

The Online Grocery Opportunity

A HARTMAN GROUP WHITE PAPER



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Often described as “spectacular” failures, the demise of online grocers like Webvan and HomeGrocer in the early 2000s soured many an investor and industry analyst on the topic of “e-grocery.” Consumers, however, never seemed to let go of the idea, in part because of their increasing immersion in all things Internet and digital. Whether simply browsing the Internet for meal and recipe ideas, or undertaking a major grocery shop, the fit between in-home, and now mobile, behaviors and the relatively complex task of in-store grocery shopping has developed positive synergies with today’s online grocery business models. One simple reason for this lies in the fact that shopping itself has progressively gone virtual, and while food (especially perishables) remains one of the last few remaining categories of consumer products to “go digital,” there is growing evidence that several aspects of grocery shopping are trending to online. This occurs as an escalating number of conventional and specialty food retailers offer e-grocery solutions, typically some form of online ordering with in-store pickup, and pure-play online grocers like Peapod, Amazon and FreshDirect grow.

The online grocery opportunity has long shimmered as a hypothetical pot of gold at the end of a complex and immense food retail market: while estimates of U.S. food retail sales often describe a \$500 billion market, the entire dollar volume for food retail, when diverse and specialized channels are considered, is over \$1 trillion.¹ Whether club stores, dollar stores, drug stores, or fresh format markets, food at retail has become very complex, with shopping behavior running somewhat chaotically parallel as shoppers frequent a wide array of retail formats for groceries. Despite the size of the overall food retail market, the dollar value of the online grocery opportunity is not to be ignored: U.S. online sales of food and beverage products are expected to grow to \$15.4 billion by



2013, according to Forrester Research, and comScore Inc. noted in 2011:

“Although e-commerce accounts for only 1.2% of total sales made at supermarkets, mass merchandise and convenience stores, consumers are shifting at least some of their consumer packaged goods purchases, like soap and groceries, to e-commerce sites. Consumers spent approximately \$15 billion online for packaged goods products in 2010, 10% more than in 2009, comScore says. Approximately 12% of Internet users say they’ve bought grocery items online.”²

¹Retail consulting firm Willard Bishop, in its annual “Future of Food Retailing,” now tracks 13 different formats of retailers selling food, with just over \$1.026 trillion in total sales attributed in 2010. While estimates of total food retail sales in the U.S. often focus on the figure of just greater than \$500 billion, such figures are reflective of sales through traditional food retail formats (e.g., grocery) rather than non-traditional such as dollar stores, discounters, wholesale club stores or even farmer’s markets. See: www.bishopconsulting.com/

²comScore conference call, as reported in Internet Retailer, May 18, 2011, <http://www.internetretailer.com/2011/05/18/e-retail-gains-more-ground>

