppers reported spending more currently than earlier in their membership. One can speculate that since high income is highly correlated with higher educational attainment, these high income club members, once they have had adequate membership time to evaluate the club membership experience, apparently recognize it as a genuine value and increase their club patronage and spending.

TABLE 15
Club Member Spending At Wholesale Clubs:
Current Spending vs. Initial Spending

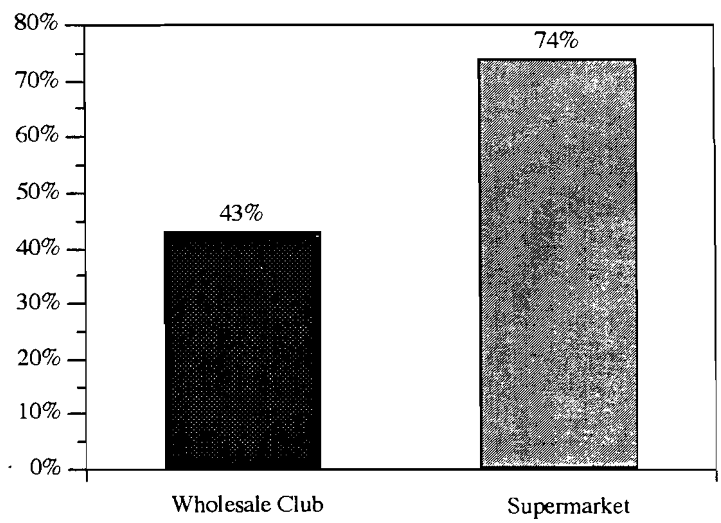
Current Spending Compared With Initial Spending	CORNELL STUDY	FMI STUDY	BISHOP STUDY
		% of respondents	
MORE	21.1	33	28
SAME	41.4	46	60
LESS	15.0	18	12
DON'T KNOW	22.5	3	--

TABLE 16
Influence of Income on Club Member Spending at Wholesale Clubs:
Current vs. Initial

ANNUAL INCOME LEVEL ($000'S)	CURRENT SPENDING COMPARED WITH INITIAL SPENDING			
	MORE	LESS	SAME	DON'T KNOW
		% of member respondents		
Under $20	11.1	66.7	22.2	0
$20-$60	14.1	28.1	57.8	0
Over $60	30.8	15.4	50.0	3.8

Nearly three quarters of members use a list when shopping at a supermarket, while only 43 percent use a list when shopping at wholesale clubs (Figure 14).

FIGURE 14
Shopping List Use at Wholesale Clubs and Supermarkets
- % of shoppers -



Source: Cornell University, 1992

Despite the popular notion that impulse shopping is more common with shoppers who do not use shopping lists, the Cornell study found the opposite relationship. When list use was compared to spending per shopping trip and frequency of shopping at both supermarkets and wholesale clubs, list users actually spent more per trip compared to non-users (Table 17). List users spend 26 percent more than non-list users in a club store and 11 percent more in a supermarket.

TABLE 17
Effect of Using a List on Club Member Spending: Supermarkets and Wholesale Clubs

	SUPERMARKETS		WHOLESALE CLUBS	
	USE LIST	NO LIST	USE LIST	NO LIST
Average amount spent per trip	$ 89	$ 80	$ 78	$ 62
Average number of trips per month	7.5	7.8	1.8	1.7
Average spending per year	$8,004	$7,488	$1,680	$1,260

SUPERMARKETS RESPOND

In conjunction with the consumer survey discussed in the preceding section of this report, a survey was conducted of New York and New Jersey supermarket retailers to gauge the impact of wholesale clubs on food store sales and reactions of supermarkets to wholesale clubs in the two state area. The entire spectrum of retail/wholesale size and organization was represented in our survey respondents: from a multi-billion dollar metro New York/New Jersey wholesaler to a single store independent supermarket operating in New York's north country.

