

Different! *By Design*

RETAILERS TALK ABOUT DIFFERENTIATION AND OFFERING A DISTINCT VALUE PROPOSITION, BUT FEW BRING IT TO LIFE LIKE SMART & FINAL. > **By Mike Troy**

The phenomenon of channel blurring is common throughout the retail industry, but no company takes the concept to the extreme as much as Smart & Final. The \$4.6 billion company is a major regional competitor to other retailers of food and consumables, but good luck neatly classifying it as a club, supermarket, discount, hard discount format or food wholesaler. In reality, Smart & Final combines merchandising, marketing and operational elements of all those channels to create what it describes as a value-oriented food and everyday staples retailer that serves household and business customers.

What that looks like to shoppers is a footprint of 322 small format stores in eight Western states operating under the banners of Smart & Final, Smart & Final Extra! and Smart Foodservice Warehouse Stores. Founded nearly 150 years ago in Los Angeles when the city had only 6,000 residents, the company derives its names from J.S. Smart and H.D. Final, who founded the Santa Ana

Grocery Company and merged with the Hellman-Hass Grocery Company founded in 1871.

That legacy, while notable, matters little to shoppers today in the “what have you done for me lately,” world of retail. No one knows that better than Smart & Final President and Chief Executive Officer Dave Hirz. He joined the company in 2010, three years after it was acquired by Apollo Management. In 2012, Smart and Final was acquired by Ares Management, then the company went public in 2014. The food retailing veteran spent much of his career with Kroger’s Food4Less and Ralph’s divisions prior to joining Smart & Final in 2010. He served as President of Food4Less from 2007 to 2010, President of Ralph’s from 2004 to 2007 and President of Food4Less from 1999 to 2004.

“I’ve never seen change happen so fast, but I probably would have said the same thing 20 years ago,” Hirz said of the retail industry. “I don’t think anyone is as innovative as they would like to be. I think all of us think we are little bit behind, but at Smart & Final we are in a pretty good position.”

Having a highly differentiated strategy helps, but the company is also aggressively embracing technology and moving fast to integrate its physical and digital operations with some impressive results. More than 85 percent of Smart & Final stores offered online delivery at the end of the second quarter and online sales increased more than 100 percent from the prior year, which Hirz concedes is off of a small base. The average online ticket is higher than the in store ticket and the ticket is even higher for shoppers who engage with the company using the retailer’s newly launched app.

“The rate of adoption of delivery is incredible how fast it is growing,” Hirz said.

It helps that Smart & Final has been focused on upping its technology game by investing in all manner of systems upgrades to keep pace with shifting shopper preferences. The company is spending \$29 million this year on a range of technology upgrades, according to Hirz.

“I’m fortunate to have a really talented CIO who is leading the charge with an incredible team that is bringing new technologies on board all the time,” Hirz said. “There is more investment from us and a lot of our competitors in technology over the last several years than there has been historically. We announced about a year and a half ago that we slowed down store growth a bit so we could take some of that capital and invest it in technology to upgrade systems and to roll out our digital infrastructure.”

BEING DIFFERENT

Smart & Final’s digital moves mirror those of the supermarket



▲ Dave Hirz, Chairman and Chief Executive Officer, Smart & Final.

world where click and collect and home delivery have quickly gained acceptance. But that's where the similarities to traditional grocers ends. Smart & Final stores offer many of the same product categories, with an emphasis on perishables. However there are no expensive service departments to operate, which is consistent with a low operating cost and low price model.

"Our core customer is a value customer," Hirz said, noting that Smart & Final prices are typically lower than conventional supermarkets by double digits. "Value is important whether you make \$30,000 a year or \$100,000 a year."

Another thing that's important is convenience, which is why Smart & Final stores tend to be smaller, on average about 25,000 square feet. This also helps with the company's expense structure, which looks more like a typical warehouse club. During its most recent fiscal year, Smart & Final's gross margin rate was a Costco-like 14.74 percent and its expense rate was 13.59 percent. However, Smart & Final claims to offer twice as many club sizes as club competitors but it doesn't enjoy the financial benefit of charging a membership fee.

Smart & Final also borrows from the business model of limited assortment, private label centric retailers such as Aldi and Lidl. Most of its stores offer about 16,000 Skus and that is after a decade long initiative to add roughly 4,000 mainly perishable items and rebrand stores as Smart & Final Extra! The transformative effort launched in 2008 essentially repositioned and remerchandised nearly the entire real estate portfolio. Larger stores were given expanded assortments and where possible existing stores were expanded or relocated. By the end of the last fiscal year, the company had completed conversions of 102 stores and opened 92 others so that 194 of its 260 stores, nearly all of which are located in California, were operating as Extra! stores.



A major store transformation and re-merchandising effort a decade in the making has resulted in stores operating under the Smart & Final Extra! banner generating nearly 40 percent of sales from perishables.



The Extra! transformation bumps up the contribution of the perishables department to 37 percent of sales in Extra! stores compared to 29 percent of sales in legacy Smart & Final stores.