FIGURE 1: ONLINE GROCERY'S LONG TAIL

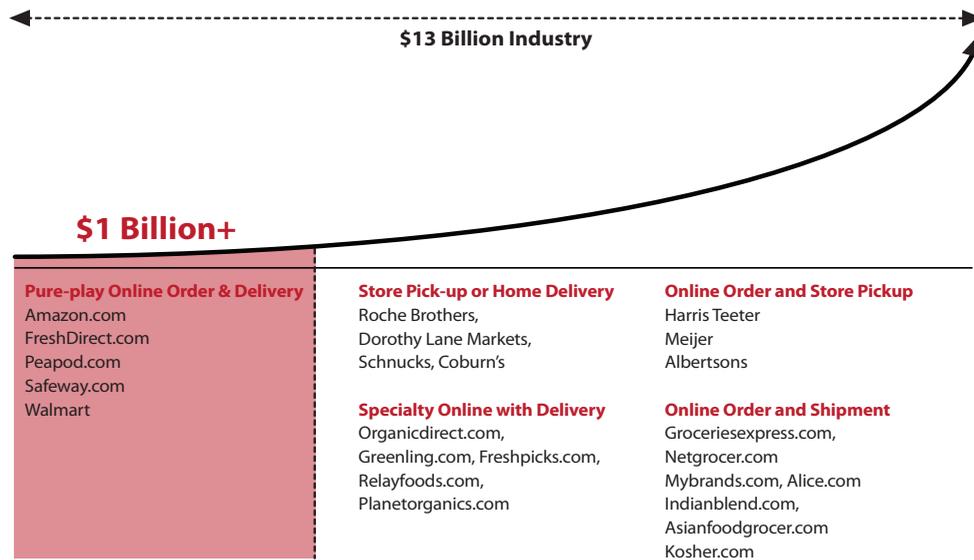


Figure 1: Online Grocery’s Long Tail: while an estimated \$1 billion or more in sales occurs through a small group of pure-play “online order with delivery” business models like Peapod.com, numerous brick and mortar food retailers (e.g., Meijer, Schnucks, etc.) and hundreds of virtual online retailers like Netgrocer.com and Kosher.com make up the long tail of the online grocery market’s remaining \$10 to \$12 billion in sales. Delivery of fresh, perishable and meal solution products will continue to define the most successful yet challenging business models because of limitations of fresh delivery.

While substantial in potential opportunity and often delineated by descriptions of Ahold’s Peapod.com or FreshDirect (which, combined, sell over \$500 million annually in shelf-stable and fresh groceries), one element of the online grocery business often overlooked is its “long tail” composed of hundreds of diverse pure-play shippers as well as brick and click online scenarios (Figure 1): these operations range from specialty online sites shipping primarily shelf-stable groceries (e.g., Kosher.com) to long-established online entities like Netgrocer.com that ship a wide assortment of foods and beverages. Sandwiched in between the diverse online shipment segment and large grocery delivery concerns like Peapod are the numerous brick and mortar “click and collect” services such as those offered by Harris Teeter, Meijer or Schnucks. Of great interest, because of consumer preferences and interests in fresh products, delivery of perishables and meal solutions will continue to define the most successful yet challenging business models because of the limitations of fresh delivery.

ONLINE GROCERY: AN OPPORTUNITY DESPITE LIMITATIONS

As just hinted at, while considerable in terms of opportunity, online grocery has historically been hampered by several

limiting factors, including the following from the shopper perspective:

- Limitations with the experience of online grocery shopping itself: while easy to proclaim as an opportunity, shoppers interviewed in our recent social media study “Clicks & Cravings” note that online grocery shopping is still not a preferred way to shop for groceries: those who shop online typically only do so in special situations when normal routines are interrupted. We did find that using online grocery services is higher in families where both parents work and those who do shop groceries online report paying more for groceries, but feel the convenience justifies the cost. In parallel survey results, we found that only 14% of consumers said they were very or extremely likely to order or purchase foods or beverages from an online retail website in the next month.³
- A lack, on the part of many traditional grocers, of providing some form of digital engagement with shoppers that enables online grocery shopping and ordering: this issue has gradually evolved to the current state of today’s online grocery market,

³Clicks & Cravings: The Impact of Social Technology on Food Culture; The Hartman Group, Inc. 2012

which finds forward-thinking food retailers offering at least some form of online grocery shopping and ordering capabilities—or at least a compelling digital experience relating to food: shopping services range from shipment of shelf-stable products to nearly any location, typically provided by third-party grocery fulfillment specialists (e.g., Kehe Distributor’s Eye Level Solutions,) to online order with in-store pickup (e.g., Harris Teeter), and finally to full-service online ordering with delivery (e.g., Ahold’s Peapod, FreshDirect or Safeway).

- Limitations associated with “fresh”: namely, the limiting factor being that perishables (including fruit, produce, frozen, dairy, fish, meat, etc.) require attended delivery to avoid spoilage. Aside from clearly defined time windows for attended delivery by services like Peapod, other solutions are being experimented with, one notable test being Amazon Fresh and its Pre-Dawn Delivery which leaves orders prior to 6:00 a.m. “in temperature-controlled totes” on customer doorsteps.
- Limitations due to fees for delivery or shipment: despite the low margins associated with most food retail, free shipping is fast becoming

an expectation within the digital shopping experience. ComScore reports that 59% of consumers stated in an April 2012 survey that if they reached the end of an e-commerce transaction and free shipping was not offered, they would cancel their purchase at that retailer.

- Limitations with regard to shopper location: while shoppers were formerly tethered to home or work PCs, this limitation has nearly disappeared with the meteoric rise and use of mobile devices (e.g., smart phones, tablets, laptops) and wireless connectivity, which enable shoppers today to order groceries from practically any location—home, work, school, restaurants, etc.