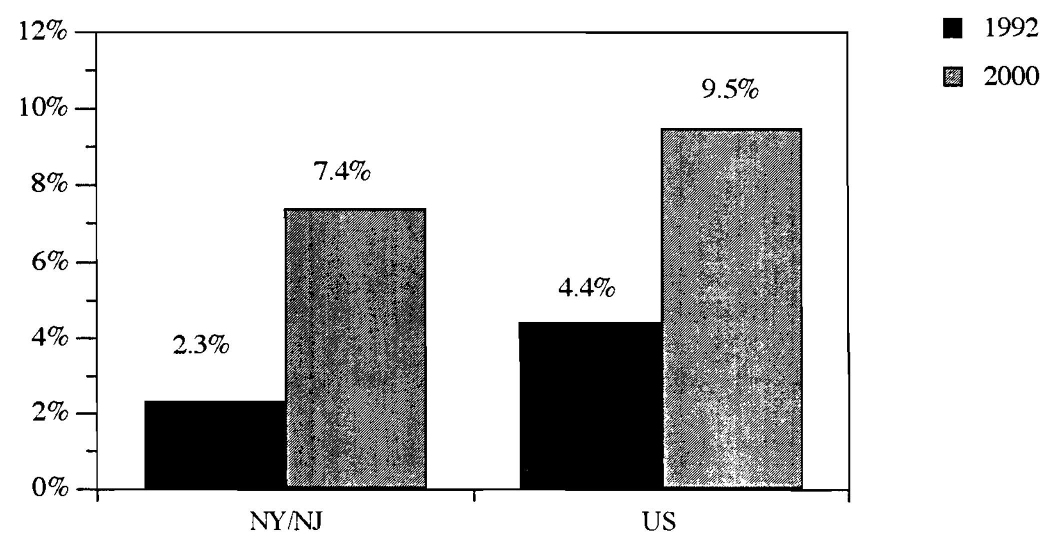
WHOLESALE CLUB SHARE OF FOOD AND GROCERY SALES

When supermarket operators were asked to estimate the current share that wholesale clubs take away from supermarket food and grocery sales in their own trading areas, responses ranged from a high of 10 percent of sales through club stores to a low of zero. This latter estimate came from retailers who felt their stores were not within the drawing radius of club stores. While the "zero impact" response was common among independent supermarket operators located in more remote small towns, when asked to project wholesale club food sales share in the year 2000, only one retailer responded "zero," while the high end of the range of responses increased to 20 percent.

The average estimate from supermarket executives of wholesale club share of current grocery sales in New York/New Jersey was 2.29 percent (Figure 15). A national study published by the Food Marketing Institute estimated the wholesale club share of U.S. food sales was about 4 percent in 1992 (FMI, 1992). The lower estimate in New York/New Jersey may be explained by the low penetration level of club stores in the New York/New Jersey region relative to the rest of the U.S.

By the turn of the century, the national forecast for wholesale club market share of grocery sales is considerably higher than that given by the New York/New Jersey retailers in this study (9.5% vs. 7.4%). Again, the lower projected share for New York/New Jersey may reflect the relatively late introduction of most of the major club operators into Northeast markets. Despite its lower magnitude, the New York/New Jersey estimate for the wholesale club share of food sales projects over twice the growth rate in New York/New Jersey during the next decade than is expected across the country (+222% vs. +100%).

FIGURE 15
Supermarketer Estimates of Wholesale Club Share of Grocery Sales, 1992 & 2000

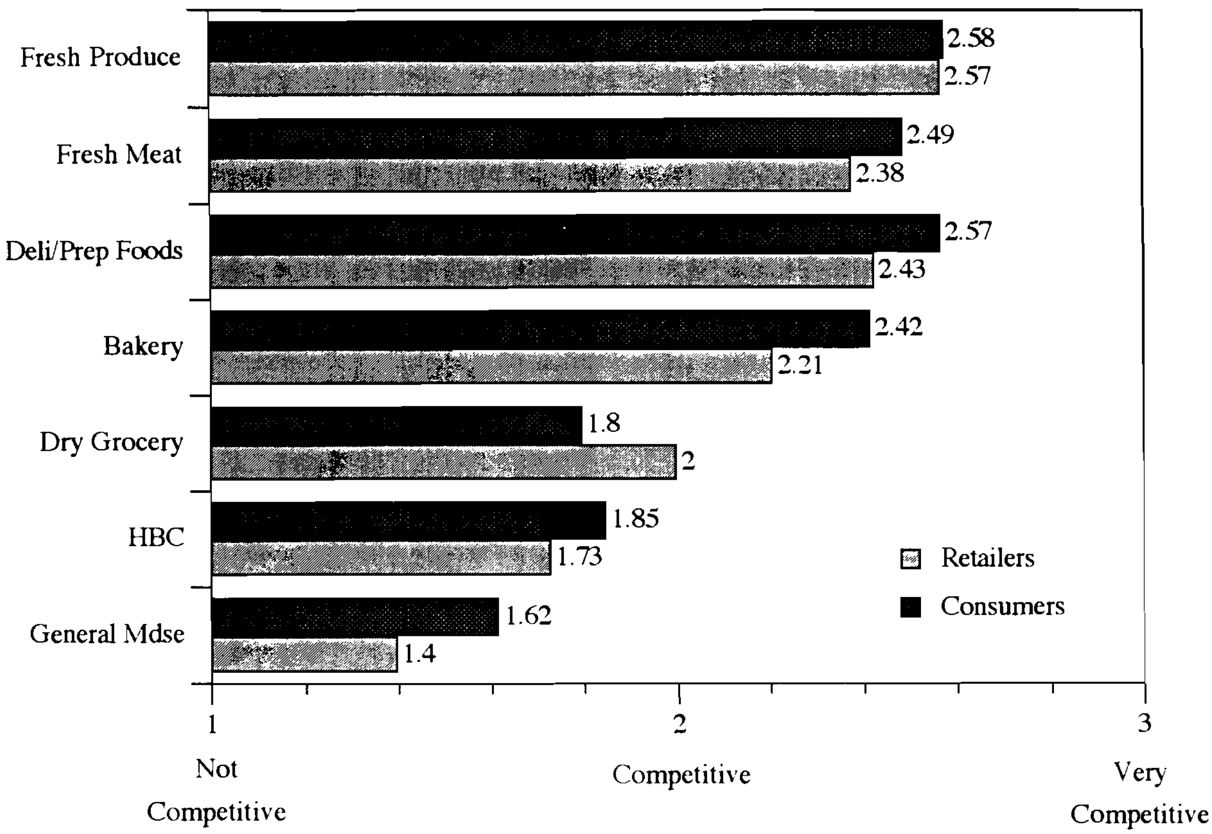


Source: Cornell University, 1992 and FMI, May 1992

RETAILERS AND CONSUMERS RATE OVERALL VALUE OF SUPERMARKETS

Supermarket retailers were asked to evaluate themselves relative to wholesale clubs considering overall value to consumers across seven major departments present in both formats (Figure 16). In parallel fashion, consumers were asked to choose whether supermarkets or wholesale clubs represented the greatest overall value with respect to the same seven departments. Retailer and consumer responses were remarkably similar, with average ratings for each department varying very little between the two groups. Both groups agreed that supermarkets offer the best overall value in the perishables and service departments: produce, meat, deli and bakery. Conversely, in the non-perishable and non-food categories -- dry grocery, health and beauty care, and general merchandise -- both groups agreed that wholesale clubs offer the best overall value.