PRIVATE LABEL GROWING

National brands matter at Smart & Final, but the retailer's fastest growth is coming from private label.

"National brands are still really important," Hirz said, "but what we tell branded suppliers all the time is they have to continue to innovate. That is why you see so many of the big companies buying up natural and organic operators."

Smart & Final's natural and organic brand, Sun Harvest, is also its fastest growing and highest margin private brand. But the company's largest brand is called First Street and recent moves have seen the company consolidate many of its smaller private label brands under the First Street banner, which now accounts for more than 80 percent of private label sales.

Private label overall already accounts for 28 percent of sales at Smart & Final stores, but Hirz sees that figure heading higher thanks to recent moves in addition to brand consolidation. For example, Michelle Narain, a 16 year veteran of Albertsons and Safeway, joined Smart & Final in May as Vice President of Private Label.

"She has been a great supplement to our private label team with some great ideas that are going to take us to 32 percent private label penetration in a couple years," Hirz said.

That's not at the level of private label centric retailers such as Aldi or Trader Joe's but it puts the company well ahead of most mainline supermarket and discount competitors such as Walmart or Target.

"Our private brands really create loyalty because when a customer finds a product they love there is only one place they can get it," Hirz said.

The company currently offers about 3,000 private label items but the assortment continues to grow with more than



▲ Exterior messaging at this Los Angeles area Smart & Final store educates shoppers about key tenets of the retailer's value proposition.

100 new items, many in large club sizes, added during the first half of the year.

“We have a strategic sourcing department that is out bidding every week to make sure we are getting the best quality at the best price,” Hirz said.

A NOT SO SECRET WEAPON

The warehouse club aspect of Smart & Final’s business model fully reveals itself in a format called Smart Foodservice Warehouse Stores. As the name suggests, food service customers account for 90 percent of sales at a \$1 billion division that has quietly expanded at a faster pace than its parent company. There are currently 63 Smart Foodservice Warehouse Stores with locations in Washington, Oregon, California, Idaho, Montana, Nevada and Utah and plans for a total of four new locations this year. However, judging from some key personnel moves and a mid-year rebranding more expansion is in store.

Most notably, the division changed its name to Smart Foodservice Warehouse Stores from Cash & Carry Smart Foodservice. The

change to a nameplate acquired 20 years earlier may seem subtle but is designed to eliminate potential confusion around what the banner stands for when entering new markets.

“The updated name better reflects our mission and provides a much clearer message to current and future customers about the products and services we offer. This new name is a much more accurate reflection of who we are and what we do,” said Derek Jones, President, Smart Foodservice Warehouse Stores and Executive Vice President, Smart & Final.

Jones joined Smart & Final in April 2017 after spending the previous 11 years with SpartanNash, the Michigan-based grocery distributor and retailer. Prior to SpartanNash, Jones held operational roles with Walgreens, Office Depot and Walmart. More recently, Jones was given added responsibility to oversee all of Smart & Final’s supply chain activities.

Another key indicator of the company’s food service aspirations is the addition of a real estate executive to secure future locations in California and beyond.

California is a very attractive market because of the population density, according to Hirz, but that also makes it arguably one of the nation’s most competitive. That’s why a company like Smart & Final, lacking the scale of larger national competitors, requires a highly differentiated approach to serving shoppers. **RL**



▲ Smart & Final CEO Dave Hirz is among the company’s home office employees who spend two days working in stores each year as part of a program called Engagement Days.

LEADING BY EXAMPLE

Many senior retail executives get their start working in stores. Some as part-time employees while still in high school or after graduating from college. Either way, every successful retail executive understands the importance of spending time in stores to gain first hand insight into what is or isn’t working and to connect with employees who interact with shoppers on a daily basis.

Smart & Final President and CEO Dave Hirz is no exception. He began at the lowest rung working in retail along with most of Smart & Final’s other senior executives and operational leaders. He makes it a point to be in stores every week and laments that he isn’t able to spend as much time as he would like in stores.

Soon enough, Hirz and other home office employees will be spending time in stores the day before Thanksgiving. That’s when they participate in a program called Engagement Days. Twice each year — the other day is July 3 — home office employees pitch in on the front lines to perform whatever tasks are needed.

The program is consistent with the retailer’s servant leadership culture, which espouses the view that senior leaders and all of those who work at the company’s headquarters are there to support stores. It’s why the company refers to its headquarter as the Store Support Center. It is just one example of a corporate culture that is as unique as the store format and value proposition Smart & Final offers shoppers.

“It takes a lot to create a culture with an engaged workforce in an environment where you try to set yourself up to be an employer of choice,” Hirz said. “It tough because there are so many options for people who are looking for work.”

It helps that the average hourly wage at Smart & Final stores is \$17 an hour and more than \$20 an hour at Smart Foodservice stores, but other intangibles help differentiate the company as well. For example, the company offers education opportunities through its Smart University program that reimburse employees who are going to school. It also operates the Smart & Final Education Foundation which awards half of its scholarship dollars to associates attending four year schools and the other half to their children. Additionally, there is a Smart & Final foundation focused on other types of giving.