Online Grocery Business Models
Click & Collect and Drive

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June 2015

Know Tomorrow Today

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CURRENCY & FORECASTS

All data in this report is presented in USD currency using 2013 constant exchange rates. Had another currency been used, different conclusions may have been drawn.

There are a few key watch-outs to keep in mind throughout this report.

Currency – In markets with weak local currencies and poor economic fundamentals such as high inflation and limited foreign exchange reserves, there is a potential for a black market exchange rate to develop. These rates for foreign currencies are priced at a significant premium to the official exchange rate.

Inflation – Individual markets are very dynamic in this regard.

Use of Estimates – There are several analytics and database components where estimates were used. For this reason, all of the underlying databases are available for each market on www.retailnetgroup.com.

For any additional questions or concerns regarding this report, please contact Hannah Donoghue at hannah@retailnetgroup.com.

ONLINE GROCERY BUSINESS MODELS – LANDSCAPE OVERVIEW

INTRODUCTION & DRIVERS OF CHANGE

The online grocery landscape is rapidly evolving, and now more than ever it is critical to understand the distinct business models that are emerging and expanding in the US today. Online grocery will have a significant impact on retailers and suppliers alike, directly through category migration and indirectly through digital influence on store-based retail. This report examines two of the leading global online business models, Click & Collect and Drive. The analysis includes the implications to both retailers and suppliers and identifies specific growth opportunities for the deli, dairy, and bakery categories.

In 2014, estimates range from 3%-4% of total grocery category sales shifting online. However, the category is expected to grow at a 14% CAGR through 2016E, in line with other categories like consumer electronics and baby. [1] Although online grocery still remains a small fraction of all grocery sales, full basket grocery purchases are a rapidly growing component of online CPG sales, a trend that is expected to accelerate as full basket purchases continue to shift online. While grocery has traditionally been one of the slower categories to shift online, the consumer adoption of these business models will determine the future online grocery scenarios. Dairy, deli, and bakery departments will need to be optimized both in packaging and pack sizes to meet specific online consumer demands. These departments will also need to be particularly mindful to maintain product freshness while working with various online grocery supply chains.

As digital technologies continue to influence consumer preferences, retailers must increasingly engage shoppers across both digital and physical storefronts in order to develop a competitive, seamless retail strategy. Three key factors that are driving investment in online grocery are:

1. A shifting shopper base with distinct shopping behaviors and preferences means that more digital natives are beginning to increase their grocery spend online
2. Technology innovation and adoption has led to a vastly improved user experience
3. New supply chain and fulfillment innovation and approaches are favorably changing the economics involved in online grocery business models

Digital business models are meeting consumer needs across food-relevant categories, expanding the relevance to various trip types farther than the traditional big box. Online grocery is quickly becoming an area of intense competition between traditional retailers and new entrants. Early adopters like Peapod continue to invest in growth, pure-players like AmazonFresh are steadily expanding to new markets, and new entrants like Instacart are accelerating models that leverage store-based retailers' physical assets. While online grocery still has low adoption in the US, markets like the UK and France – despite their unique differences – have shown the viability of online grocery, across all business models, in high-density geographies. In the US, leading national retailers including Walmart and Kroger continue to test and expand both the Drive and Click & Collect business models, making it increasingly important to understand these models' potential impact to the grocery channel. Online grocery business models will compete across trip types and emerging 3rd party delivery networks will further support their viability to win the convenience and immediate need quick trips.

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[1] RNG Research & Estimates, Packaged Facts, Bricks Meet Clicks

Digital Aligning with All Shopping Occasions
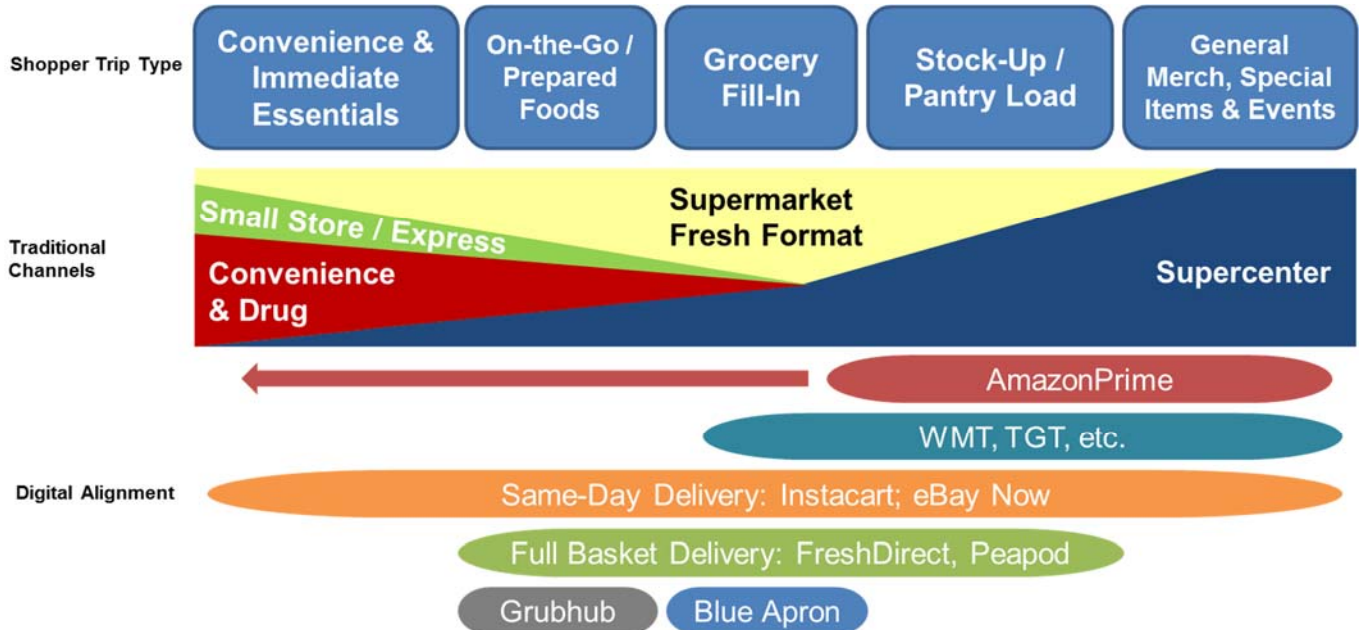
Source: RNG Research & Analysis

Online grocery opens new, important avenues to retailers for customer loyalty, retention, and trip aggregation. Winning the online trip is essential for top line sales growth. Retailers such as Nordstrom, Dick's Sporting Goods, and Williams Sonoma all report multi-channel shoppers spend 3 to 5 times more than single channel shoppers. In the UK, Tesco has noted historically the value of consumers shopping across channels and indicated the important distinction that it still may not be a high share of the total shoppers, but it is a quickly growing segment and one that over-indexes on spend.
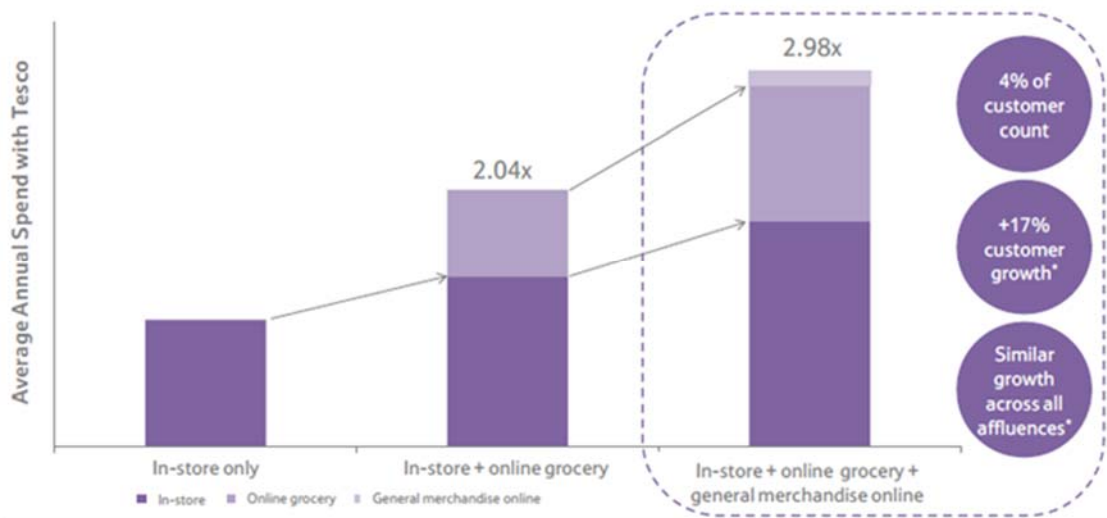
Source: Tesco Investor Relations

With little addressable population growth in the US today, the competitive landscape is becoming more focused on customer retention versus customer acquisition in order to maintain share of household requirement. As retailers' look for differentiation and competitive advantages in this lower growth environment, many leading players are pursuing online, full basket models, despite the cost to gross margins in the bottom line, as they allow these retailers to retain customers in their networks (physical and digital), capture shopper data and gain share. As retailers continue to improve their online offering, improve customers' online shopping experiences and create more relevant, targeted promotions, the transfer of sales from offline to online (or click & collect) will accelerate, creating a new and changing grocery environment for consumers, retailers and suppliers alike.

INTRODUCTION: SPECTRUM OF ONLINE GROCERY BUSINESS MODELS

Online grocery business models fall into three primary categories: Delivery, Order Online & Pick-Up In Store (Click & Collect), and Drive. Each model offers distinct tradeoffs for retailers and consumers. Many players compete in this space, ranging from pure-play retailers (i.e. Amazon), to third-party technologies that aid and enable brick & mortar retailers to offer these capabilities (i.e. Instacart), and to brick & mortar retailers that build the technology internally. For the purposes of this report, we will focus on Click & Collect and Drive, models that involve physical pick-up locations.

