

CASE 13

TRADER JOE'S: A REMARKABLY QUIRKY- AND SUCCESSFUL- GROCERY RETAILER

In the mid-1960s, Joe Coulombe owned a chain of “Pronto Market” convenience stores in the greater Los Angeles area, but they were under heavy competitive pressure from 7-11. He began to ponder the idea of opening up a new kind of store, one with more unusual goods for people who had acquired more diverse tastes while traveling and yearned for flavors they could not get at home. He went on vacation in the Caribbean and came home inspired: He opened up his first Trader Joe’s store (named after himself) in 1967. His store would focus on delivering innovative, hard-to-find foods with prices that would deliver great value. He also made a point of carrying every California wine available. He imbued his new store with a distinctive South Seas theme, lining the walls with cedar planks, creating displays out of fishing nets, and having employees wear Hawaiian shirts.

The formula was a hit. By the late 1970s, there were 20 Trader Joe’s in southern California, and by the late 1970s the chain had attracted the attention of the German Albrecht family, owners of a chain of discount supermarkets called Aldi Nord. In 1979, Theo Albrecht offered to buy Trader Joe’s, keeping

Joe on to run the business. Coulombe continued to run the company until 1987. He then retired and was succeeded by his friend, John Shields, who expanded the company into Arizona, the Pacific Northwest, and Brookline and Cambridge (near Boston). When Shields retired in 2001, Dan Bane succeeded him and continued to expand the chain. By May 2014, the company had 418 stores in nearly 40 states, more than 10,000 employees, and an estimated \$12 billion in annual sales.

A DISTINCTIVE PRODUCT STRATEGY

From the beginning, Trader Joe’s had a distinctive product strategy. Whereas a typical grocery store might carry 50,000 different items, Trader Joe’s carried closer to 4,000, and most products (roughly 80%) bore one of Trader Joe’s own brand names. Many of the names are a fun twist on the name Trader Joe but modified to reflect the nature of the food, such as “Trader Jose’s”

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37. Anonymous, "Citing Shift to Online Sales, Staples Says it Will Close Up to 225 Stores by the End of 2015," *Reuters*, March 6, 2015.
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39. M. de la Merced and D. Gelles, "Staples and Office Depot Say Merger Will Keep Them Competitive," *New York Times*, February 25, 2015.
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(for Mexican food), “Trader Ming’s” (for Asian food), and “Pilgrim Joe” (for New England favorites such as clam chowder). The company focused on gourmet and organic foods, vegetarian offerings, and imported foods, as well as wines and interesting frozen entrees.

Trader Joe’s is very selective about the products it stocks. Its biggest R&D expense is for its top buyers to travel the world looking for new, trendsetting items such as the wildly successful Trader Joe’s cookie butter, which is a gooey, Belgian spread known as “Speculoos” in its home country. The company does not charge slotting fees to suppliers to get on the shelves; instead, it makes them compete to demonstrate they can sell in high enough volumes and at low enough prices to keep their shelf space. Trader Joe’s routinely discontinues products that fail to deliver on these dimensions, cutting the 10% worst performers to make room for new items. Customers do not seem to mind the narrower selection—in fact, analysts speculated that customers actually felt *better* about their choices when there were fewer options. Trader Joe’s had cultivated a reputation of choosing products very carefully, which in turn inspired customer faith in the company’s offerings. As articulated by a former employee, “If they’re going to get behind only one jar of Greek olives, then they’re sure as heck going to make sure it’s the most fabulous jar of Greek olives they can find for the price.”

Trader Joe’s also took a fairly strict stance on issues pertaining to the environment, humane practices, and food safety. For example, products sold under the Trader Joe’s brand name could not contain artificial colors, flavors, preservatives, or genetically modified ingredients; Trader Joe eggs could only come from cage-free hens; and Trader Joe dairy products had to come from cows that were not given artificial hormones. In 2007, it announced that it would discontinue stocking most products from China due to concerns about inadequate monitoring of food safety.

The carefully curated product line turned out to have big economic advantages. Selling a narrower selection of high-volume products helped drive down supply costs because Trader Joe’s could negotiate deep discounts on each item. At the same time, managing a narrower product line lowered inventory carrying costs, and stocking only items that turned quickly boosted sales per square foot. Trader Joe’s stores sell roughly \$1,750 per square foot—more than double that of Whole Foods. As a

result, many analysts speculated that Trader Joe’s was significantly more popular than typical grocery retailers (actual profits were unknown; Trader Joe’s, a privately-held company, did not share its income figures).