Despite such limitations, the confluence between increasing mobile device ownership and broadened online shopping behaviors among consumers now implies that, at the very least, the online grocery opportunity has reached an inception point quite different from ten years ago when business models like Webvan and HomeGrocery imploded: Despite the substantial fresh limitation, recent insights from The Hartman Group’s “Clicks & Cravings” social media study highlight the fact that shoppers today are deeply engaged with a broad

FIGURE 2: SOCIAL MEDIA IS TRANSFORMING THE LIFE CYCLE OF A MEAL

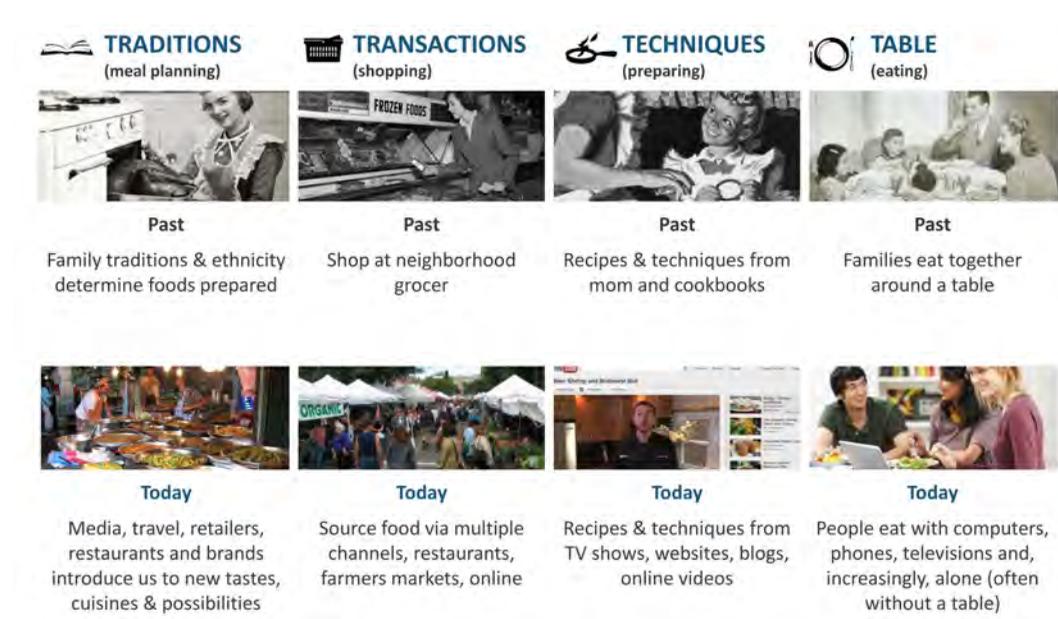


Figure 2: Upending many traditions of the past, social media influences the lifecycle of a meal from inception to purchase and finally to consumption. Source: “Clicks & Cravings: The Impact of Social Technology on Food Culture,” The Hartman Group, Inc. 2012)

array of behaviors that intersect with online grocery shopping. Specifically, social media, defined as the various platforms, apps and technologies used by consumers via a variety of devices, is altering contemporary food culture by changing how consumers plan, buy, cook and eat food (Figure 2).

Within the context of the sharp upswing in both mobile technology ownership and increasingly common online behaviors that relate to food culture, elements of digital behavior that connect to online grocery shopping abound. Consider the following:

- 75% of consumers say they are shopping online for products and services
- 54% of consumers say they use social media to discover new foods: the same number say they use social media to share food experiences
- 49% of consumers say they learn about food via social networking, and 40% say they learn about food via websites, blogs or apps
- 49% of consumers say they are very or extremely likely to respond to daily deals sent by food

retailers from sites like Groupon.com or Living Social

- 20% visit websites like Allrecipes.com monthly

When looking for inspiration on what or where to eat, as well as where to shop for or how to prepare foods and beverages, consumers say they still use traditional sources like television and cookbooks: 31% and 29% say they've done so, respectively, in the past year. However, new online and digital resources for food inspiration are quickly catching up: 25% of consumers say they've used recipe websites or phone apps in the past year and 24% say they used food or beverage coupons found online (Figure 3). Of specific interest in relation to online grocery shopping, 13% of consumers say they've used grocer websites or apps as a source of food inspiration, a number surprisingly consistent with the number of consumers saying they are likely to buy groceries online.