Ecommerce Business Models	Pure-Play	3P Technology	B&M.com
Delivery – GM (National Ship)	Amazon	Google Shopping Express	Walmart.com
Delivery – Full Basket	AmazonFresh, Fresh Direct	Instacart, Blue Apron	Safeway.com, Peapod
Click & Collect – GM	Amazon Lockers	Curbside	Walmart.com, Target.com
Click & Collect – Full Basket	Fresh Direct	Instacart	Walmart.com, Shoprite, Peapod
Drive – Full Basket	N/A	N/A	Walmart-To-Go, Zoomin Market, Peapod

Source: RNG Research & Analysis

Click & Collect has evolved with a variety of business model distinctions across retailers. The first distinction is where customers actually pick-up their groceries. Click & Collect pick-up can sit within a store, adjacent to the store or in an automated location (i.e. lockers). These lockers are often located in or outside of the retailer's own store or in a different retailer's store that wins on convenience & proximity (i.e. 7-Eleven). Each model has its own strengths for the retailers – third-party locations tend to be more convenient for shoppers but store-

based models better leverage existing assets. The second distinction is the picking model that prepares the click & collect orders. Among the store-based models, picking for orders can come directly from the in-store (or backroom) assortment or delivered from a warehouse.

Spectrum of Grocery Pick-up Options

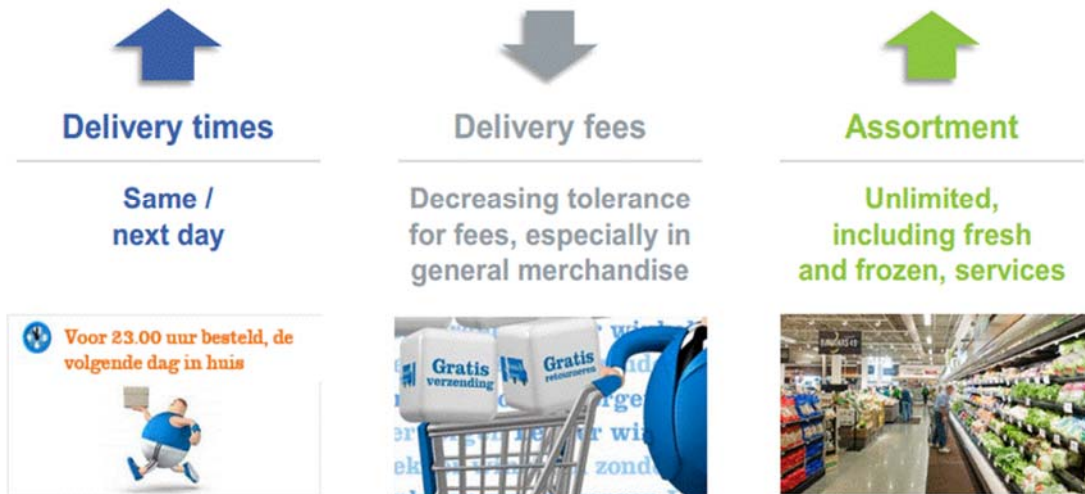| Location	Click & Collect at Store			Click & Collect at 3rd Party Location	Drive
	Drive-Up	Inside Store & Lockers	3rd Party		
Picking Models	Pick from Store or DC	Pick from Store or DC	Pick from Store	Pick from DC	Pick from Drive
Examples	• Shoprite From Home • Peapod • Walmart (Denver)	• Harris Teeter • Peapod	• Instacart	• Peapod	• Walmart (AR)

Source: RNG Research & Analysis

CONSUMER DRIVERS OF CHANGE IN ONLINE GROCERY

Consumers behave differently online, and consumer expectations are can be harder to meet online compared to in store-based retail, where the in-store customer service can facilitate the shopping experience. Consumers regardless of channel are looking for and expect a convenient, seamless experience, which can be difficult to deliver in an online grocery business model. Digital increases transparency in pricing and assortment, and as a result, retailers will need to carefully track inventory and potentially re-examine pricing strategies in order to align to shopper expectations in 2020.

Consumers are looking for added value and while they want the convenience of online shopping, many do not want to pay for that convenience and tend to be resistant to delivery fees and restricted delivery times, driving complexity into the economic model of online grocery. Ahold noted the evolution of consumer expectations in their November 2014 Online Strategy Event, that consumers are expecting more flexibility for order fulfillment, lower fees associated with these services, and a greater assortment to attend to various dietary needs and preferences.

Customer expectations are increasing rapidly

Delivery times	Delivery fees	Assortment
Same / next day	Decreasing tolerance for fees, especially in general merchandise	Unlimited, including fresh and frozen, services

Source: Ahold

Shoppers of online grocery models tend to skew younger, changing the dynamics of the target shopper. Millennial consumers are digitally dependent and use online services more frequently as digital natives, but they are also more likely to make several mini-trips when grocery shopping offline. For these shoppers, online orders are still more likely to generate large average basket sizes due to list building and minimum order requirements. However, baskets are also more likely to include products geared towards ready-to-eat, and less towards scratch cooking. Regardless of channel, Millennial consumers continue to prioritize speed and convenience even when food shopping. While Millennials have deferred many key life stages, as they enter peak consumption years, their distinct preferences and shopping behaviors will drive new needs in online grocery business models.

Over the past decade, consumers have fragmented trips by shopping at various retailers across segments with more fill-in quick trips, but when a consumer shops for groceries online, she often consolidates trips back into one retailer. This is largely due to:
- Order minimums and sunk costs of delivery, which trigger consumers to increase basket size in order to get the most out of their investment
- Convenience of grocery delivery
- Lead time between ordering and fulfillment, which leads to shoppers editing and adding to their list (potentially done by multiple different members of the household) multiple (3+) times before the order is fulfilled

Each business model caters to different consumer preferences. Based on the individual consumer's value equation, she would choose one business model over the other. When considering why consumers might select one online grocery business model over another, there are advantages and disadvantages to each. Retailers will need to understand the demographics surrounding their stores to understand how their shoppers would weigh the advantages:

In-store click & collect	Drive	Delivery
✚ Free Service	✚ Free Service	✚ Full service package
✚ Contact with staff in the store	✚ Time efficient	✚ Time efficient
✚ Payment in the store	✚ Some flexibility in timing	✚ Do not have to carry products
✚ Some flexibility in timing	✚ Payment at delivery	▬ Cost for delivery
✚ Same day delivery possible	▬ Need to drive to store	▬ Need to be at home
▬ Need to drive to store	▬ Limited contact with staff	▬ Very limited contact with staff
▬ Less time efficient	▬ Have to carry products home	▬ Payment before checking the products
▬ Have to load products in car		
▬ Have to carry the products home		

Source: RNG Research & Analysis

As a result of the distinct consumer behaviors relating to online grocery, it presents unique opportunities for retailers to scale:

	Lower Impact → Higher Impact		
Reach New Shoppers	Referral program via existing users (refer-a-friend) New digital first shoppers	Reaching shoppers outside of catchment areas (e.g. ShopRite Delivers)	Capturing other groups of commerce transactions (e.g. B2B)
Expand Consumption	Promotions (e.g. BOGO), coupons	Auto replenishment can increase consumption (e.g. ShopRite Delivers)	Delivery pass, Larger pack sizes
Premiumize	Online merchandising (e.g. website look and feel)	Service (online chat, troubleshoot, social media engagement)	Offering premium / specialized SKUs (e.g. gourmet/artisan, organic, ethnic)
Gain Wallet Share	Expanding assortment (Carry more SKUs)		Consolidating trips (competitive share gains)

Source: RNG Research & Analysis, Note: Delivery Pass signifies membership program, where delivery fees are reduced when shopper enters a longer commitment for the service, i.e. Google Express membership model.

CLICK & COLLECT VS DRIVE – DISTINCTIONS, COST & SALES POTENTIAL

Both Click & Collect and Drive require customers to drive to a dedicated location to pick-up groceries. Click & Collect models run inside stores or alongside warehouses where Drive models run as standalone locations, complete with their own warehouse to fulfill orders. These different models setup different trade-offs for consumers (as discussed above).

Consumer Shopping Journey

Tesco, the UK-based grocery retailer, operates a highly developed click & collect model. Tesco has integrated Click & Collect into various points inside its stores or in its parking lot that leverage its physical assets. The example below highlights consumers shopping process when using the Click & Collect model.

Tesco – Process for Click & Collect

Source: RNG Store Tours, Tesco

In the above example, the click & collect pick up point is located adjacent as opposed to within the store, which is not always the model. Tesco operates a variety of click & collect models, seen below, with placements inside and outside of the store based the existing store structure and the local consumer demands.
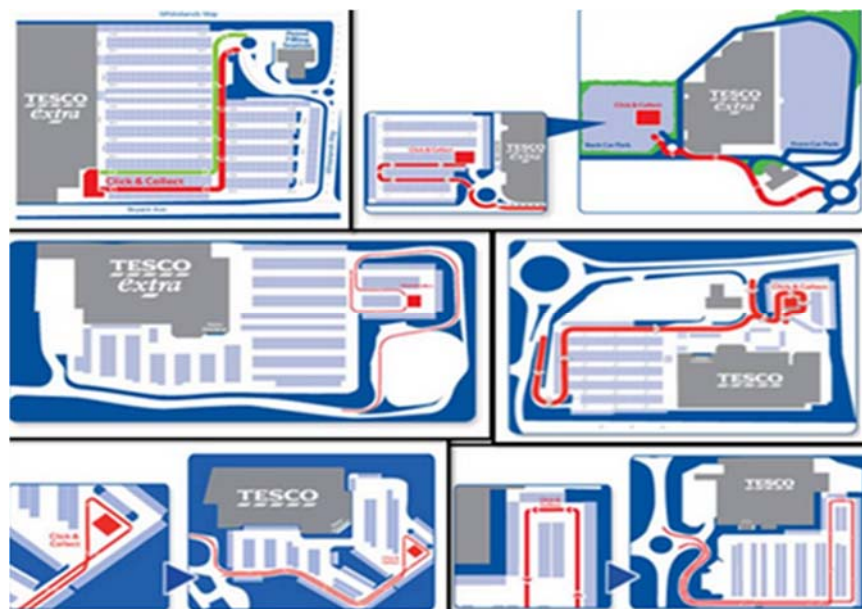
Source: Tesco Investor Relations

Comparatively, Auchan, the France-based grocery retailer, operates a highly developed Drive model. The process has been optimized for automation and standardization across locations and is considered best-in-class for Drive around the world. The example below highlights consumers shopping process when using the Drive model.