LOGISTICS AND MARKETING

Most Trader Joe’s store locations were leased, and about two-thirds operated out of existing buildings rather than being newly built. The stores ranged from 8,000 to 15,000 square feet, and were typically opened in nonprime locations (though its Manhattan stores were notable exceptions). From its inception, Coulombe recognized that the stores would fare better in communities that had adventurous, educated people, and thus he targeted college towns and other educated communities.

Rather than working with national or regional distributors, Trader Joe’s purchased directly from manufacturers, which shipped their products straight to Trader Joe’s distribution centers. This process streamlined the distribution process and reduced costs, but also limited where, and how quickly, Trader Joe’s was able to expand. For example, it took Trader Joe’s longer to enter Texas and Florida (despite entreaties from customers in those locations who had become familiar with Trader Joe’s stores) because they were not easily accessible through its distribution centers.

Trader Joe’s spends very little on advertising, instead relying on regional radio advertising, word of mouth, and its newsletter, the “Fearless Flyer.” The newsletter is customized by region and offers detailed, witty write-ups of new products that emphasize their authenticity and uniqueness.

UNIQUELY FRIENDLY EMPLOYEES

A big part of Trader Joe’s strategy (and image) is the friendliness of the experience in the stores. Employees are encouraged to interact with customers, getting to

know the names of regulars, and generating a fun, informal vibe. Store employees can work in any function in the store, and all are expected to be knowledgeable about the products and be able to make recommendations. If a customer asks a Trader Joe employee about a product, the employee will typically enthusiastically share their own experience with the product, will often accompany the customer to the location where the product is shelved, and may open a package to offer the customer a sample.

Management at Trader Joe's believed that a significant reason why people shop in stores is not about food at all—it's about interacting with people, sharing a smile or a joke, and feeling welcomed. Trader Joe's therefore did not offer online ordering, nor did management feel particularly threatened by the growth of online grocery shopping. The Trader Joe's experience was distinctive enough, and fun enough, that online shopping was not direct competition. However, creating this fun and friendly vibe in the stores had become a growing challenge as the chain grew: how would Trader Joe's ensure that its distinctive store culture of friendly interaction would be retained when stores and employees were being added to the chain quickly? Protecting and reinforcing this culture was a priority that Trader Joe's management took seriously.

One way Trader Joe's attempted to preserve the employee culture was through its pay policies. When Joe Coulombe founded Trader Joe's, he decided to pay

full-time employees the median California family income rather than the much lower salaries typically offered to workers at convenience and grocery stores. Today, store managers and full-time crew members at Trader Joe's are still paid better than typical store employees. According to Glassdoor, a company that gathers pay and benefits information from employees at over 300,000 companies, hourly store employees at Trader Joe's earned an average of \$14/hour in 2014, and store managers earned over \$100K. Trader Joe's also contributes 15.4% of employees' gross income to tax-deferred retirement accounts.

COMPETITION

The traditional grocery retail industry was mature and had famously slim margins. Firms relied on rapid turnover and tight cost control, while also selling premium items such as made-to-order sandwiches, imported cheeses, and cut flowers to bolster earnings. Whole Foods, which was strongly differentiated by its focus on high-quality, organic foods, had somewhat higher margins than other industry-leading grocery chains, but even Whole Foods had net margins of only 4%. Wal-Mart's net margins hovered in the 3.5% range, and most grocers had net margins under 2% (see Table 1). This meant there was little room for waste or error in the grocery industry.

Table 1: Revenues and Net Profit Margin at Select U.S. Grocery Chains

Grocery Retailer	Gross Revenues (\$millions)	Net Profit Margin
Costco	112,640	1.96%
Kroger	108,465	1.59%
Safeway	36,330	0.31%
H-E-B	15,600	—
Whole Foods	14,194	4.04%
Stop & Shop	11,554	—
Trader Joe's	10,500*	—
A&P	8,078	-6.95%

*Sales for Trader Joe's are estimated.