Aside from their traditional and now digital sources linking them to food culture, of great interest is the notion that not only are mobile technologies and social media platforms

FIGURE 3: FOOD INSPIRATION: DIGITAL, PRINT AND RETAIL FOOD RESOURCES USED IN THE PAST YEAR

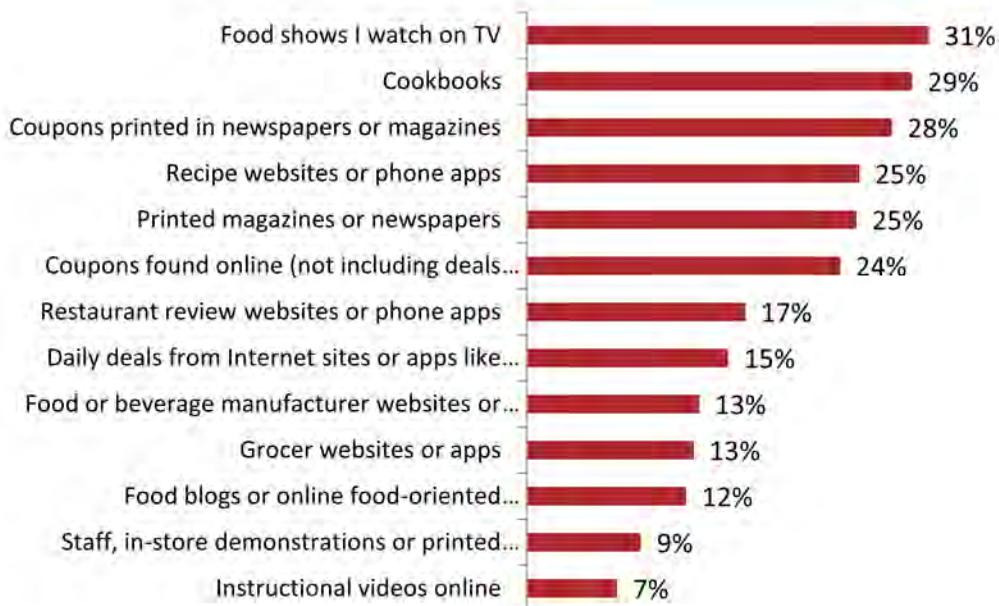


Figure 3: For food inspiration, consumers still use traditional resources like television and cookbooks for inspiration about food but new technologies like recipe websites, food apps and online coupons are catching up. Source: "Clicks & Cravings: The Impact of Social Technology on Food Culture," The Hartman Group, Inc. 2012

transforming how consumers discover and craft new food experiences, new technologies are also transforming how they shop for groceries inside stores themselves. Insights from our “Clicks & Cravings” study show that while shopping inside food retailers:

- 40% of consumers said they called someone in their household to ask about items they needed while shopping
- 29% said they texted someone in their household to ask about needed items while shopping
- 18% said they consulted a shopping list maintained online or on their phone
- 16% used a smart phone to find or consult a recipe
- 13% used a smart phone app to search for an online coupon

Such findings underscore the fact that while currently a minority of the population is engaged in an array of behaviors that link to online grocery shopping, we are in the early days of such activities in terms of adoption and diffusion into the mainstream: signaling just how new it all is, from December 2010 to December 2011, smart phone ownership nearly doubled in terms of penetration of the mobile audience in the United States, rising from 27% to just under 42%.⁴

NAVIGATING THE ONLINE GROCERY OPPORTUNITY

From high altitude, the online grocery opportunity appears substantial, yet at the landscape level the specifics of what make up a compelling online grocery offering are diverse: as we’ve seen, among many behaviors, consumers are reading about food online, looking for meal inspiration, recipes and deals, and sharing food ideas with each other. While all of these variables in one form or another present opportunities for today’s food retailers, we believe food retailers can no longer be all things to all shoppers: in terms of competitive advantage, delivering just some of the online grocery variables relevantly and authentically can create strategic advantage. In particular, digital content that is unique and authentic and communicates narratives that enable consumers to immerse themselves in food culture is quickly becoming a formidable competitive advantage to which online grocery ordering and fulfillment can be added when deemed appropriate.

Specifically, we believe digital experiences that communicate the creative use of fresh, local and ethnic ingredients in the form of meals and recipes created by shoppers (or cooking professionals) are central to building compelling online grocery experiences. Compared with commoditized store circular communications that typically promote legacy shelf-stable brands (now available in countless online and physical retail formats), the provision of digital experiences that link to changing food culture and its focus on fresh ingredients and new taste experiences is a key stepping stone in navigating the online grocery opportunity: it is also the hallmark of leading-edge food retailer’s today—whether or not they actually offer virtual shopping and purchase of groceries.