Auchan – Process for Drive

Step 1: Enter your order number or scan loyalty card to activate the order
Step 2: Processing the request
Step 3: Choose an Auchan loyalty card:
- Auchan Waaoh! Card
- Auchan Accord Credit Card
- Auchan E-card
- "I don't have an Auchan loyalty card"

Pay online or pay at check-in kiosk

6 kiosks directs vehicles to 12 different lanes

Step 4: Choose payment method – only major credit cards accepted
Step 5: Authenticate payment – either pin or signature accepted to verify
Step 6: Take your receipt and proceed to your space (#11)

Source: RNG Store Tours, Auchan Drive

Business Model Distinctions & Potential

The online grocery business models involve different capex requirements and returns. Click & Collect models located within stores require a relatively low initial set-up cost, but the sales volume is typically capped at around $2 million per store. One of the main reasons for this sales volume limitation is that retailers need to ensure the online business does not interfere with in-store experience, assortment, and profitability, in turn requiring retailers to enforce a Click & Collect sales ceiling, typically about 10% of store sales. In developed markets, once this threshold is reached, retailers have opened dark stores or expanded click & collect locations in nearby stores. Drive, on the other hand, requires over 160x the capital of Click & Collect, but the sales potential is limited only by labor and product availability.

Metric	Pick-up	Drive	Delivery	What's Driving Differences?
Picked Location	Store	Drive	Warehouse	Shopper Location
Capex	$20-30k	$3.2-4.5m	$129-322m	Cost of maintenance
Gross Margin	24%	29%	27%	Buying power, Promotional sophistication, Shrink
SKU Range	Low	High	Medium	Size of warehouse, Interest in GM
Productivity (units / hour)	100-200	200-300	500-700	Number of employees, Degree of automation
Retailer Packaging Costs	$0.05	$0.05	$0.05-0.20	Attended vs. unattended, Van refrigeration
Labor Time to Prepare	20mins	4-5mins	4-5mins	Efficient loading
Sales Ceiling	10% store sales	$13-19m	$516-1,548m	Product availability, Labor allotted
Average Basket	$115	$130	$160	Selection, Recommendations
Units / Order	30-60	30-61	30-63	Selection, Recommendations
Average Sales / Year	$2m	$10m	$20m	Quality of experience, Returners to service

*Source: RNG Research & Analysis, Bank of America Merrill Lynch*

Each of these business models have their own respective strengths and weaknesses, which has led to different paces of development:

	Click & Collect *Centralized DC*	Click & Collect *Store-Picked*	Drive
Examples	Peapod	Shoprite from Home, Walmart-to-Go	Walmart Drive, Auchan Drive, Chronodrive
Strengths	• Inventory accuracy & transparency • Selection • Freshness (faster turnover & fewer touches) • Lower labor costs • Lower supplier delivery costs • Scalability	• Lower capital investment • Minimizes self-cannibalization in early stages • Increases service levels • Established supply chain	• Full store selection • Convenient • No delivery cost attractive to price-sensitive shoppers • Can help win fill-in trips
Weaknesses	• High upfront capital investment • Customer acquisition costs can be high	• Best perishables go to online customers, lowering in-store presentation • Assortment limited to in-store stock • Lower labor efficiency • Impact on stock levels, especially high-velocity SKUs	• Tight time constraints • Shoppers generally prefer delivery if available • Limited inventory at specific locations

Capturing Share of Household Requirement

Retailers have demonstrated the potential for online grocery models, particularly the pick-up models, to lead to incremental sales growth. Both Ahold and Sainsbury reported that with each new online grocery model offered, share of wallet expanded.   It is important to recognize that this is not to say that these models are not always creating new consumption, but instead shifting it from one channel or retailer to another. In the case of Ahold, shown below, the addition of new online business models was incremental on the retailer's sales as the new models allowed Ahold to gain new shoppers and further share from existing shoppers.
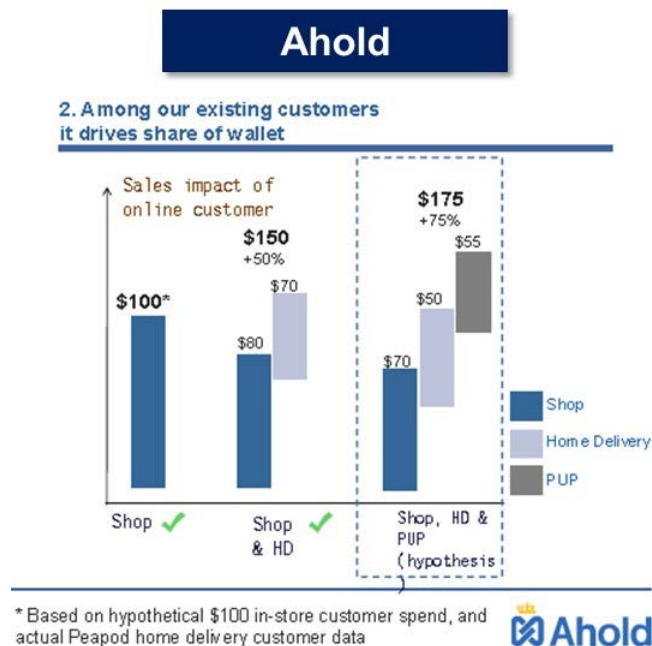
Source: Ahold Investor Relations, Note: HD stands for Home Delivery and PUP stands for Pick-up Point

Opportunities – Efficiency & Impulse

For retailers operating these models, two critical initiatives to focus on are continuously improving efficiency and driving impulse. The economics of online grocery are more challenging than store-based models in that the retailer is taking on work that the consumer normally does (i.e. picking and packing) which requires additional labor. If retailers can improve the efficiency of the models, they can increase the number of consumers that can potentially be served, all while increasing the convenience and improving the experience, supporting customer retention.

Impulse is harder to prompt and merchandise in an online grocery environment, with a distinct checkout experience that does not provide the same opportunity to merchandise as many products as one would in the store. Impulse spend remains critical to win though in order to expand the overall basket size and improve the retailer economics of each trip (in particular for those orders that are being delivered). Below is an example of how Auchan is integrating steps in its Drive process to improve upon those two initiatives:

"Destockage" Shelf: products that are close to expiring are offered at discounted prices to encourage impulse purchasing

The pickers wear finger scanners in order to optimize the time it takes to scan groceries. In this case, the picker is also the employee who brought the order to the vehicle
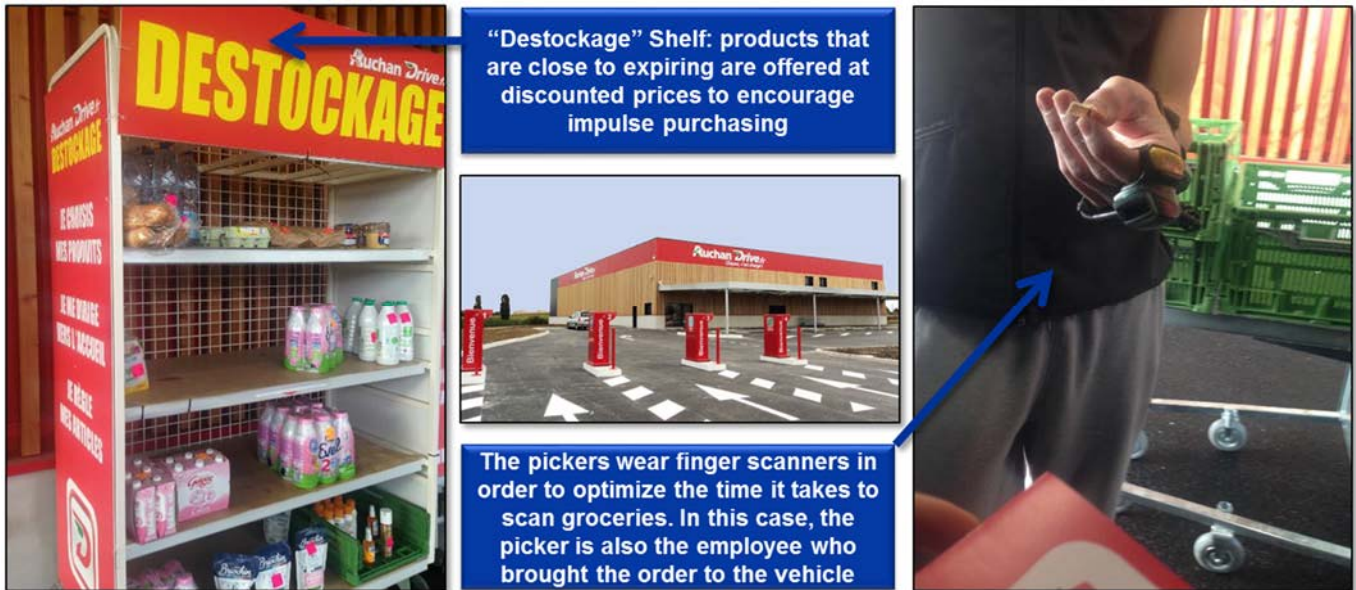
Source: RetailNet Group store tours

GLOBAL MARKET DEVELOPMENT

Various macro-economic and societal factors determine which online business model will succeed in a given market. In analyzing these factors for two of the most developed online grocery markets in the world, France and the United Kingdom, it becomes easier to predict which business models will grow and the potential scalability. Population distribution, in particular the density within a certain radius, is critical to the success of the Drive business model. The high capital required to build a Drive requires an outlet location that is accessible to a densely populated area to get the needed return on the investment.

In France, the population is spread across urban and suburban areas, resulting in a high percent of the population that owns a car. French shoppers place a premium on quality product and are sensitive to the conditions of fresh produce, in particular.