FIGURE 16
Consumers and Retailers Compare Supermarkets' Overall Value with Wholesale Clubs



Source: Cornell University, 1992

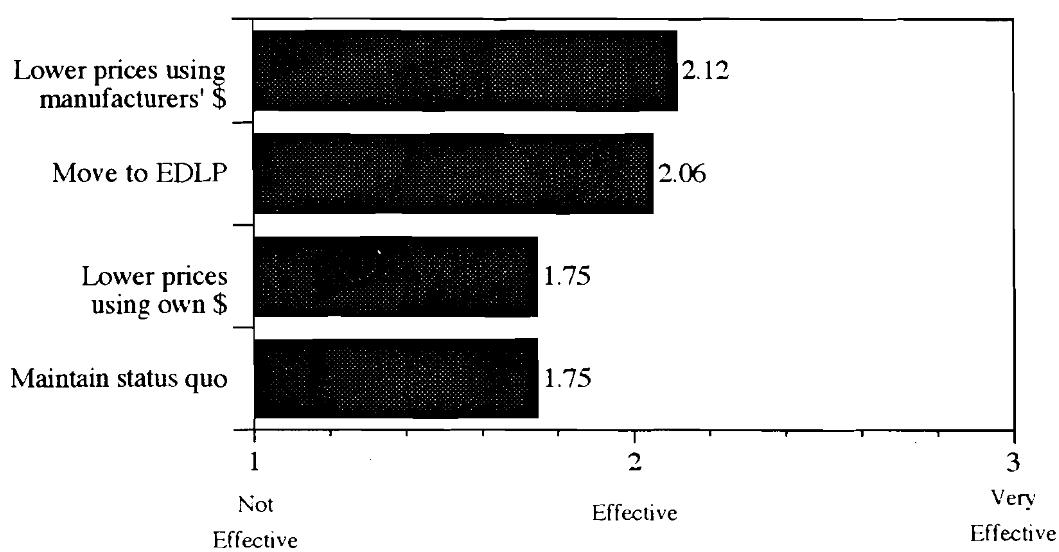
RETAILERS EVALUATE STRATEGIES

Supermarket retailers were asked to evaluate the effectiveness of a range of potential strategies that might be employed to respond to wholesale clubs. These strategies were classified into the following groups: pricing, operational, marketing, product and location. For each of the specific strategies presented, retailers were asked to indicate whether the strategy was ineffective, effective or very effective. "Very effective" strategies received a score of 3 and "ineffective" strategies received a score of 1.

Lowering prices using manufacturers' funds, that is, with the financial support and cooperation of suppliers, was considered the most effective of the four pricing strategies (Figure 17). Moving to everyday low pricing (EDLP) was ranked a close second in effectiveness although both strategies were considered far from "very effective" (i.e., a score of 3.0). Curiously, maintaining the status quo and lowering prices using retailers' own funds only were both considered somewhat less than effective. Although, apparently, retailers feel that something must be done to compete with wholesale clubs, they do not feel that any single pricing strategy will be particularly effective, essentially conceding the lower price advantage to wholesale clubs. However, one pricing strategy which we did not specifically ask retailers to evaluate was using "multiple unit discount" pricing. This strategy was suggested and considered "very effective" by one supermarket operator responding to our survey. This strategy calls for discounted prices whenever consumers purchase more than one package of an item in a given shopping trip. Other retailers utilize "caseload" sales -- whereby special low prices are put into place when the shopper buys in full case quantities -- to achieve the same effect. This strategy seems particularly effective for small supermarkets which do not have the physical space needed for club packs, warehouse shelving or wholesale club sections.