For example, consider:

- **Whole Foods Market (WFM):** *fl@vors*, its shopper e-newsletter, provides a wide range of high-experience, unique and authentic digital content including recipes, meal preparation stories from shoppers, and narratives that relate to fresh products for sale in specific WFM stores. *fl@vors* is a lengthy e-newsletter offering information on store specials and events, as well as access to general WFM videos, apps, blogs and podcast content. While WFM is not actively involved in online ordering and delivery, the retailer’s complex digital presence in food culture works to complement high experience in-store shopping as well as shopper immersion in food culture outside of the store.



- **Wegmans:** Similar to the WFM e-newsletter in terms of depth and authenticity of food narrative, Wegmans provides *Fresh News* to shoppers. *Fresh News* provides recipes, news about new items and shopper card specials, store events, and links to Wegmans blogs, twitter feeds, videos, apps, and related digital content. As implied by the name, *Fresh News* provides stories about prepared foods, meal planning tips, and store brand launches and specials that relate mainly, but not exclusively, to fresh or prepared foods. As with WFM’s *fl@vors*,

⁴ComScore, 2012 Mobile Future in Focus, February 2012

FIGURE 4: DIGITAL EXPERIENCE AND ENGAGEMENT DEFINE ONLINE GROCERY'S FUTURE SUCCESS



Figure 4: Online Grocery's Future Rules of Success: depend on providing some combination of compelling digital engagement with shoppers (e.g., online shopping, lists, coupons, ordering, delivery), authentic digital narrative focused on food and, where applicable, innovative in-store food experiences. Authentic, high-experience digital content (i.e., "narrative") relating food producer stories, food preparation ideas and recipes will increasingly become a defining characteristic of the most successful online food retailers. For physical food retailers, one significant competitive advantage available over pure-play online grocery will be the ability to offer a combination of compelling digital as well as in-store food experiences—Wegmans and Whole Foods Market are notable market leaders in these capabilities, with a marketing emphasis on fresh and prepared foods. Note: placement of retailers is based on analysis of digital products, services and content offered.

Fresh News is an authentic, high-experience digital platform that links to both in-store experiences and consumer involvement with food culture outside of the stores.

- Relay Foods:** Call it online grocery retailing 2.0, but Relay Foods, which sources and delivers locally grown foods in Charlottesville and Richmond, VA, seeks to pick up where Webvan left off. According to Forbes, "Founded in 2007, Relay sources its groceries from a select group of local small-scale producers (e.g., artisan bread and cheese



Source: Relayfoods.com

makers, family farms, organic butchers) — and delivers their products to a few strategically placed drive-thru pick up locations like health clubs, hospitals, corporate parking lots and commuter-friendly stops where customers can easily drive through and pick up their groceries in 30 seconds.⁵ Of interest, Relay digitally profiles each local producer with photographs and narratives, building connections between shoppers and small local brands. Such content captures opportunities inherent in the ongoing shopper interest in authentic, local food stories, products and experiences.

Of particular interest to navigating opportunities in online grocery shopping, Whole Foods, Wegmans and Relay Foods

⁵An Online Grocer for Web 2.0. Just Don't Call It Webvan 2.0., Forbes, 6/1/2011, <http://www.forbes.com/sites/nicoleperiroth/2011/06/01/an-online-grocer-for-web-2-0-just-dont-call-it-webvan-2-0/>

share important distinctions in terms of competitive advantage over other food retailers, namely high-digital engagement coupled with a compelling and authentic digital food experience that focuses heavily on fresh food narratives. While only Relay physically delivers food, both Whole Foods and Wegmans deliver authentic digital food experiences in a wide combination of formats (e-news, video, blog, etc.) that is in turn complemented by high-experience in-store shopping (Figure 4).

As highlighted in Figure 4, many of the largest food retailers offer some form of online grocery shopping or food-related digital engagement today: these services range from those that skew heavily toward high technical proficiency (in terms of shopping, ordering and user experience—e.g., Amazon and Peapod) to those that skew toward a highly effective digital food experience (e.g., Wegmans or FreshDirect). While a majority of food retailers ranges between high-digital technical proficiency or practically none at all (e.g., Family Dollar), very few offer some form of digital food experience without accompanying technologies. Trader Joe's is an interesting exception in this area, and is an excellent example of a food retailer that, despite its lack of a complex digital platform, still maintains a presence in digital food culture, in part from a halo cast over the brand by its great popularity with shoppers, bloggers and food industry analysts, all of whom write about the retailer extensively on the Web.

