Georgia Institute of Technology

Trader Joe's Case Study

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Question 1

How do firms in the supermarket industry make a profit? In answering this question think thru the typical business and economic model. Why are profit margins so slim? To help answer this question perform a Porter 5 Forces Analysis from the perspective of Trader Joes.

Historically, the supermarket industry has been very competitive with extremely low profit margins (somewhere around 1-3% per item). This is mainly due to the low barriers to enter the industry and overall lack of differentiation between items sold across different stores. Consequently, most groceries stores make money by selling large volumes of items and benefiting from economies of scale.

Because of this, chains have attempted several different ways to gain some competitive advantage in this business. Giants like Walmart and Kroger are always trying to lower costs by optimizing their supply chain as well as rewarding loyal customers through their frequent shopper's programs. Specialty stores like Whole Foods decided to focus on organic and premium items which have higher profit margins.

Due to its unique business strategy, Trader Joe's has emerged as one of the most successful grocery stores by achieving both the low prices of large chains and the premium quality of specialty stores. In fact, it was ranked America's favorite supermarket in 2013 while generating the highest sales per square foot. However, vendors like Albertson's, Tesco and Safeway have been adopting many of the characteristics that have made Trader Joe's so successful, which could impact their future growth.

Porter's Five Forces Analysis:

- **Rivalry:** The rivalry within the supermarket industry is high. While Trader Joe's' successful strategy has put it atop the industry, incumbents are constantly competing for market share. Companies copying some of their tactics and the financial resources of larger chains could be problematic for Trader Joe's in the future.
- **Supplier Power:** Trader Joe's unique business strategy has significantly lowered their suppliers' power. By carrying only a few different brand names, competition between suppliers escalates. However, the main source of Trader Joe's bargaining power comes from its own branded products. Due to their non-disclosure agreements it is very hard to determine if they have switched suppliers.
- **Buyer Power:** While the buyer power is lower than for other traditional stores, it can still be considered high for Trader Joe's. Even though it has built loyal customer base, if it stops delivering on low prices and high quality products, customers have plenty of other options in such a competitive business.
- **Threats of New Entrants:** The threat of New Entrants can be considered medium. Besides the high capital requirements, the barriers of entry to the overall industry are fairly low. However, to build a relationship with suppliers similar to Trader Joe's' along with such a respected image in the minds of the consumers would be very hard.

- **Threats of Substitutes:** The threat of Substitutes can also be considered medium. Once again, Trader Joe's has positioned itself in a favorable position within an otherwise unattractive industry. The success of its own branded products, response to local clientele requests and highly trained staff create a higher switching cost to the consumer.

Question 2

What generic strategy is Trader Joe's following? Here focus on the three generic strategies defined by Michael Porter – cost leadership, differentiation, and focus.

Trader Joe's is such a unique company that, within a focused strategy, it manages to simultaneously be a cost leader and a differentiator.

- **Focus:** Trader Joe's has been so successful by understanding and focusing on their target market. This target market is mainly composed of young price-conscious professionals who value both the premium selection of products and the more personal atmosphere offered at Trader Joe's. By tailoring business practices to the specific needs of those consumers, Trader Joe's has been able to increase profitability and build a strong reputation.

- **Cost Leadership:** One of Trader Joe's' most important selling points are its low prices, which are achieved through a number of calculated business decisions. By operating smaller stores very efficiently, it saves on lease and utility costs and hires less employees per store. By focusing on its own brand, Trader Joe's orders in large quantities directly from its suppliers, significantly reducing the cost of acquiring inventory. Additionally, Trader Joe's spends virtually no money on TV, print and digital advertising, relying instead on earned media and word-of-mouth.

