

# Fresh Prepared Foods: A Growth Driver for Your Company?

Growth of fresh prepared foods is accelerating, and retailers are committed to its continued success. Those that are winning are winning big. The implications affect players all across the North American food industry.



Years of stagnating wages and a prolonged economic downturn have forced many consumers to scale back restaurant visits and do more grocery shopping. While frozen and refrigerated packaged goods are one potential solution, they lack appeal for many and are seen as less healthy than other alternatives, as declining sales would seem to indicate. By contrast, fresh prepared foods have benefited because, though consumers may have less discretionary income, they are still time-starved and want the convenience of fresh meals they do not have to prepare.<sup>1</sup>

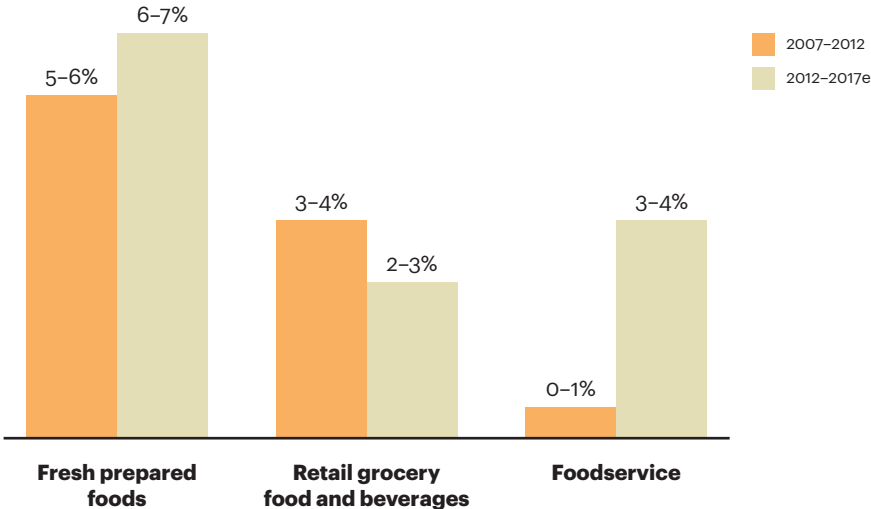
In reality, as a new generation of fresh prepared foods offers what is perceived as a fresher, healthier alternative, packaged goods manufacturers are under threat. Restaurant offerings, too, are imperiled by more than their often higher price points. Full-service restaurants, especially, cannot offer the same convenience as fresh prepared foods, and innovation in many restaurant segments has been lacking. Whereas menus have not changed substantially in recent years, upgrades in retailers' fresh foods departments are more readily apparent to the consumer.

Shifts in household composition are another boon to demand for fresh prepared foods. Smaller households (singles, couples) and urban consumers in particular want healthier, fresh products with a value orientation. These are consumers who may lack cooking skills or may not have the kitchen space for food storage and more elaborate meal preparation. As they have recognized advances in fresh prepared foods, they have been a key driver of growth.

Thus far, performance has been impressive. Over the last five years, fresh prepared foods have been a bright spot in the U.S. food and beverage industry—a \$26 billion market with growth outpacing that of both retail packaged goods and foodservice, and with expectations for even greater gains (see figure 1).

Figure 1  
**Fresh prepared foods sales growth is expected to continue to outpace the industry**

**Sales growth in select U.S. food and beverage segments**  
 (CAGR, 2007–2017e)



Source: Technomic analysis

<sup>1</sup> Fresh prepared foods refers to fully or partially prepared foods requiring minimal preparation and sold at service counters or self-service areas. These are offerings that would be associated with a deli or prepared foods department rather than the center store. Refrigerated products may be included within this definition, but frozen products are not.

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## Waiting on the Sidelines Is Not an Option

Food retailing is more competitive than ever, with mass merchandisers and warehouse clubs joined by drug and dollar stores, online providers such as FreshDirect and Amazon, and others encroaching on supermarket territory. With the blurring of channels, share of stomach is becoming more and more fragmented. Retailers need a unique offering to shift decisions about store choice beyond the traditional criteria of prices and location. Emphasis on perishables—with a growing perimeter and shrinking center store—is a prevailing theme, but the fresh prepared foods department offers one of the best opportunities to truly differentiate. It also brings higher-margin categories that can serve not only as a traffic driver but also as a potential growth avenue and profit center that will be critical for retailers to survive in today's environment. For retailers, "cracking the code" for fresh prepared foods is imperative.