FIGURE 17

Retailers' Evaluations of Pricing Strategies

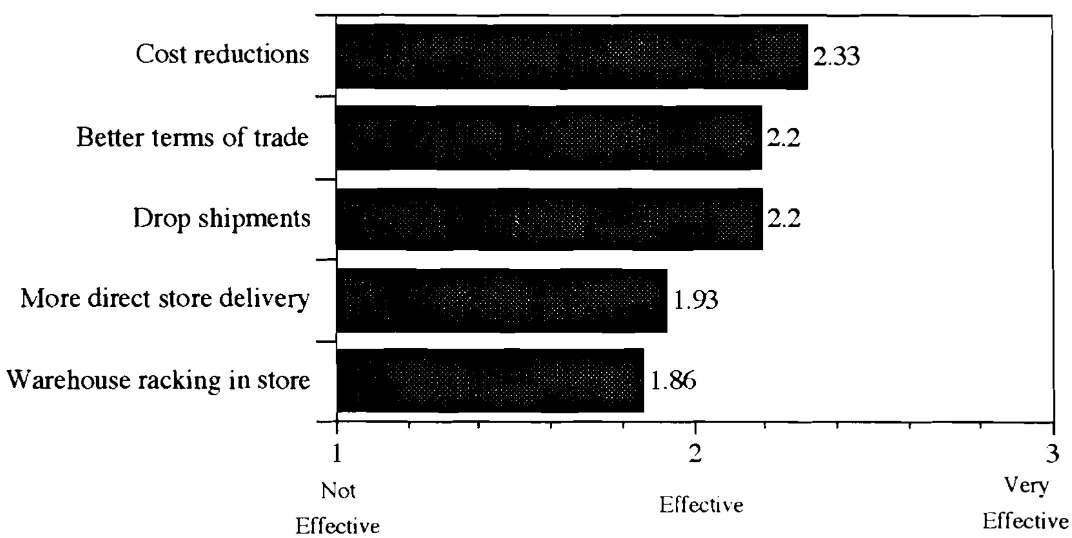


Source: Cornell University, 1992

As a group, operational strategies were generally considered more effective by the supermarket executives in the Cornell survey than pricing strategies (Figure 18). Reflecting the realization by supermarket operators that wholesale clubs have devised a truly low cost distribution system, reducing costs was considered the most effective and perhaps most inevitable of the various operational strategies. However, better terms of trade from manufacturers and drop shipments of full pallets directly to stores were also seen as moderately effective by many retailers. Interestingly, use of warehouse racking in stores, a strategy currently employed by many retailers throughout the New York/New Jersey area and across the U.S. in general, was considered the least effective of these operational strategies.

FIGURE 18

Retailers' Evaluations of Operational Strategies

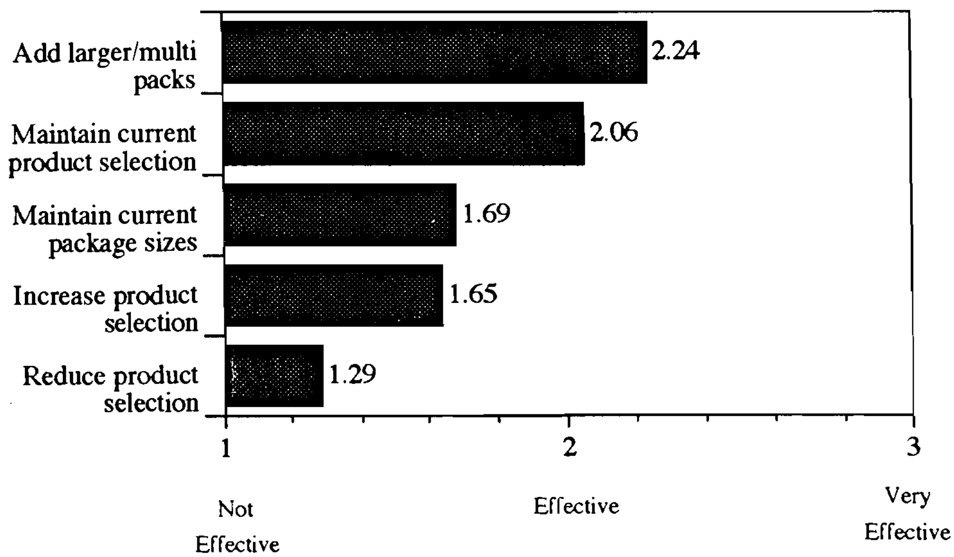


Source: Cornell University, 1992

Product strategies, as a group, were considered the least effective of the five groups of strategies (Figure 19). However, the product strategy rated most effective in this group was adding larger and/or "multi" package sizes to the current supermarket product selection.

There are many examples of large and multi-pack programs now being offered by New York/New Jersey supermarket operators. These programs are usually identified and promoted by names such as "Big Deals" (Pathmark), "Budget Values" (Hannaford) or "Giant Values" (Wakefern). Typical "large size" programs offer an average of 100 to 300 SKU's. Supermarket companies are still experimenting with placement of club packs in their stores.

FIGURE 19
Retailers' Evaluations of Product Strategies



Source: Cornell University, 1992

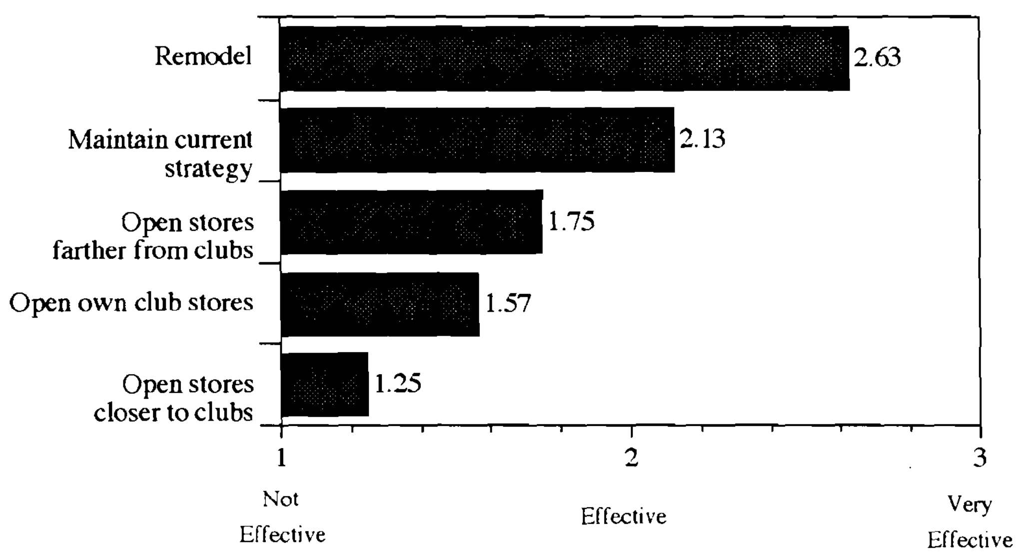
The most widely practiced approach is an entire dedicated aisle or group of aisles with warehouse-type shelving and pallet loads of club size packages. A few companies, such as Foodarama of Edison, New Jersey, have converted the backroom area of their supermarkets into warehouse formats. Other supermarket operators have integrated club packs into the appropriate category's section within the standard shelving display. Some supermarket chains have dedicated a special section of normal (non-warehouse type) shelving which contains all their club pack items. Most larger supermarket chains are experimenting with a combination of some or all of these variations in an attempt to determine the optimal mix of package sizes and store placement.