In contrast, the United Kingdom has large, dense urban and ex-urban population distribution and public transportation is widely available, making it less necessary for consumers to own a car. The value equation of quality vs. convenience is also different for shoppers by market. These different environments support the success of different business models – the Drive model in France and the delivery model in the United Kingdom.

France

- Lower population density
- High % Own Vehicle
- Shoppers highly value fresh & quality
- High % working females

Drive Preferred Model

United Kingdom

- High population density
- Lower % Own Vehicle
- Shoppers less concerned about fresh & quality
- Lower % working females

Grocery Delivery Preferred Model

Source: RNG Research & Analysis

France is the most developed market globally in terms Drive evolution and adoption. It is a strong model market to study in considering the development and adoption of the Drive model. The first Drive was opened by Auchan in 2000. Shortly after, other leading French grocers followed with their own format and by 2007, the total Drive market surpassed $1 billion in sales.

France Drive - Sales (USD bil)
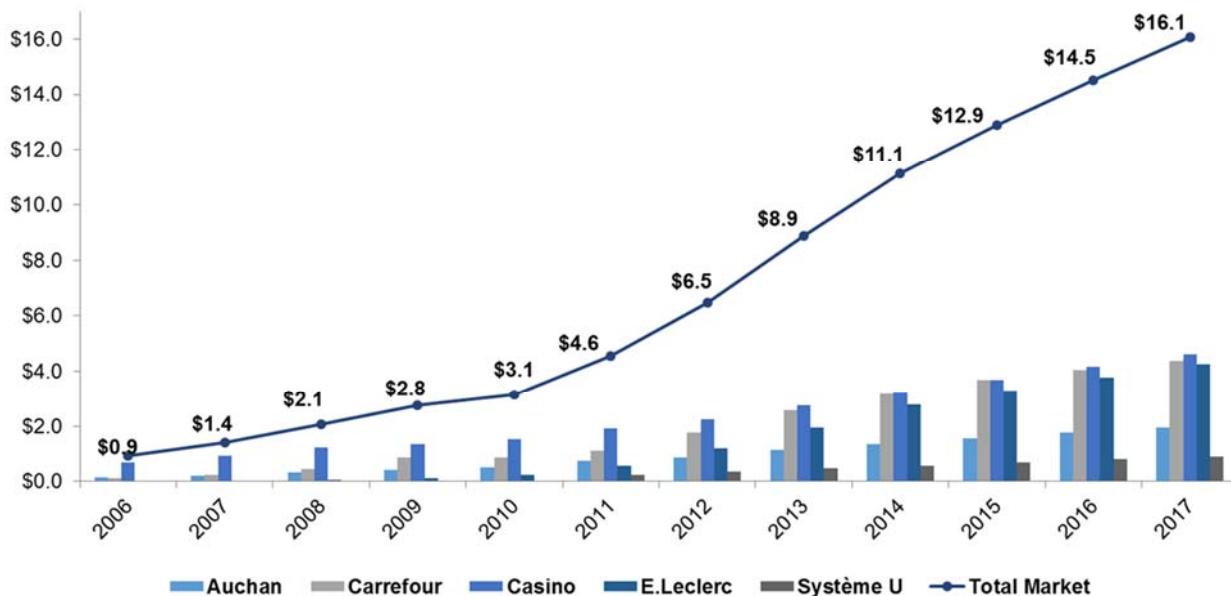
Source: RNG Database, USD Constant 2013

Over the past five years, retailers have quickly expanded their Drive networks in the market. Total Drive locations almost doubled during each of the formative years from 2006 to 2011. Today, the market continues to add about 200 Drives per year and the Drive outlet growth trend is forecasted to continue in the short term.

France Drive - Stores
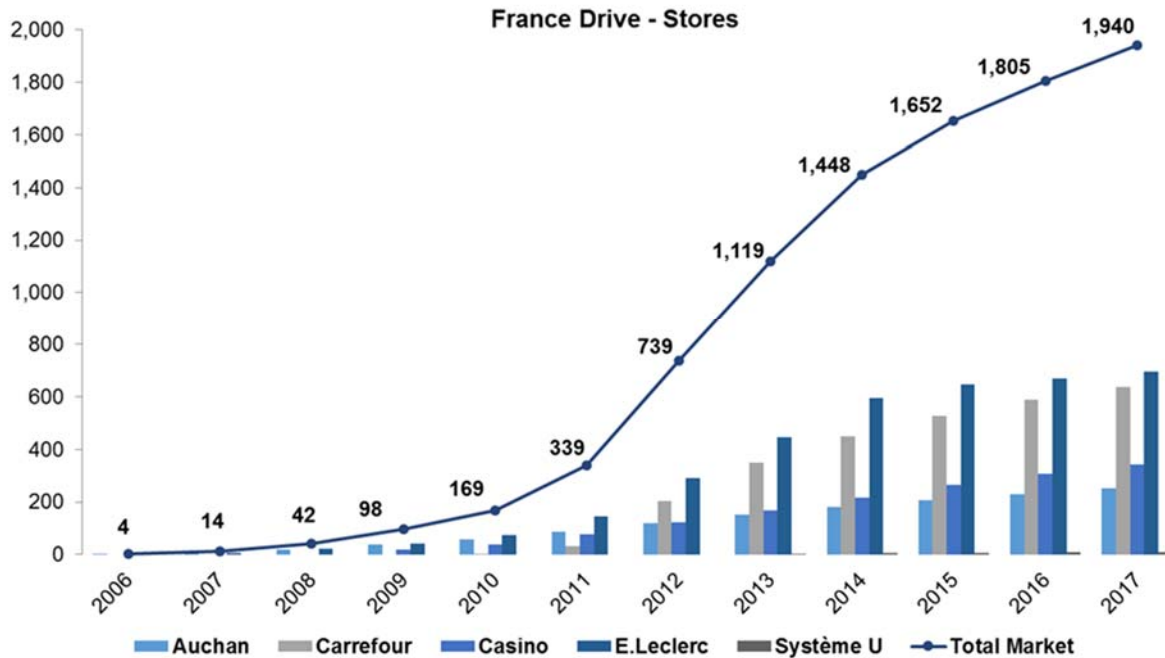
Source: RNG Database

Location choice of the drive outlets is important as too much density creates traffic and urban congestion, the top barriers to customers wanting to own and/or use a car. Drives are often located close to off ramps of the highways adding convenience for those shoppers on their way to or from work. These locations are typically in lower rent real estate in order to maintain the needed economics of the building.

French retailers have strategically expanded their Drive formats to suburban areas. The maps below display the distribution of E.Leclerc Drive locations, another French grocery retailer. As evidenced in the maps below, E.Leclerc built Drives across France along key metro points, but avoided heavily populated areas such as Paris. The Drive locations nearest to Paris surround the city but do not come near the city proper, likely due to the congestion and higher real estate costs.

Exhibit 2: Inhabitants per drive in France
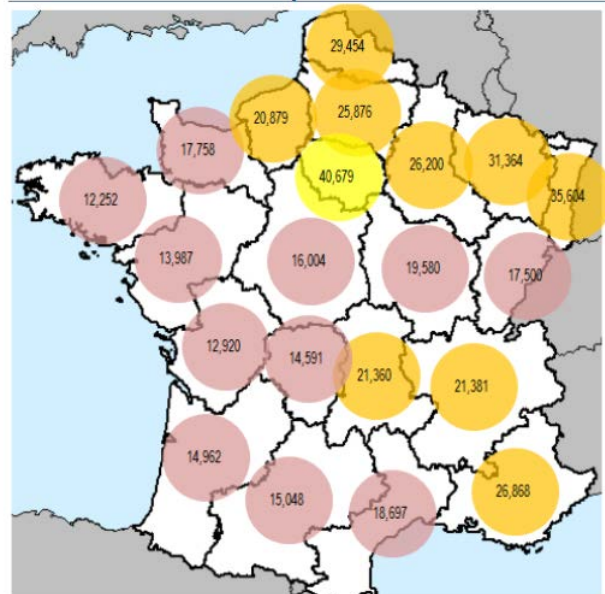
Source: A3 Distrib, Editions Dauvers , BofA Merrill Lynch Global Research
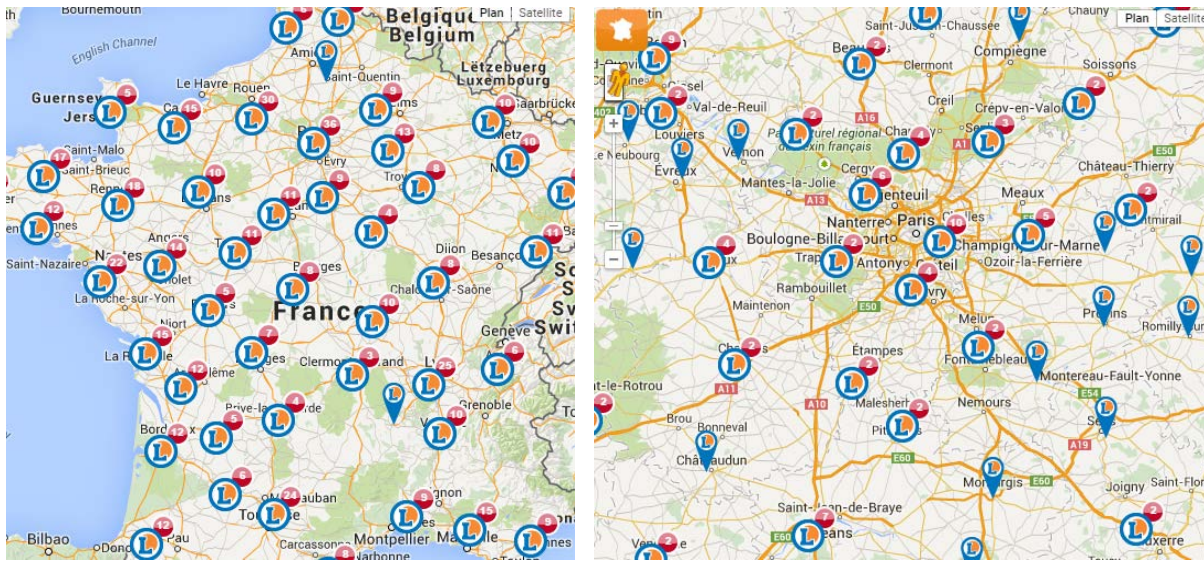
Source: leclercdrive.fr