Retailer emphasis on prepared foods certainly isn't a new phenomenon. Many in the industry still remember the era of home-meal replacement in the 1990s as a relative failure, and skepticism lingers about whether this next generation will fare any better. Since that time, however, significant advances in food technology have given "fresh" a longer shelf life, and supply chain enhancements are revolutionizing the speed and scale of food delivery. These developments warrant giving the fresh prepared foods market another look.

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The fresh prepared foods segment represents either an **immediate threat** or an **opportunity** for all players and will require **changes to overall strategies**.

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What's more, important factors differentiate retailer fresh prepared foods today from the home-meal replacement wave of two decades ago. Chief among them: Winning retailers have a different approach. Whereas home-meal replacement was just that—convenient versions of the same types of foods consumers were cooking at home—prepared foods today are increasingly positioned as "restaurant quality," rather than simply easy. Retailers now offer a broad range of options portioned to meet consumers' needs, such as ready meals for one or two and offerings priced by weight. More importantly, they also feature contemporary culinary influences and a "better-for-you" orientation that make fresh prepared foods an appealing alternative to the takeout market, which is dominated by pizza delivery, chicken chains, and Chinese restaurants.

Beyond product upgrades, retailers have also grown savvier about marketing these offerings. Positioning food as a restaurant alternative conveys higher quality, but retailers are also highlighting value by actively promoting lower price points versus restaurant alternatives (or the expense of purchasing ingredients for cooking, in some instances). They have also implemented more bundling. A tiered approach is increasingly common, with both basic and more premium options to appeal to varying levels of price sensitivity (for example, main course and side dish combinations at \$6, \$8, and \$10).

All of these factors have created positive momentum for fresh prepared foods and much discussion about how to capitalize on the trend. But while growth has been solid, the segment

could perform even better. Many retailers are investing, but the group of true winners with best-in-class programs remains relatively small. Beyond Whole Foods, many are regional; key examples are Bristol Farms (California), H-E-B's Central Market (Texas), Lunds and Byerly's (Minnesota), Mariano's Fresh Market (greater Chicago), Giant Eagle's Market District (Pennsylvania and Ohio), The Fresh Market (Southeast), and Wegmans (East Coast).

## Formula for Success

The "Whole Foods effect" is deeply ingrained in discussions about contemporizing the segment, but that model is not applicable across the entire retail landscape. Not all retailers can (or should) have an assortment that mirrors a food court with an array of specialty stations. Though some of the innovative ideas from leading players can be adapted for use elsewhere in the retail channel, for many success will come from keeping things simple, doing a few things well, and finding ways to do a better job of profitably meeting consumer needs.

The key to achieving differentiation and growth is to develop a product mix and merchandising strategy focused on freshness, healthfulness, and value, and to build an efficient supply chain with the right economics.

### Product mix

Without a doubt, most retailers are making a more concerted effort to align their offerings with culinary trends and paying more attention to activity on the restaurant side (see sidebar: The Battle for Dinner). But the meaning of "restaurant quality" depends on the individual retailer and the segment. The fresh prepared foods trailblazers, most of which are upscale formats, have an extensive selection that often spans comfort food, progressive ethnic fare, healthy options, and perhaps even premium choices on a par with higher-end restaurants (including prime rib, lamb, truffle risotto, and flatbreads).

### The Battle for Dinner

**Dinner will prove to be the key battleground for fresh prepared foods and restaurants. Retailers have already lost share for breakfast and lunch, as quick-service restaurants in particular have taken occasions that used to be fulfilled with products purchased in grocery stores. Much of foodservice growth has come from changing consumer habits: buying coffee instead of making it at home, going to the drive-through window for a breakfast sandwich, and picking up lunch at quick-service or fast-casual restaurants instead of brown-bagging.**

**Dinner is where fresh prepared foods have the best prospects to become established as a meal staple for consumers. Breakfast is a challenge, and lunch success is largely dependent on location. With a differentiated dinner positioning centered around "better-for-you" and approachable but elevated cuisine, however, there is opportunity to play a much greater role in the takeout market. Casual dining chains have yet to establish a good model for it, most quick-service operators are better suited for lunch occasions, and delivery options remain limited in terms of**