Considered almost equally effective, however, was maintaining current product selection. Independent supermarket operators who belong to voluntary and affiliated wholesale groups or those who operate smaller "conventional" supermarkets often do not have the freedom to add enough club pack items to create a sufficient impression as a club alternative to consumers. Within voluntary and affiliated wholesale groups, where the size of individual stores often varies over a wider range than within a supermarket chain, the largest stores, which may have the capacity to add club packs, are often unable to do so because of their joint advertising efforts covering small stores as well. Partly in response to this dilemma, several wholesalers are creating new banners for larger stores to distinguish larger member stores from smaller. For example, Scrivner recently announced its new "Jubilee Foods" banner under which its larger members will advertise and sell private label products. Scrivner's smaller member stores will continue to operate under the "Super Duper" banner.

By far, the most effective location strategy, as perceived by retailers, was remodeling current store locations (Figure 20). This strategy could be particularly critical for smaller supermarkets which may not currently have extensive service departments and/or product selection. The high effectiveness rating for this strategy could also be explained by the fact that in most market areas in New York and New Jersey the best supermarket sites have already been developed. In fact, several 1992 proposals for new wholesale club development in northern New Jersey and other metro New York sites have met with rejection by local zoning authorities.

FIGURE 20

Retailers' Evaluations of Location Strategies



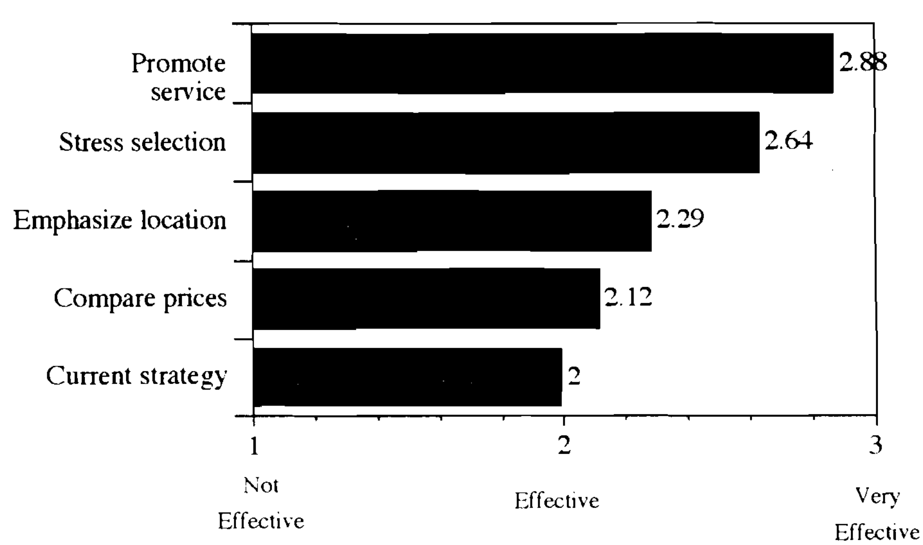
Source: Cornell University, 1992

The second most effective location option, to maintain current strategy, may well apply to those progressive supermarkets which already are meeting the service, selection and variety needs of their customer base and therefore can clearly differentiate themselves from wholesale clubs. The location strategy rated least effective was to open new stores closer to wholesale clubs. In most cases where wholesale clubs and supermarkets operate in close proximity, often in the same strip shopping center, the club store has invaded a location in which the supermarket was already established. In some cases, such supermarkets have been hurt badly by sales lost to the club store. In other cases, supermarkets have experienced higher overall sales volume due to the tremendous drawing power of the club store, in effect increasing consumer traffic through the entire shopping center.

Perhaps in light of this phenomenon and despite its rating as least effective in our survey, there are notable examples in the New York/New Jersey region in which supermarkets have opened new stores specifically located as close as possible to wholesale clubs. For example, soon after Sam's Wholesale Club opens in Niagara Falls, New York in 1993 a new Tops Supermarket is scheduled to open directly across the street.