CURRENT & FUTURE US LANDSCAPE

Compared to Europe, the US lags in online grocery development. Click & Collect and Drive both exist in the US, though the number of players that operate Click & Collect models far exceeds those operating Drives. Retailers are still optimizing online grocery for the US consumer and have thus far remained primarily regional in geographic scope.

|	amazon fresh	Walmart Grocery	freshdirect	Peapod	from HOME	Harris Teeter express lane
Launch Date	2007	2011	2002	1989	1999	2001
2014 Revenue (US$)	129		488	646	257	92
Geographic Coverage	Seattle, LA/SF, NYC, PA	AZ, AR, AL, CA, CO*	NY, PA, DE, CT, NJ	CT, DC, IL, IN, MA, MD, NH, NJ, NY, PA, RI, VA, WI	CT, DE, MD, NJ, NY, PA	DC, DE, GA, MD, NC, SC, TN, VA
Pricing	Aspirational	OPP	Aspirational	Mainstream	Mainstream	Aspirational
Target Customer	High Income	Family	High Income	Family	Family	Family
Delivery Fee	$0-10, Free	$5-7	$5.99	$6.95-9.95	$10-21	$4.95
Delivery Options	Attended, Unattended, Pre-Dawn	Attended, Pick-up	Attended, DC Pickup	Pickup, Attended & Unattended Delivery	Pickup, Attended Delivery	Pickup, Limited Attended Delivery
Same-Day Delivery	Yes	Yes	No	No	Yes	Yes
Minimum Order	None, $35-50	$30	$30	$60	None	None
Loyalty Program	Big Radish, Prime Fresh	None	DeliveryPass, Chef's Table	Stop & Shop Card	Price Plus Club	$16.95 / mo or $99.95 / yr
Store Base	No	Yes	No	Yes	Yes	Yes
# of SKUs	1,000,000+	35,000+	8,000+	15,000+	30,000+	25,000+
Fulfillment Model	DC	Store	DC	DC, Store	Store	Store

Source: RNG Database, Constant 2014 (USD mil), RNG Research & Analysis

As a result, the online grocery landscape is still largely fragmented due to the regional nature, with a few larger primarily digital players that blend both click & collect and delivery (i.e. Peapod, FreshDirect & AmazonFresh) and smaller, but growing operations of store-based retailers leveraging multiple business models.

State of the Industry – US Click & Collect and Delivery
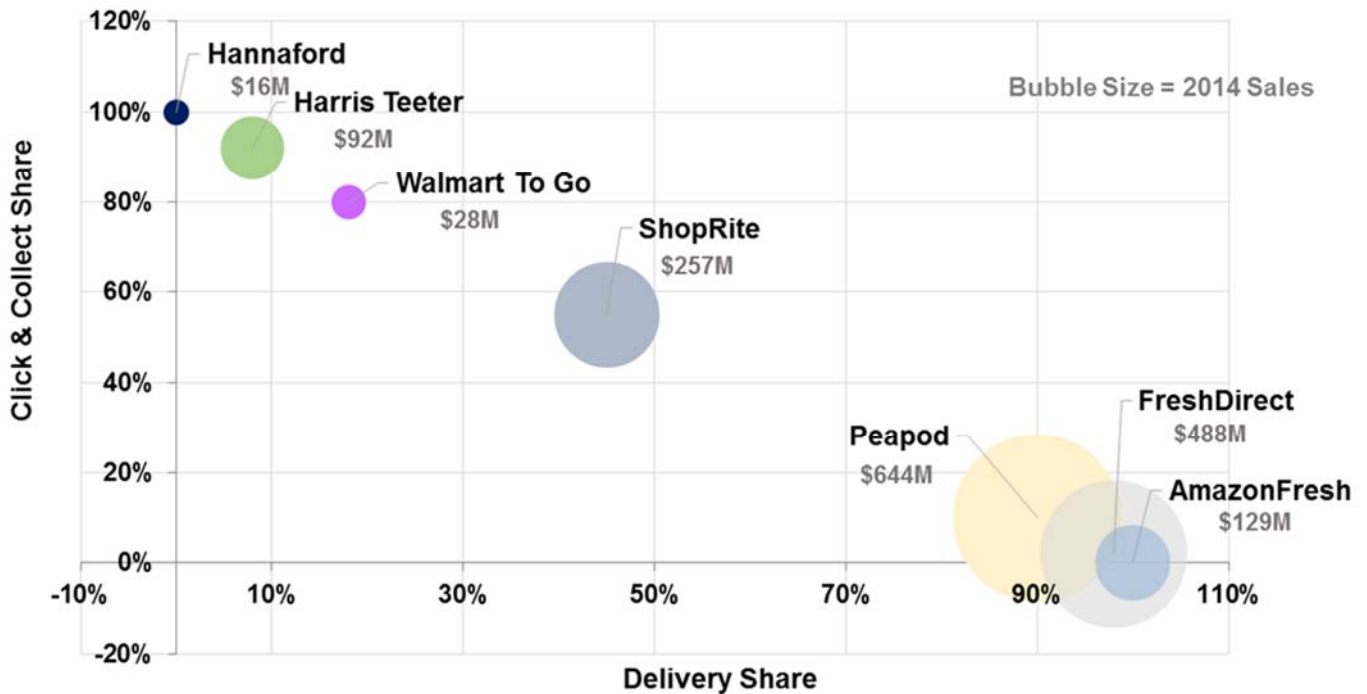
Source: RNG Database, Constant 2014

Current State of Click & Collect in the US

US Click & Collect models are divided among retailers and technology companies that provide the service for only general merchandise and those that provide the service for a full basket trip. Expanding the assortment to cater to fulfilling the full basket trip increases the complexity of the business model, as fresh SKUs have different temperature requirements and customers are more particular of their quality and their own preferences (i.e. ripeness, deli slice thickness).

Ecommerce Business Models	Pure-Play	3P Technology	B&M.com
Delivery – GM (National Ship)	Amazon	Google Shopping Express	Walmart.com
Delivery – Full Basket	AmazonFresh, Fresh Direct	Instacart, Blue Apron	Safeway.com, Peapod
Click & Collect – GM	Amazon Lockers	Curbside	Walmart.com, Target.com
Click & Collect – Full Basket	Fresh Direct	Instacart	Walmart.com, Shoprite, Peapod
Drive – Full Basket	N/A	N/A	Walmart-To-Go, Peapod

Source: RNG Research & Analysis

In-store Click & Collect models will likely become table stakes for entire store networks. To date, few Grocery retailers have breached 50% of stores that offer Click & Collect, but given the national rollout of GM Click & Collect by players such as Walmart and Target, it is possible that full basket Click & Collect could reach similar levels if innovation, efficiency improvements and partnerships support the economics. New entrants are still emerging in this space and it will be 5-10 years before the model matures in the US, although the pace of digital continues to accelerate.

US Click & Collect	Walmart	Shoprite	Whole Foods	Hannaford	Harris Teeter	Price Chopper
# Pickup Points	42	140	2	12	151	6
% Stores w/ Pickup	1%	54%	1%	6%	64%	4%
Service Fee	No	~$10	$1.99	No	$4.95	$10
Minimum Order	$30	No	$10	$125	No	No
Membership Plan	No	No	Yes	No	Yes	No
Delivery	Yes	Yes	Yes	No	No	Yes

Source: RNG Research & Analysis, Note: Not including GM, Whole Foods Click & Collect Operated by Instacart

One such new entrant is Instacart, a third-party technology company that has recently started to offer Click & Collect solutions for brick & mortar retailers. In 2014, Instacart added Click & Collect to its delivery model through a partnership with Whole Foods. This first of its kind partnership provided Whole Foods customers with a Click & Collect full basket model. Instacart employees work inside Whole Foods stores to pick, pay, and deliver orders to in-store Click & Collect lockers. Though the long-term results remain to be seen, Whole Foods noted the average basket size for Instacart customers increased 2.5 times the size of the average in-store customer in its second quarter 2014 report.

**Retailers Leveraging 3rd Party Logistics Marketplaces**

Instacart has resulted in digital shopping carts 2.5X the size of in-store baskets

Source: RNG research & analysis

Current State of Drive in the US

As of February 2015, there are only three US retailers that operate Drive formats: Walmart, Ahold (Peapod), and Zoomin Market (an independent retailer). Each operates one Drive location. Walmart's Drive is located near its headquarters in Bentonville, AR; Ahold's Drive is in Deerfield, IL; and Zoomin Market is outside of Kansas City, MO. Each follow the European Drive model closely.