- **Differentiation:** Along with the low prices, Trader Joe's' has attained success by separating itself from other supermarkets in the eyes of the consumer. One of their strongest differentiators is creating a "local-neighborhood feel" despite being a national chain. Trader Joe's achieves this by having smaller stores, better-trained and more casual staff (referred to as "crewmembers" instead of employees or associates) and listening to local clientele requests and stocking their shelves accordingly. Trader Joe's has also opted not to operate online shopping or loyalty programs in order to simplify their relationship with its customers. Finally, by dramatically reducing the number of different options in each product category, it makes it much easier for customers to make purchasing decisions when compared to larger stores.

Question 3

What are the key sources of Trader Joe's competitive advantage? What are the main threats to Trader Joe's competitive advantage? Is their advantage sustainable? Why or why not.

It is undeniable that Trader Joe's has achieved considerable competitive advantage in the supermarket industry. Here are a few the key sources for this advantage:

- **Culture and Brand:** By far the most valuable asset to Trader Joe's is the reputation of its brand. After decades of developing a close relationship to its customers Trader Joe's has become one of the most beloved chains in the country, synonymous to high quality, low prices and great customer service.

- **Low Prices for High Quality Products:** As a direct result of its business strategy, Trader Joe's is able to offer high-quality (many times exclusive) products to its customers at very reasonable prices. Along with reducing the power of its suppliers and applying cost-leadership tactics, Trader Joe's achieved this by focusing heavily on its own branded products. Generic names coupled with beautiful yet simple label designs invoke a local and organic feel to their products that resonates with consumers.

- **Fewer Product Options:** Contrary to popular belief, more options is not necessarily better for consumers. Several studies by psychologists and economists have shown that after a certain number of options, people tend to get confused and become less likely to make a decision. By significantly reducing the alternatives for products of the same category, Trader Joe's makes it easier for shoppers to choose improving their overall shopping experience. In addition, this also increases Trader Joe's' bargaining power with suppliers.

- **Customer Service:** A strong argument can be made that Customer Service is at the heart of every successful business. Trader Joe's achieves high quality customer service in two main ways: listening and reacting to customer feedback and by employing a well-trained and enthusiastic staff. Store managers (known as captains) can be easily approached, regularly attend to specific requests by customers and request inventory based on feedback from the local community. The rest of the staff (known as crewmembers) wear more casual clothes and are always available to help customers with all their needs.

- **Store Locations:** Finally, by locating its stores in easily accessible strip malls in areas highly populated by members of its target market, Trader Joe's has become an integral part of those neighborhoods.

However, success can never be taken for granted in such a competitive industry. Here are a few of the main threats to Trader Joe's competitive advantage:

- **Strategy Imitation:** After Trader Joe's' tremendous success, many businesses are trying to imitate some of its tactics. Large chains like Walmart and Kroger and smaller ones like Aldi, Tesco and Safeway have been attempting to create the "local neighborhood grocery store" feeling typical of Trader Joe's.
- **Threat of Entry:** While Trader Joe's has put itself in a privileged position in the industry, there is always the threat of new entrants. E-commerce giant Amazon, for example, has made substantial moves into this industry, by launching its fully automated Amazon Go stores and increasing the number of Whole Foods 365 locations (which focus heavily on the whole foods 365 brand).
- **Threat of Substitutes:** There a few substitutes that could potentially threat Trader Joe's competitive advantages. Two notable ones are the growing popularity of local farmer's markets and the expansion of on-line grocery delivery services like Instacart, Blue Apron and Hello Fresh.
- **Lack of Advertisement:** While Trader Joe's' earned media and word-of-mouth advertising model has worked well so far, we live in a highly digitized world. If there is a sudden change of image in the mind of the consumers Trader Joe's' might not be able to respond to it effectively at a large scale.

In spite of the numerous threats Trader Joe's will face in the future, I believe its competitive advantage is sustainable. Its consistent success thus far is a direct result of competent management, which should be a good indicator of how the company will continue to operate in the future. Additionally, it takes years of sustained quality performance for a company to build such a respected brand as Trader Joe's. Finally, I think the most important indicator of sustained competitive advantage is that Trader Joe's constantly listens to feedback from its customers and takes necessary actions to address requests.