Finally, marketing strategies, as a group, were rated the most effective of the five strategic groups. None of the marketing strategies were considered less than "effective" (score: 2.0) (Figure 21). Emphasizing unique features that differentiate supermarkets from wholesale clubs were the highest rated marketing strategies. Considered particularly effective was the strategy of emphasizing service departments in supermarkets. Wholesale clubs typically offer extremely limited services in efforts to maintain their lean cost structure. However, this is rapidly changing as wholesale clubs strive to differentiate themselves from each other with service delis, bakeries, meats and even fresh pizzerias being added to existing club stores and designed into new clubs. Custom meat cutting and bakery orders are typically offered in club stores at no additional cost. Also considered quite effective was emphasizing the

FIGURE 21
Retailers' Evaluations of Marketing Strategies

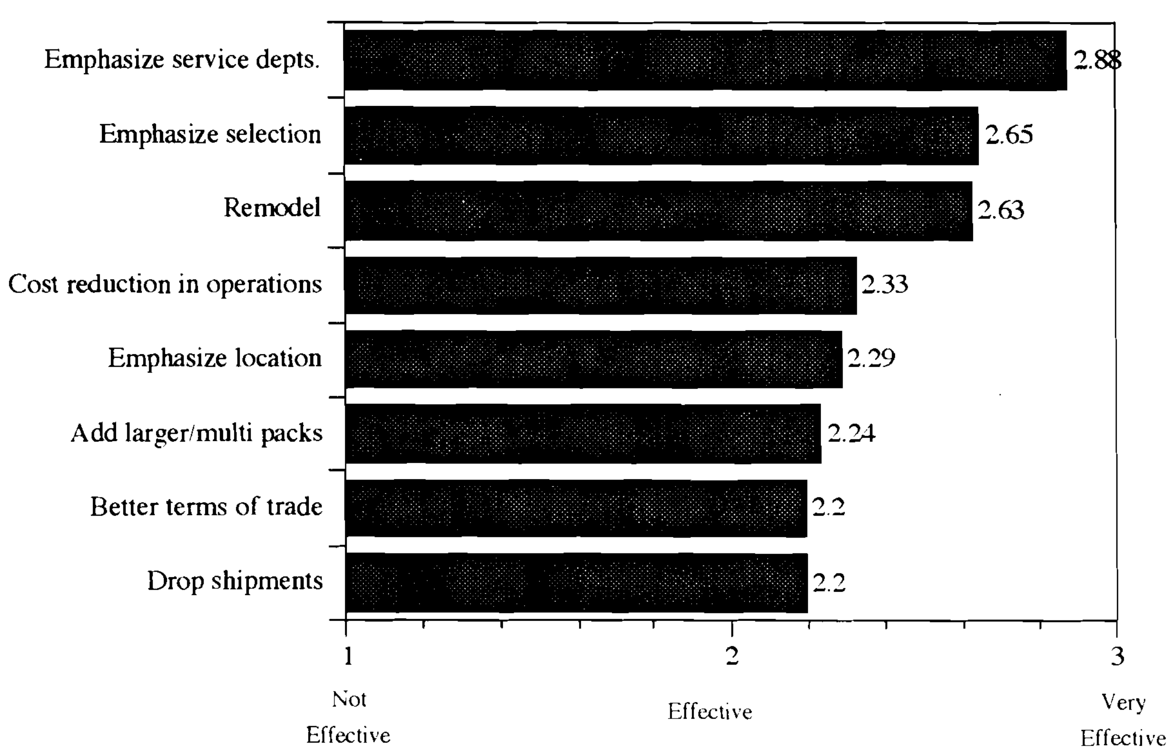


Source: Cornell University, 1992

selection of products, brands, sizes and varieties offered by supermarkets. Wholesale clubs deliberately limit the number of stock keeping units (SKU's) to fast moving brands and sizes in order to maintain high stock turnover and minimize inventory investment. This supermarket advantage in product selection is not likely to diminish as clubs evolve, since limited SKU's is key to the club store formula for profitability. However, supermarkets may be able to streamline the number of SKU's carried within many categories, without noticeably changing the shopper perception of vast selection compared with clubs. Such a streamlining strategy would reduce supermarket inventory investment and handling costs as well as free up scarce shelf space for additional club pack offerings.

Summarized across all strategy groups, the eight most effective single strategies as evaluated by New York/New Jersey supermarket operators, are illustrated in Figure 22. These "most effective response strategies" offer a prescription for supermarket operators faced with the imminent entrance of a wholesale club into their trading areas.

FIGURE 22
Most Effective Overall Strategies



Source: Cornell University, 1992

FUTURE PROSPECTS AND STRATEGIC PERSPECTIVES

FUTURE PROSPECTS

Many retail industry analysts suggest that the average wholesale club requires a population base of about 400,000 people within its drawing radius to reach its operational and financial objectives. Using this guideline, the Pacific, Mountain, and West South Central states are nearly saturated already with wholesale clubs. By contrast, the Middle Atlantic states had by far the fewest wholesale clubs per capita of any region in the U.S. in 1992: over 1 million residents per wholesale club, while the Pacific states had just 389,000 people per club location (see Figure 5). In other words, in 1992, the Pacific states had about three times as many wholesale clubs per capita as the Middle Atlantic states, suggesting perhaps considerable additional expansion opportunities for clubs in the Middle Atlantic states.

In its recent report on alternative retail food formats, the Food Marketing Institute (FMI) projected approximately 950 wholesale clubs by the end of the decade (Table 18). While forecasting more than double the current number of clubs, the FMI report also predicts that grocery related sales will more than triple. These predictions reflect both anticipated increases in wholesale club sales and a greater emphasis on grocery related products in the wholesale club product mix.