Walmart Drive
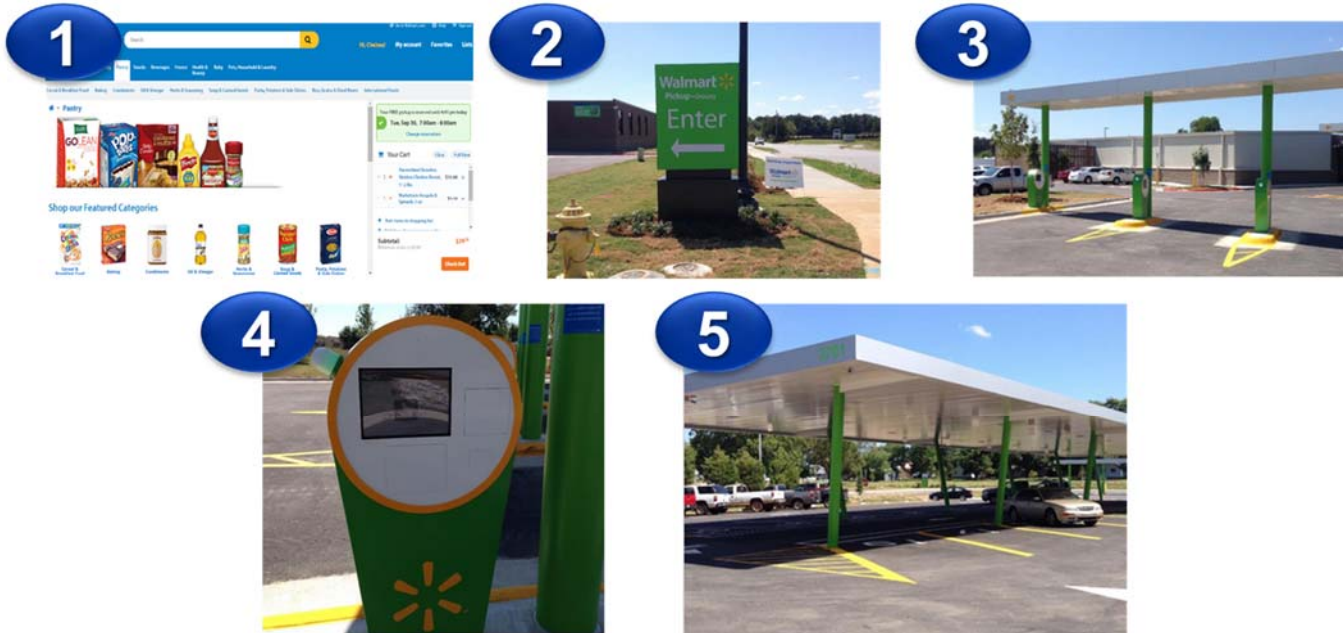
Source: RNG Store Tours, Walmart Drive

Independents Opening Drives – Zoomin Market

- Drive concept, online ordering 24/7 and pickup daily from 8am to 8pm
- Orders ready in 30mins, enter a pin number, pull into parking spot and groceries delivered to car
- No service charge
- Easy-to-use web and mobile interface (no app)
- Inspired by Auchan's Chronodrive format in France

Source: RNG Research & Analysis, Zoomin Market

Potential for Drive in the US

RNG analyzed the state of the Drive format in France and the relative macro and societal drivers that influence the business model development to forecast US development of this model. Given the saturation of Drive in the top metros in France, we forecasted which metros have the most similar demographics in the US and what the potential scenarios could be for the number of drives in each metro.

Top Metros for Drive in France
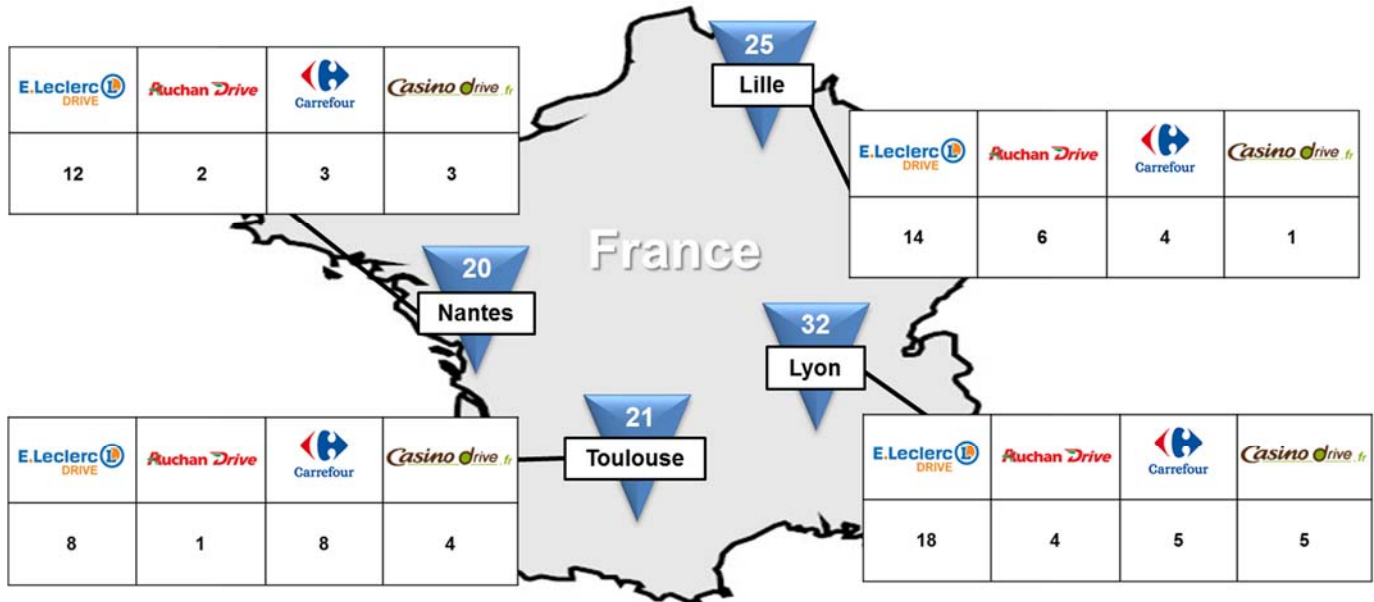
Source: RNG research & analysis

There are three clear commonalities between the top metros for Drive in France. First, high volumes of Drive locations (across retailers and metros) are located in suburban areas. Second, traffic is not a significant barrier to driving in these metros. Third, household income is above the market average, though not well above average.

Commonalities amongst Top Metros for Drive in France

- **Location** – surrounding urban center, but not directly inside city limits

- **Traffic** – mid-tier congestion compared to global averages

- **Household Income** – above average compared to market averages

Metric	Lyon	Lille	Toulouse	Nantes
Population	2,188,759	1,159,547	1,250,251	884,275
Population Density	942	3245	602	694
Household income	$38,271	$34,483	$37,079	$37,172
Congestion	27%	20%	24%	20%

Source: RNG research & analysis

Considering the development of Drive in the model market, France, there are 30-40 viable metros in the US that have demographics suitable for a profitable Drive. RNG forecasts a strong rollout of Drive across these key metros in the US, reaching around 30 Drives per metro at saturation.

Potential for Drive in the US

Source: RNG Research & Analysis

There are a variety of metrics that contribute to this analysis. Population-weighted density determines which metros will make sense for retailers to invest, metros that are too dense will prefer delivery and those that are too sparse will not be worth the investment. GDP and personal income per capita relate to the wealth of a given metro. Drive will work best in metros where these two metrics rank somewhere between the market average or slightly above. Relatedly, the wage gap between men and women is important as the lower the gap, the more likely there are time-strapped working mothers looking for the convenience of online grocery business models. The percent of the population that owns a vehicle is perhaps the largest driver (or barrier depending on the market) of Drive, as the model requires the use of a car. Likewise, metros with lower percent of the population using public transportation are preferable for the success of Drive.

Metric	Dallas / Ft Worth	Minneapolis / St. Paul	Denver	Phoenix	Houston	Las Vegas	San Diego	Seattle	Atlanta	Orlando
Per capita real GDP	$60,730	$61,711	$61,595	$44,803	$72,258	$43,079	$57,955	$74,701	$52,178	$45,855
Per capital personal income	$46,136	$50,260	$50,936	$38,006	$51,004	$36,676	$49,719	$53,328	$40,963	$36,412
% Own vehicle	63%	72%	72%	61%	59%	63%	66%	74%	65%	67%
Wage gap btwn men & women	85¢	80¢	81¢	85¢	78¢	87¢	84¢	73¢	80¢	80¢
Population-weighted density	3,909	3,383	4,803	4,394	4,109	6,527	6,920	4,721	2,173	2,774
% Using public transportation	2%	7%	6%	3%	2.8%	6%	5%	10%	5.5%	2.4%

Source: RNG Research & Analysis, US Census Bureau, Note: Cities ranked by % Own Vehicle

In considering the scenarios for the US development of the Drive business model, there are similarly three major factors that will impact the expansion forecast:

1. **Population Distribution** – Comparing Houston and New York metro areas, Houston offers the optimal population distribution for the Drive business model. New York is too dense and as a result, is more likely to embrace the Delivery model.

Too high density levels are bad for Drive – they lead to congestion, lower car ownership and increased public transportation usage

2010 New York-Northern New Jersey-Long Island, NY-NJ-PA Metro Area
2010 Houston-Sugar Land-Baytown, TX Metro Area

Ideal Drive conditions – large population spread over large distance, high car ownership and wealth

(600 people/sq. mile) Necessary conditions for grocery delivery
*Total UK = 650 ppl/sqm

*Total France = 289 ppl/sqm

People per sqaure mile (in thousands)

Distance from city hall (in miles)

2. **Car Ownership** – US metros with high car ownership will better serve these models. The largest US metro areas average approximately 68% car ownership. By the same token, high traffic inhibits Drive growth because customers are less willing to use their cars and prefer delivery. Los Angeles and San Francisco may be good metros for these models due to their larger populations and high car ownership, but would be hampered by the high traffic in the area.

Low Levels of Car Ownership and High Traffic Barriers for Drive

Most Congested Cities* by Country

*Congestion measured as a percent increase in travel time due to traffic; All cities within top 10 most congested for each country
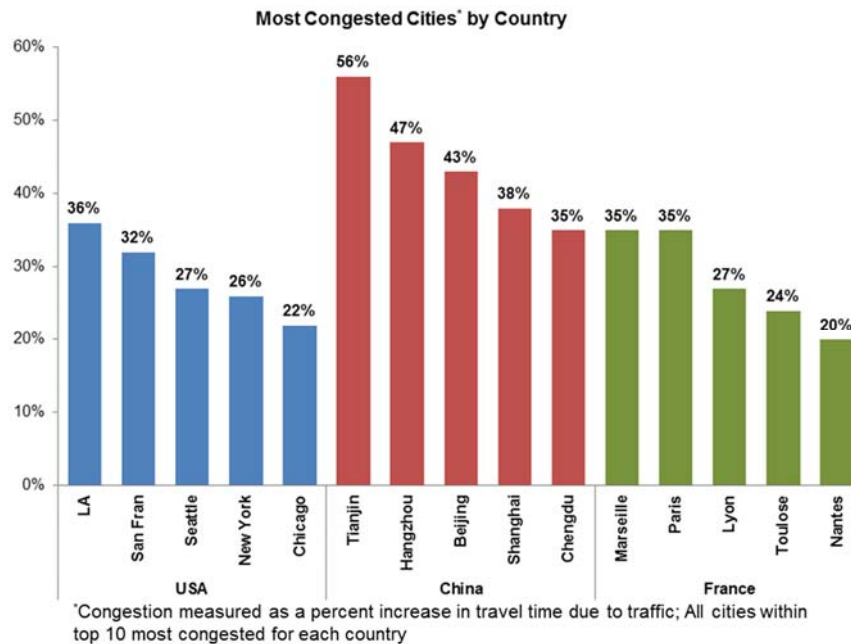
Source: RNG research, TomTom Traffic Index

3. **Household Income** – The Drive model tends to be used by two-income households where both parents are working, impacting their need for convenience, yet they may not want to spend the extra money for delivery. As a result, it is important to look at the household incomes of not only the metro areas but the neighborhoods relative to the US average in determining the Drive opportunity.