Compared with food retailers offering commoditized online grocery shopping experiences that typically include promotions of legacy brands via circulars and pro forma digital narratives such as recipes or health news sourced from the same third parties, the three digital platforms profiled here deliver highly-effective online food experiences relevant to changing food culture. While neither Whole Foods nor Wegmans offers online shopping or physical delivery of groceries, it's somewhat easy to see how such a service would be embraced by shoppers who are already able to engage fully on a digital level with the retailers.

ONLINE GROCERY COMPETITION: AMAZON AND WALMART

In addition to what are quickly becoming expectations on behalf of today's digital food shoppers—(expectations like personalized grocery list storage, recipe search, e-coupons and more)—delivering high-quality digital food experiences is

now a key component of competing in online grocery. And yet, perhaps the stiffest competition today in online food retail lies in the area of competing for price-oriented fulfillment of shelf-stable legacy brands: while digital shoppers are able to order Cheerios

from diverse online or physical "click and pick-up" food retailers, the real battle for shelf-stable goods ordered online is just forming between Amazon and Walmart: Both retailers are experimenting with delivery of diverse groceries (including fresh and perishables), and the price-driven transparency implied by widely available name brands means that both retailers will increasingly wage price wars on shelf-stable items purchased online. With over half of Walmart's 2012 global revenues of \$444 billion now coming from groceries, Walmart's experiments in online grocery will not likely go unnoticed in online food retailing. Similarly, with Amazon selling thousands of grocery SKUs already, it's clear that the company is more than experimenting with the online grocery business: as noted in one source in 2011, Amazon is "building at least 13 new fulfillment centers in the U.S. this year which will allow it to accelerate delivery and perhaps even expand its nascent grocery-delivery business beyond Seattle."⁶

The price battle destined to heat up between Amazon and Walmart in terms of name-brand shelf-stable foods bought online is itself an inevitable e-commerce scenario: as noted in a May 2012 RetailNet Group webinar comparing Walmart and Amazon's online efforts:

"E-commerce tends to be "deflationary" meaning that because pricing is transparent, and consumers can shop accordingly, it does not necessarily grow margin—it drives everything to a price oriented decision."

In other words, if you're in the online grocery business, and you think you're competing in the area of shelf-stable name

FIGURE 5:



In online grocery, especially if functioning as a pure-play fulfillment business where you probably don't want to be is trying to compete on price in shelf-stable name brands: Amazon and Walmart will increasingly drive price wars in these product categories. (Source: CVS Store Circular)

⁶Amazon Shipping Groceries, Wall Street Cheat Sheet, <http://wallstcheatsheet.com/trading/tech-biz-cheat-sheet-amazon-shipping-groceries-intel-pummeled-by-tablet-sales.html/>, October 24 2011

FIGURE 6: WHY BUY FOOD FROM A PRODUCER ONLINE?

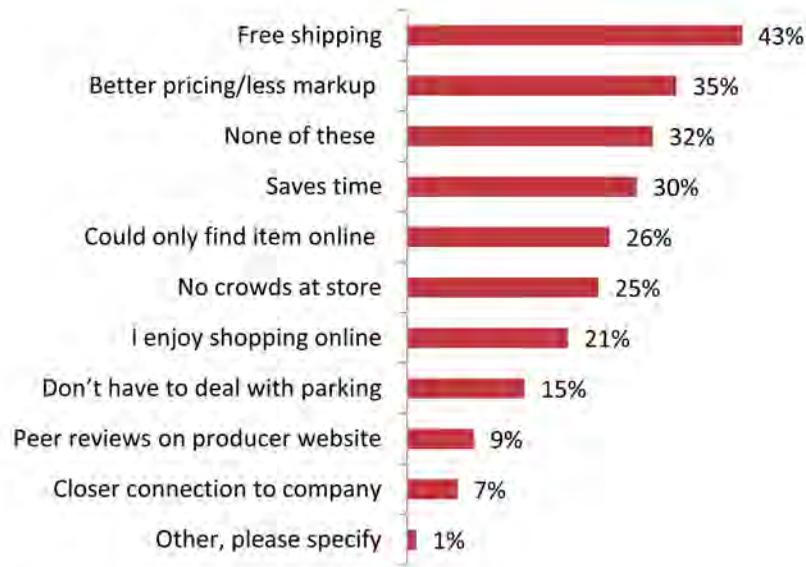


Figure 6: Why Buy from a Food Producer Online: among the 46% of shoppers who said they were at least slightly likely to buy products directly from food producers online, free shipping, lower prices and exclusivity were top reasons given. Source: “Clicks & Cravings: The Impact of Social Technology on Food Culture,” The Hartman Group, Inc. 2012

brands—beware—the capability of shoppers to digitally price shop and compare among such brands is rapidly evolving and becoming more sophisticated and deal-driven by the day.