**cuisine—not to mention ill-suited to meet consumer demand for fresh food.**

**Retailers also have a considerable advantage in that they can offer one-stop shopping for ready meals and other household needs. Retailers can place both at the top of consumers' minds through tactics such as prominent signage throughout the store promoting fresh prepared foods as a convenient dinner solution, monthly calendars listing specials for each day, and menu boards promoting bundled offers.**

A more universal orientation, however, is “elevated home style”—offerings rooted in comfort food but reinvented as superior versions to what most consumers prepare themselves. This is approachable cuisine that addresses consumer demand for quality and broader definitions of value by emphasizing items that are time-intensive to prepare or feature more premium ingredients. Think macaroni and cheese with specialty cheeses or additional ingredients such as crab or bacon; rotisserie chicken with distinctive spice blends; salads with trendy ingredients such as grains; or specialty sandwiches such as panini, cheesesteaks, or even Cubans or Vietnamese *bánh mì*.

### Merchandising

Retailers, regardless of size and type, must employ high-impact merchandising strategies that clearly convey freshness to shoppers. But a word of caution: Freshness is a term used so universally in food marketing that it has lost its impact on consumers. Defining fresh and determining specific ways to demonstrate it with merchandising are essential.

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Fresh prepared foods require **different supply chains** focused on short shelf life, product turnover, optimized assortment, and target pricing.

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The merchandising tactics available are many and well known: dish customization (in some settings), attractive packaging and display, a “made-on-premises” look, aroma, evidence of frequent rotation or replenishment, appropriate signage, suggestive selling, see-through packaging, and labeling that indicates when an item was made rather than when it will expire. All of these contribute to the desired impression of freshness and are essential to optimize the fresh prepared foods opportunity.

However, these tactics are often difficult to execute effectively in a labor-light environment when there is a very large assortment of offerings; this speaks to the need for focused attention on a core assortment. Managing assortment more effectively has become paramount in achieving the proper balance between merchandising fresh products and reducing shrinkage.

### Supply chain

From a supply chain standpoint, positioning around fresh is not without risk and requires different approaches. Fresh prepared foods have a very short shelf life and a high level of unsellable products when spoilage is not controlled. Many food manufacturers have found that the fresh foods supply chain is extremely sensitive to the economics of sales turnover and product waste, and finding the right solution is no easy task. Case in point: It took several years for Fresh Express to optimize the supply systems for its prepared salads. The same is true for retailers’ fresh prepared foods. They require different supply chains focused on short shelf life, product turnover, optimized assortment, and target pricing. In addition, food safety concerns mean that retailers must partner with reputable suppliers that can handle all of the complexities of fresh distribution.

Retailers can consider four options to tackle fresh:

- **In-store preparation** (“A kitchen in every location”). This approach provides the ultimate localization of food through on-site preparation. From a sensory standpoint, this offers consumers a credible and substantiated value proposition. While attractive in concept and prevalent in practice, the in-store preparation model has significant drawbacks: high labor costs, complex and fragmented inventory management, difficulties ensuring quality and food safety standards, and very low economies of scale.
- **In-store finish** (“Frozen-fresh delivery”). This involves partnering with the traditional frozen product supply chain and manufacturing to support “fresh” offerings. Some retailers today provide meal solutions that consumers perceive to be fresh but in fact have been delivered frozen and reheated in the store “kitchen.” This strategy builds on existing frozen capabilities, taking advantage of the fact that 50 to 60 percent of the processes for manufacturing frozen and fresh are nearly identical, thereby providing significant advantages in economies of scale.

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The best model depends on a retailer's overall **fresh food strategy** and the **trade-offs** it is willing to assume.