High Levels of Car Ownership in the US but Lower Population Densities and Varied Income Levels
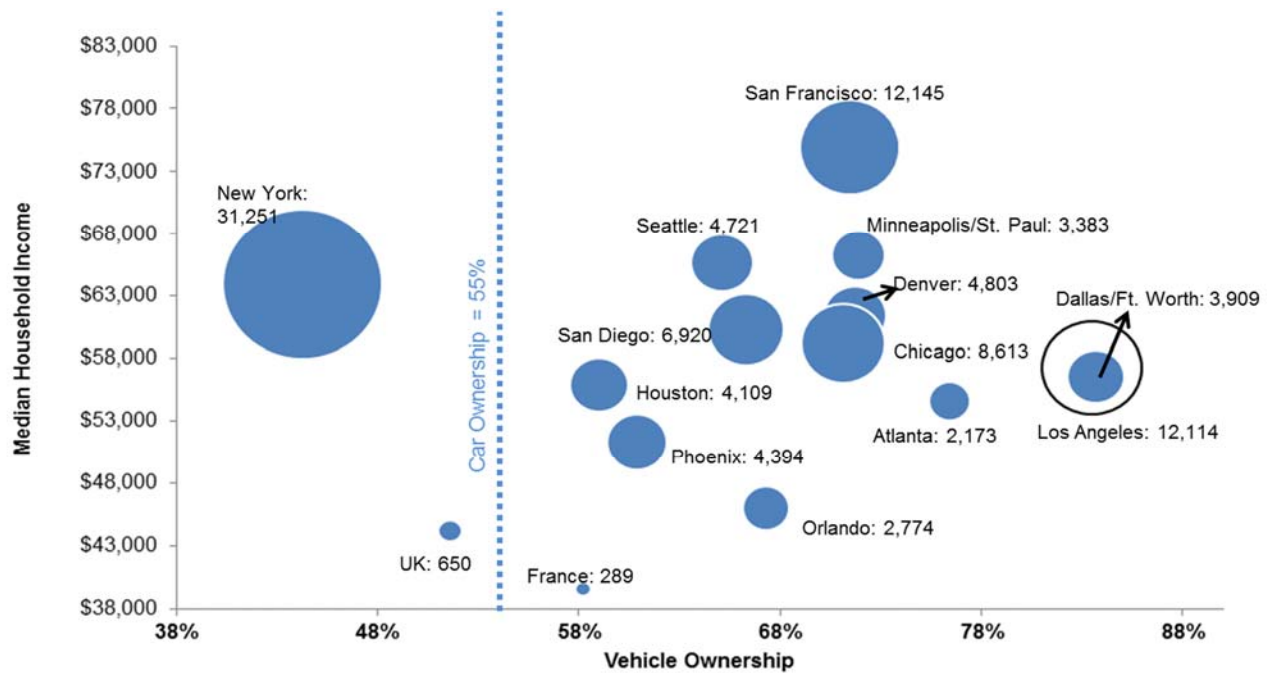
*Data labels indicate major metropolitan area and population density
Sources: RNG Research, US Census Bureau*

IMPLICATIONS TO RETAILERS

Retailers are focused on a number of strategic initiatives to align their businesses to meet longer-term goals. Online grocery business models add a high degree of complexity to store-based operations and retailers choosing to add or expand these models must assess the impact to their strategic initiatives. In order to manage these new economics, retailers will need to establish certain strategic priorities from the start.

Positioning

Retailers typically operate through a low cost or differentiated positioning and having a clear positioning will be critical to success in the future as what it means to be truly differentiated or low cost continues to move. Some retailers balance these two core positionings by including elements of both, but these "tweener" models tend to result in a lower ROI. Low cost retailers depend on automation, simplicity and supply chain efficiencies to maintain low prices in the store. The addition of Click & Collect and/or Drive adds complexity to a model based on simplicity (i.e. labor, supply chain). Low cost operating models can still be achieved, as long as the retailer is willing to accept the higher investment costs and lower ROI while the online models ramp up.

Differentiated retailers prioritize being on trend, customer experience, quality assortment, culinary expertise, and services in their stores. Online grocery is hard to adapt to differentiated models, as merchandising and experience are limited to a 2-D presentation. Differentiated retailers must work to ensure a seamless experience, where the quality and breadth of assortment offered in-store is available and easily understood in an online format. Click & Collect store picking can impact the experience for in-store customers and will need to be managed in order to maintain the same high levels of customer experience. Additionally, parking lot space will need to be optimized as space allocated to Click & Collect customers decreases the parking availability for in-store customer parking.

Organizational Structure & Labor

Corporate organizational structure will be impacted by these new online grocery business models. Organizational structures today are creating new roles in digital and analytics and the capabilities required in many adjacent functions will also be impacted by these new models (e.g. logistics).

Store Network & Renewal

Online grocery business models will directly and immediately impact store network initiatives. Retailers must answer the following questions:

- Which geographies should we prioritize Delivery vs. Click & Collect vs. Drive?
- Should we assess each market individually or will these models be implemented across our entire store network?
- Could we or should we lead in a new market entry with an online grocery format or should we test stores in these markets before the addition of online grocery?
- How do we want to allocate our capital and where do we want our assets to be in the future – new stores or digital?

Pricing & Promotion

The future pricing & promotion ecosystem is changing. Retailers will be required to answer many critical questions regarding their pricing strategy that will impact the online grocery business models go to market strategy. For example, will retailers price match across all formats digital and physical or use separate pricing strategies given the different model economics? If retailers choose different pricing models, how will they explain the strategy given the transparency that digital provides shoppers?

Retailers will also need to determine whether convenience fees should be added for the services or whether the retailer should assume that cost. As far as promotions, online models will require new integration with offer engines (delivery and application of coupons) and if matched by store pricing, will need to be integrated into the store-based promotional schedule. Finally, loyalty programs may need to reward customers in new ways. Loyalty for online business models should be less item-oriented and more focused on bringing the customer to an established shopping list. The retailers that win list management will have greater success long-term on customer loyalty in online business models.

Payment

Online payment, as opposed to payment completed at the store or at a Drive location, encourages a seamless experience, though there are barriers to overcome. Payment method innovation will continue to be necessary, in particular to reach low income shoppers that may prefer cash over credit cards, but use of credit may encourage higher basket sizes. Retailers will need a strategy for item substitutions as payment can take place prior to the order fulfillment. Google Shopping Express, which runs Delivery from certain Grocery retailers, holds a charge for the order amount, but finalizes the charge after substitutions have been determined, promising shoppers that substitutions will not exceed the original item price or the item will be removed from the basket.

Supply Chain

Online business models significantly impact supply chain & logistics. The Drive model requires a new set of logistics from delivery to stocking to establishing efficiency in order preparation. Click & Collect pressures in-store labor and in-stocks. Retailers will need to deepen their forecasting skills and collaborate with suppliers in order to avoid out of stocks, in particular for high frequency items (e.g. perimeter categories).

BEST-IN-CLASS ONLINE PRESENTATION & ASSORTMENT EXAMPLE

Waitrose provides a best-in-class example of how the dairy, deli and bakery categories can be presented online. The UK retailer has built its online assortment around labor efficiency and shrink reduction, packaging products for ease of picking and long-lasting freshness.

First, Waitrose offers many different solutions similar to the Barilla / Peapod partnership, all labeled by serving size and preparation time. In the Waitrose model, customers can easily find the products that go together, but do not have to buy the whole kit and instead may personalize their meal solution.

Source: Waitrose

Second, Waitrose offers unique pack sizes of fresh categories, built for long-lasting freshness. These products require careful handling, but are easier to pack than eaches. Waitrose does offer eaches (individually packaged) through their own private label assortment.

Source: Waitrose

Third, Waitrose also wins with food theater, bringing the in-store experience online. Cheese boards are segmented by different themes, based on product origin or shopper type. These groupings are easily identifiable and informative, but continue to offer shoppers the ability to pick and choose.

Replicate Food Theater Experiences Online

Source: Waitrose

After the retailer aligns its online grocery business models to total company strategic initiatives, it will be up to the individual store to manage the execution. Early data suggests that it will take about two years for an online grocer to break even in its delivery business, and another 2-5 years to focus on market consolidation, cost optimization, and customer acquisition (both existing and new shoppers). Different market dynamics will require each store to decide for itself how to manage the following store level decisions.

Store Picking

How many employees should be allocated to store picking? Should picking times be limited to certain times of day? Harris Teeter stores can handle anywhere from 3-5 Click & Collect reservations per hour with the help of one full-time employee (40 hours/week) and one part-time employee (32 hours/week), but limit orders to that amount in order to optimize labor efficiency. Peapod takes a different approach, delivering Click & Collect orders from warehouses which offer a higher degree of automation in the process, but do not leverage the in-store assortment.

Perishable items add another layer to these operations. *Should deli orders be custom or standardized to certain products and/or sizes? When should these orders be prepared – all day or at established times throughout the day when there is less traffic in the store?*

Number of Pick-up Bays

Should there be a large number of bays to support Click & Collect orders or should these spots be limited to prevent disruption to store experience? What is the optimal number of Click & Collect and/or Drive orders per hour that should be reinforced by the number of bays? Drive models are easier in this respect, as the total Drive parking lot serves only Drive customers. For Drive, the question becomes how large should the real estate land be and how best to use that space between warehouse and order pick-up.