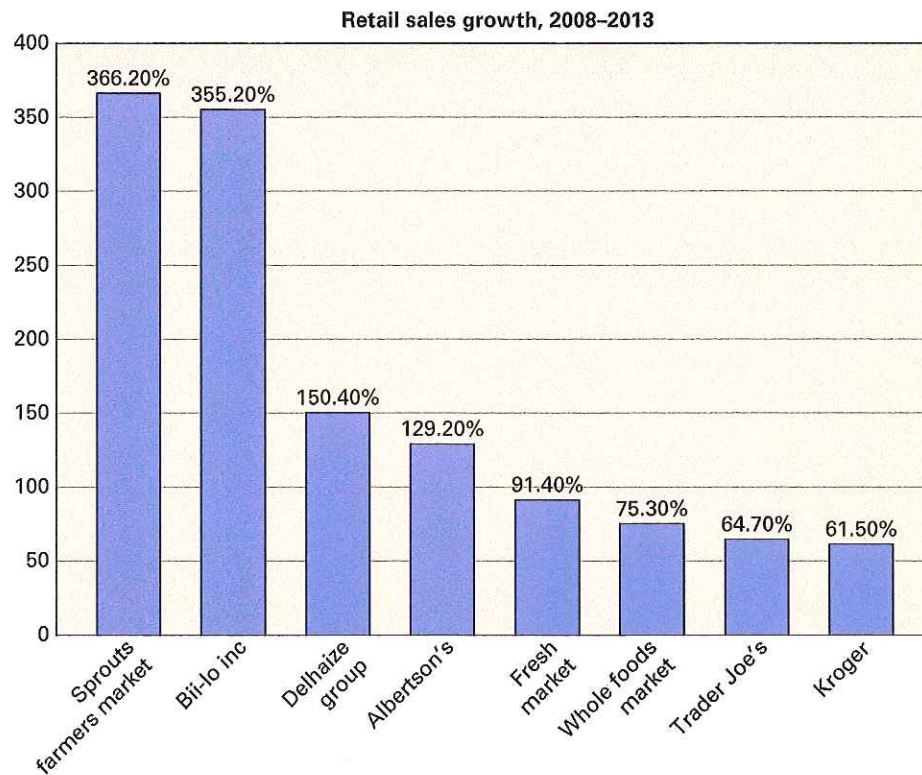
Though many customers were attracted to Trader Joe's because of its strong focus on value and its low prices, its emphasis on gourmet and healthy foods caused many people to view the store as being more like Whole Foods than a discounter grocer like Costco. Being a lower-cost Whole Foods was a valuable and unique niche position. However, there was growing risk that this particular niche would become more crowded as new, alternative grocers emerged. One such competitor was Sprouts Farmers Market. In 2014, Sprouts Farmers Market was primarily located in the Southwestern states, but it was growing far faster than any other retailer in the country (see Figure 1). Its business model focused heavily on fresh produce, sold at 20 to 30% discounts to conventional competitors. Its low-cost strategy was simple: whereas conventional grocery stores piled produce high in aesthetically attractive displays that connoted abundance, Sprout Farmers Market used smaller

“low displays,” which resulted in far less than the nearly 15% of produce that is typically discarded by a grocery store.

REMARKABLY SUCCESSFUL, FAMOUSLY SECRETIVE

In 2013 and 2014, a survey conducted by Market Force Information found that Trader Joe's was ranked as America's favorite supermarket chain. Perhaps not coincidentally, this was just two spots ahead of Aldi, its lesser known sibling. Both chains were praised for their courteous, fast service, and their high-quality, private-label lines. Trader Joe's success could also be observed in the growth in the number of its stores and its estimated revenues. It was unknown, however, just

Figure 1: Retail Sales Growth, Selected Chains, 2008–2013



Source: Euromonitor.

how much the company earned on those revenues. Was Trader Joe's remarkably profitable?

Trader Joe's had always been privately held and famously secretive. It did not reveal its sourcing, and made suppliers sign contracts forbidding them to publicize their relationship with Trader Joe's. There were no signs with the company's name or logo at the Monrovia California headquarters, and management routinely denied requests for interviews from magazines and newspapers. Such secrecy made it hard for competitors to know what profits Trader Joe's earned or how it generated those profits. It also facilitated suppliers' ability to sell products at a lower cost to Trader Joe's without alienating their other retailers.

Remaining privately held, however, came at a price. By not franchising or accessing capital through the stock market, Trader Joe's forfeited opportunities

to grow faster. Some analysts expressed concern that this left a lot of opportunity for competitors to imitate Trader Joe's business model and product strategy and seize geographic regions that Trader Joe's had left unserved. This left many wondering: How much more profitable was Trader Joe's than other grocery retailers? Should the company grow faster? And if it did, how could it preserve its company culture and store culture?

Sources: B. Kowitz, "Inside Trader Joe's," *Fortune*, 162 (4) (2010): 86–96; E. Z., "Trader Joe's Doubles Its Growth Rate," *SN: Supermarket News* 62 (9) (2014): 24–26; Anonymous, "America's Favorite Super: Trader Joe's," *MMR* 31 (9) (2014): 87; M. Gustafson, "Trader Joe's Remarkable Journey," *Private Label Buyer* (November 2008), pp. 42–46; M. Nisen, "The Secret to America's Most 'Disruptive' Supermarket—Fruits and Vegetables," *Reuters*, June 30, 2014; Hoovers; www.traderjoes.com, accessed May 25, 2015.