TABLE 18
Ten Year Growth Projections for Wholesale Clubs

	1991	2001*	% INCREASE
UNITED STATES	450	950	+ 111%
No. of Stores			
Grocery related sales	$11 bil.	$39 bil.	+ 255%
NEW YORK/NEW JERSEY			
No. of stores	30	152	+ 407%
Grocery related sales	$574 mil.	$5.9 bil.	+ 935%

Source: Food Marketing Institute, 1992.
Cornell University, 1992.

*Projected

FMI's projection of 950 wholesale clubs by the year 2001 is based on the assumption that wholesale club penetration across all major metro markets in the U.S. will reach the level of the current most saturated markets: about 1 club store for every 150,000 to 175,000 people. Applying this standard to the combined population of New York and New Jersey results in an estimated maximum of 152 club stores possible for the two state area. Compared with Cornell's estimate of 30 wholesale clubs in operating during 1991 in New York and New Jersey, 152 club stores by the year 2001 represents an increase of 407%.

Our estimate of 1991 New York/New Jersey grocery-related wholesale club sales is derived by multiplying the average sales per store times the number of stores for each company operating in the two states. Applying the ratio (from the FMI study) of wholesale club sales growth rate to store number growth rate to the NY/NJ club store growth rate, New York/New Jersey grocery related wholesale club sales in the year 2001 can be roughly estimated at $5.9 billion, an increase of 935% over the 1991 estimate of approximately $574 million.

Comparing the New York/New Jersey projections of sales and stores for the year 2001 with FMI's projections for the nation reveals that almost a quarter (24.4%) of the total growth in wholesale clubs projected for the U.S. will occur in New York and New Jersey.

However, expansion opportunities may be much more limited than popular notion suggests. Consider an approximation calculated by dividing the U.S. population (approximately 253 million) by the above customer requirement (400,000). This yields a maximum feasible club store number of about 633 for the entire U.S. Yet if 400,000 people are actually required for success, then 633 stores may really be too high an estimate considering that U.S. population is very unevenly distributed. Many areas of the country simply do not have enough population density within a reasonable driving distance to support a wholesale club. Thus, the upper limit on the number of wholesale clubs may be considerably fewer than 633. Indeed, with 588 clubs expected to be in operation by the end of 1992, we may already be approaching club store saturation on a national level and, in fact, the theoretical upper limit of 633 should be surpassed by mid-1993 or sooner.

Although total sales of grocery related products from supermarkets lost to wholesale clubs was estimated at 4 percent in 1991, the club store impact on supermarket sales varies greatly by department (Table 19). Wholesale club impact on 1991 supermarket sales was estimated to range from a low of 1.9 percent in perishables to a high of 10.4 percent of health and beauty care products.

TABLE 19
Percent Volume Loss by Supermarkets to Alternative Formats, Selected Departments

DEPARTMENT	1991	2001*	% INCREASE
	%	%	%
Perishables	1.9	4.6	142
Grocery - Food	4.1	11.6	182
Grocery - Non-Food	5.3	15.1	185
Health & Beauty Care	10.4	31.1	199
Pharmacy	7.3	22.2	204
TOTAL	4.0	11.3	182

Source: Food Marketing Institute, 1992.

*Projected

FMI projects that the wholesale club share of total supermarket sales will almost triple, from 4.0 percent to 11.3 percent, by the year 2001 and the shares of each department's sales are projected to at least double in ten years. The greatest growth in wholesale clubs share is predicted for pharmacy sales which are expected to more than triple from 7.3 percent to 22.2 percent of supermarket pharmacy business.

STRATEGIC PERSPECTIVES:

- Wholesale clubs undermine supermarkets' basic premise -- i.e., combination of a consistent supply of a wide variety of brands, private labels and high quality perishables. Yet, ironically, although wholesale club stores appeal to a limited segment of shoppers and account for a very small fraction of grocery industry sales, it is the supermarket industry that is mimicking the wholesale clubs.

- It appears increasingly likely that in the future wholesale clubs will be competing for each other's customers more intensely as saturation levels are reached in the major market areas. It is thus probable that wholesale clubs will have to find ways to meet their financial and operational goals with customer bases of far fewer than the 400,000 people currently believed required for individual club success.

- Historically, a common retail strategy to maintain financial performance under leaner sales prospects has been to control costs through more streamlined operations. However, considering the already exceedingly low cost structures that characterize wholesale clubs, it is doubtful that many club operators will be able to maintain momentum by becoming leaner still. The opposite is more likely.

- To differentiate themselves from the more intense competition, especially in major markets, wholesale clubs will be forced to offer new programs, services, and products. As clubs add such new features, their cost structures will shift, diminishing their cost advantage over supermarkets. The potential exists for wholesale clubs to fall victim, as have many earlier challengers to traditional supermarkets, to the "wheel of retailing" -- essentially the addition of costly services and features, the absence of which initially formed the basis of the format's cost advantage.

- Indeed, the 400,000 person "customer standard" is based on the assumption that the club concept appeals to only a very limited subset of consumers. One of the best growth prospects for wholesale clubs may lie in attracting a broader segment of individual and business consumers. Until the late 1980's, the five major wholesale club firms did not directly compete with each other in the same market areas. That situation has now changed significantly, and is likely to continue to intensify as the remaining major markets are entered.