Unlike the online purchase of shelf-stable goods, while more complex, the fulfillment of fresh, prepared and otherwise perishable meals and groceries ordered online is a much more unique and regional form of online grocery which we believe will continue to define the future success of online food retail. Companies like Peapod and FreshDirect are current market leaders in fresh delivery. FreshDirect in particular has carved out a unique niche in delivering high-quality fresh meal solutions and perishables, the success of which hinges on the company’s close proximity to New York City and its surrounding suburbs. Unfortunately, as highlighted by the spectacular failures of companies like Webvan and HomeGrocer, being able to successfully construct online grocery business models that include fresh delivery is challenging, and may only be feasible in the near future at local or regional levels (e.g., Relay Foods). For brick-and-mortar food retailers, especially supermarkets, fresh delivery may increasingly become a source of competitive advantage over other food retailers since many grocers already serve shoppers locally or regionally, and significant competition already exists in shelf-stable foods and beverages in diverse retail formats.

ONLINE GROCERY COMPETITION: DIRECT FROM PRODUCER

Aside from distribution through virtual or physical food retailers, the capability of food producers to ship directly to consumers has always hovered in the background as competition to online grocery retailers: while scenarios like Alice.com, which promised to accomplish B2C fulfillment, have appeared with appropriate fanfare, direct-from-producer is still an emerging form of competition in online grocery. Alice.com currently offers little in the way of food, and its other CPG categories will meet increasingly strong price competition from CPG websites such as found on Amazon as well as Walmart.com.

At the same time, we find consumers interested in the idea of buying food directly from producers: when asked how likely they were to purchase foods directly from producers online in the next month, 11% of consumers said they were very or extremely likely to do so. Among the 46% of shoppers who said they’d at a minimum be slightly likely to buy from a food producer online, some of the most important reasons for doing so would include expectations for free shipping (43%), better pricing (35%) and exclusivity (the potential to only find the item online, cited by 26%) (Figure 6).

LOOKING FORWARD:

The variables that comprise online grocery today are diverse. While often defined as the ability to browse and order foods and beverages online, digital food experiences themselves, composed of narratives steeped in food culture, are also a significant part of the business and can serve to either boost in-store or online shopping experiences. Many pure-play and physical food retailers today offer some form of digital engagement with shoppers, with the majority offering relatively commoditized technical services (e.g., electronic circulars and coupons, online recipe lookup, meal planning, list storage). Those retailers that offer both a compelling digital food experience as well as technically proficient digital engagement are leading the market—whether or not they offer online grocery delivery.

- Digital engagement will continue to offer significant opportunities in retail brand building: whether communicating narratives about quality (via fresh offerings or store brands), in-store events that link to food culture (e.g., cooking, store tours, etc.), meal planning and ideas, local products, health and wellness topics, new products or product sampling, the opportunity to speak to shoppers digitally on topics that link to food culture is expanding daily, as are the technologies and platforms by which to communicate.
- Some combination of online grocery browsing, ordering and delivery offered in tandem with electronic lists, coupons, recipes and CPG product narratives will increasingly become an expectation among shoppers. Retailers can help meet these expectations by offering some form of “click and pickup” services along with other digital tools for shopping.

- Harmonization, customization and individualization of shopper interests with online digital communications will continue to be an expectation on behalf of shoppers: one size fits all, in terms of promotions and narratives, will not suffice. Local products in particular will increasingly offer opportunities for retailers to build store-specific or at least regional narratives that appeal to shoppers.
- Compared with commoditized, price-driven shelf-stable brands, fresh, prepared and meal-oriented solutions made available for online delivery or store pickup will continue to offer competitive advantage to food retailers.
- Retailers and manufacturers alike must understand that in order to remain relevant with changing shoppers, they must consider what part of the digital conversation they want to join as consumers plan, purchase and prepare foods today using a broad array of mobile devices, websites and social media platforms.



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