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- **Commissary model** (“Differentiation with scale”). This option means establishing a network of centralized kitchens to prepare and deliver ready-to-serve meals or partnering with regional fresh food providers to develop superior recipes with processing standards that support differentiated, high-quality fresh menus. It allows the creation of regional supply chain economies of scale, providing a balance between differentiated products and pricing leverage. It also facilitates consistent quality standards (relative to managing through multiple regional suppliers), thereby better supporting execution of product and merchandising strategies.
- **Food processor model** (“Go big”). This strategy works best if retailers establish a partnership with a large food processor. Many large food processors, especially those that specialize in frozen meals, already possess manufacturing facilities that can produce fresh prepared foods. The only thing they need to do is invest in supply chain and packaging to improve food safety, quality, and shelf life. And the supply chain challenge is less daunting than it seems: Just think of fresh produce, which can be shipped across the country in a matter of hours. Under the food processor model, the retailer gains access to a large-scale, well-established, consistent quality line of fresh meals, while the food processor benefits from a first-mover advantage in the fresh sector.

No one model is superior to the others. Rather, the retailer must establish its overall fresh food strategy and understand which trade-offs it is willing to assume. The strategy must be aligned with the retailer’s overall customer value proposition and focus on its strategic objectives. Frequently, the trade-off is between customizing products and merchandising versus ensuring good value and low costs. For example, a retailer with a value proposition predominantly centered on low prices will prefer a model with greater economies of scale, while a specialty retailer will prefer a highly customizable model (see figure 2 on page 7).

Figure 2

**Each fresh foods operating model implies trade-offs**

Operating model	Labor and capital	Shrinkage risk	Flexibility	Perceived freshness
<b>In-store preparation</b> Meals are prepared mostly on-site from raw materials.	●	●	●	●
<b>In-store finish</b> Meal components are prepared centrally, with final assembly in the store.	●	●	●	●
<b>Commissary</b> Centralized kitchens prepare and deliver ready-to-serve meals.	●	●	●	●
<b>Food processor</b> Pre-packaged food is delivered as ready-to-eat or eat-and-heat. No in-store preparation.	●	●	●	●

● Low ● High

Source: A.T. Kearney analysis

## Time for the Food and Beverage Industry to Act

Even with a relatively small group of best-in-class players, the retailer fresh prepared foods market has grown apace in recent years and enjoys strong retailer commitment for continued success. Those that are winning are winning big. The implications reach across the industry.

When it comes to fresh prepared foods, **retailers** must contemporize or risk losing relevance (and patronage). Traditional supermarkets especially are under severe pressure to inject new life into their formats. Improving fresh prepared foods has potential to create new revenue (and profits), but it is not a foolproof solution. Retailers should look to fresh prepared foods “winners” for inspiration, but should not proceed without a model for how to replicate ideas in a way that is economical and makes sense for their positioning. With consumers’ quality expectations and freshness, healthfulness, and good value as guiding principles, the approach should be matched to the venue, not vice versa, and investments should be chosen wisely.

**Suppliers** have a different set of considerations that include both challenge and opportunity. Center-store retail categories are under threat as retailers’ emphasis moves to perishables and fresh. Foodservice, including fresh prepared foods, is capturing share in key occasions where center-store products were once prominent. At the same time, the foodservice industry is maturing and new avenues for growth are vital. Retailer fresh prepared foods is a growth market and, moreover, one in which foodservice insight is needed and valued. Foodservice is not a retailer core competency, and unlike the era of home-meal replacement, retailers recognize that they need resources with foodservice knowledge to ensure success and avoid mistakes of the past. Suppliers that want to leverage opportunities in retailer fresh prepared foods need to determine ways that their offerings can support that. Some degree of reinvention may be needed to deliver high-quality fresh products at the right consumer price point.

Retailer investment in fresh prepared foods has created a very real threat to **restaurants**, which will require better execution to remain competitive, especially at dinner. Retailer offerings have evolved to the point that a growing number of consumers recognize not just convenience and value, but also quality and differentiated cuisine. Retailer advances raise important questions about how the restaurant industry should respond to potential weaknesses. Answers might include measures such as meaningful menu updates (versus “me-toos”) and packaging innovation to maximize takeout potential.

Improvements in retailer fresh prepared foods have the potential to change the entire food industry. The positioning around fresh will affect retailers, other foodservice operators, and food processors alike. The segment now represents either an immediate threat or an opportunity for all and will require changes to overall strategies. As it evolves, each player can choose to be an innovator—with manufacturers and retailers working together to solve the economics and supply challenges of fresh prepared foods—or a fast follower. Those that opt to wait around and see how the market develops will inevitably miss out.

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