- New York/New Jersey has long way to go before it reaches the wholesale club penetration level of the west coast. However, New York/New Jersey's saturation level may be achieved at a higher "population per club store" ratio than the west coast due to higher rents, limited sites, zoning restrictions, different shopper preferences, and higher reliance on public transport especially in metro New York/New Jersey.

- However, if, in fact, the New York/New Jersey area is penetrated to the level of the current most saturated markets in the U.S. then almost a quarter of all projected wholesale club industry growth will occur in New York and New Jersey.

- As saturation levels are (rapidly) approached for major New York/New Jersey markets, smaller club development (for example, 60,000 sq.ft. or less compared to over 100,000 sq. ft. typical of most current clubs) in smaller and rural markets is likely. Indeed, already occurring.

- The major reasons that New York/New Jersey shoppers give for <u>not</u> joining a wholesale club are their dislike both of large package sizes and the membership fee requirement. This is significant since nearly two-thirds of these shoppers complaining about large packages and bulk buying come from the largest single shopper segment (approximately 60% of all households) -- 1 and 2 person households. These perceived disadvantages of wholesale clubs should be capitalized upon by supermarket operators in their marketing programs.

- There is one arresting problem with club/multi packs: they take consumers "out of the market" thus losing frequency of shopping trips and high margin impulse items. Thus, adding these items as a defensive countermove is an expensive strategy for supermarketeters.

- Another problem with club packs: many New York supermarkets, especially independents and metro New York stores, are considerably smaller than the U.S. average and, in many cases, are physically unable to expand: perhaps "multiple unit discount" pricing could offset allure of club packs in larger stores.

- Nearly two-thirds of club members have been members for a short period of time, less than three years. This is too brief an experience relative to what is often a lifelong experience with supermarket shopping for consumers to permanently shift shopping patterns. Thus, while club stores are still regarded as somewhat novel by many shoppers, supermarket operators have a great opportunity to respond before these new club shopping patterns are permanently ingrained in their supermarket shoppers.

- Although the proportion of upper income shoppers is considerably larger among wholesale club members than non-members (eg, strictly supermarket shoppers), higher income shoppers prefer supermarket shopping over the club format and, moreover, spend considerably more in supermarkets than other income groups. In fact, upper income households spends nearly twice as much in a supermarket as low income households ($102 vs. $60). Moreover, upper income households only spend 8 percent of their annual grocery budget in a warehouse club whereas lower income households spend 23 percent of their yearly grocery budgets in the club format. Thus, by a considerable margin, the upper income shopper is the supermarket's most valuable customer.

- One early warning sign, however: nearly one-third of upper income shoppers -- twice the proportion of other income groups -- reported that they are now spending <u>more</u> at wholesale clubs relative to their initial spending levels. It is possible that as high income, highly educated shoppers gain experience with club shopping, they are beginning to conclude that the warehouse club may be a substantial value. Thus, continuing to carry the mix of products and services appropriate to upper income shoppers appears to be at least one key component of a supermarkets' strategic response to club stores.

- As expected, large households (5 or more people) spend more at the wholesale club than 1-2 person households -- in fact, over twice as much per year ($1,871 vs. $905) and also exhibit nearly twice the shopping frequency as smaller households (2.14

trips/month vs. 1.17 trips/month). In their supermarket shopping behavior the same higher degree of shopping frequency for large households is not as evident: large households patronize the supermarket 7.89 times per month while smaller households shop nearly as often, 6.14 times per month. This finding suggests that there are opportunities for supermarkets to develop improved programs and merchandising activities to attract large family shopping.

- Consumers rate the supermarket perishables departments as better overall values than the club store. Hence, continued attention to high quality fresh foods in the supermarket is one requisite of success in competing with wholesale clubs. Services must receive greater emphasis from supermarketers: fresh foods, friendly, knowledgeable personnel, one-stop shopping all serve to differentiate supermarkets in a way that club cost/margin structures can not duplicate.

- However, New York/New Jersey consumers rated the club store as representing a better value for general merchandise, health and beauty care items and, importantly, dry grocery. An alarming 70 percent of shoppers either responded that wholesale clubs represented a better value for dry goods than a supermarket or were unsure which format was better. This consumer judgement should be of considerable concern to supermarket operators, considering that generally 50 percent or more of supermarket sales come from grocery products. Yet retailers do not feel that price strategies are very effective in combatting wholesale clubs. There appears thus to be an opportunity to close the (perceived) price gap. Effective responses here are called for.

- Supermarkets might pursue a non-perishable <u>pricing</u> strategy that attempts to find the <u>price point</u> between supermarket prices and wholesale club prices at which consumers <u>equate</u> the value of the two store's offerings considering the other important aspects of shopping: convenience of location, convenience of one-stop shopping, variety, selection, service, etc.

- Although still representing a small share of total food and grocery, the growth rate of wholesale club grocery-related sales will continue to be much greater than the growth of supermarket sales. The latter may even be flat in the near future due to falling food prices and low inflation.

- Similarly, in the same way that some supermarket companies have a number of store formats, some operators will not only develop "club store sections," but will open their own versions of club stores. Indeed, this is already occurring in New York (Big V ShopRite's new "PriceRite Wholesale Club") and elsewhere (Meijer's "Source Club" and H.E. Butt's "H-E-B Bodega").

- Supermarket partnerships will grow with suppliers and resolve many of the current pricing disputes.

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