Store Layout

Some stores establish a Click & Collect station near front of store for easy access in and out. Other stores direct traffic through the store to a Click & Collect station at the back of the store. Because most Click & Collect customers place a premium on time efficiency, stations in the front of the store (though off to the side to not disrupt in-store traffic) may be more suitable.

In the UK, many grocers have moved their Click & Collect stations near fresh categories because they found shoppers would pick-up a few additional fresh items while inside the store to pick-up their online order.

SUPPLIER IMPLICATIONS & BEST PRACTICES

PERISHABLES IN FOCUS

Perishables will play a key role in the adoption of online grocery. Though CPG categories have been active in online grocery models for longer compared to perishables, growth continues to accelerate and indicates the potential for fresh growth online. Fresh is seen as the last barrier to online grocery shopping, though if retailers optimize the delivery and pick-up of fresh groceries a greater share of total retail will move online. As fresh goes online, so does the rest of the grocery trip.

Breakdown of Online CPG Sales - National Ship v. Full Basket
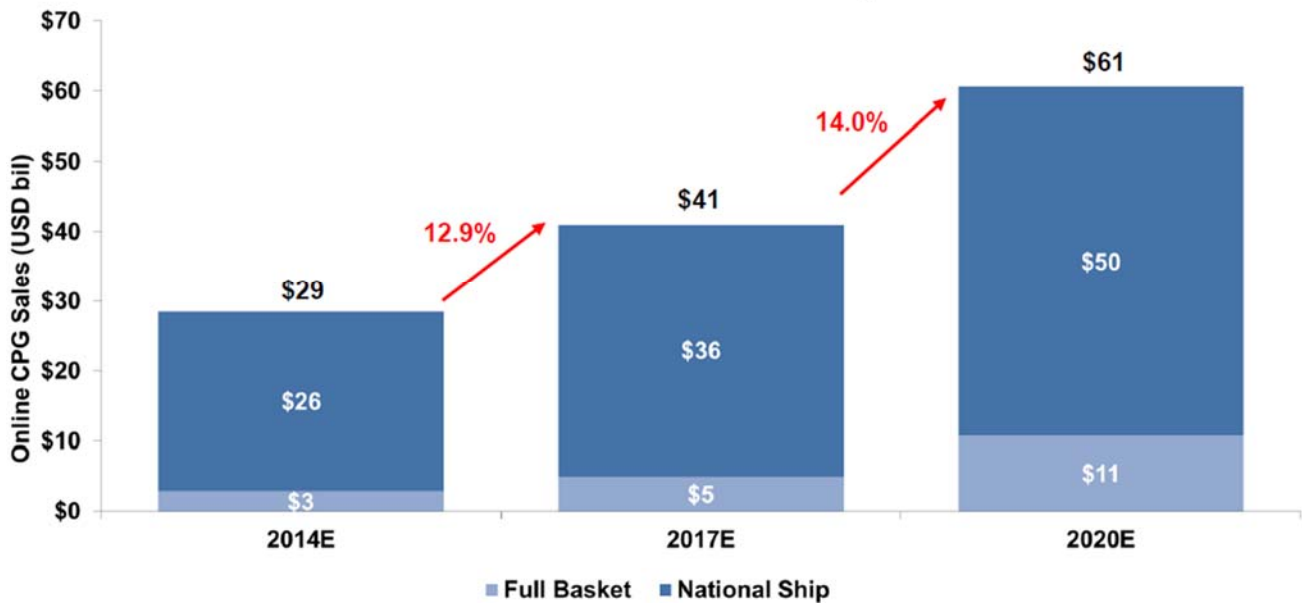
Source: RNG Research & Analysis

As mentioned in the previous sections, few Grocery retailers operate full basket online grocery models (though many grocer retailers offer deli online ordering). The percentage of SKUs between fresh categories among these retailers varies slightly. Prepared foods SKUs are among the lowest in percentage of total online assortment, though RNG expects prepared foods to be a key growth opportunity as competition increases between Grocery and QSR (Foodservice) retailers.

	amazon fresh	Walmart Grocery	freshdirect.	Peapod	from Home	expresslane
# of SKUs	25,000+*	35,000+	8,000+	15,000+	30,000+	25,000+
Dairy	6%	4%	10%	6%	7%	6%
Deli	3%	1%	4%	5%	3%	1%
Bakery	3%	1%	2%	3%	1%	1%
Meat & Seafood	6%	1%	5%	4%	4%	3%
Prepared Food / Catering	2%	-	4%	1%	0%	1%
Produce	3%	1%	7%	5%	2%	2%
Beverages	24%	8%	18%	11%	10%	17%
Dry Grocery	47%	24%	32%	34%	37%	27%
Frozen	5%	6%	9%	7%	9%	8%
HBC	**	41%	5%	9%	15%	17%
GM	**	14%	2%	11%	10%	15%
Baby	2%	4%	3%	3%	2%	2%
Other GMs (e.g. appliances)	1,000,000+	1,000+	N/A	N/A	N/A	N/A

Source: RetailNet Group research

The perimeter/fresh categories under-index as percentage of total basket online, significantly compared to the percentage in the average store basket. There are a few primary drivers of this:

- Customer perception of ordering these products online lags compared to other GM categories due to higher sensitivity to quality product in these categories
- There is a loss of food theater in online grocery, which can be very important to establish in stores to entice customers to shop these products.
- Impulse is very important for fresh categories and online customers tend to be less influenced by impulse merchandising. For example, only 35% of FreshDirect's items are added via visual browse, the rest of the basket comes directly from previous lists and recommendations.
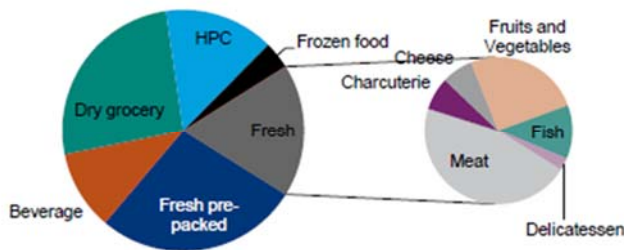

Source: Nielsen, BofA Merril Lynch Global research

Perishables will serve different roles in different online grocery models. For Click & Collect models that operate inside stores, customers may be more influenced by impulse and more likely to add an additional purchase of fresh grocery SKUs inside the store. For models where customers remain in their car for the entire pick-up process, retailers may be more likely to offer fresh bundles or meal solutions (i.e. school lunches, date night) or other pre-made lists that would be popular with time-starved shoppers.

RETAILER COLLABORATION & GROWTH OPPORTUNITIES

During the supplier customer development process, it is imperative for suppliers to take a more proactive role in generating ideas of how to bring their categories online and collaborate with retailers in executing those ideas to help grow their categories. The future vendor value equation is changing and retailers need to consider the following areas will need to change in order to better prepare for 2020 for each retailer, segment or business model. Insights & analytics will drive success in these conversations. The more suppliers can come prepared for these meetings with insights & analytics that explain their category, target consumer, and the differences in the way their customer interacts with various business models, the better the conversation.
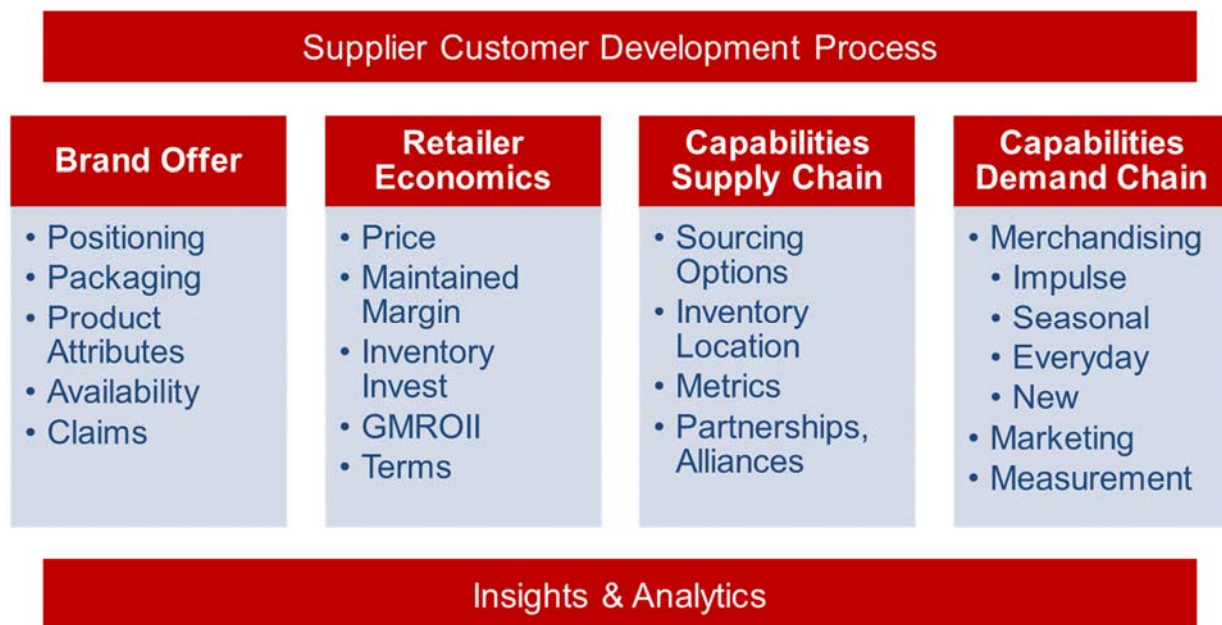
Source: RNG Research & Analysis

Digital Merchandising & Content Management

The digital shelf offers a wholly different environment to store-based retailing, where visual presentation through images and descriptions must be able to compete against an in-person presentation. The lower engagement makes it more difficult for online retailers and brands to highlight and promote the value of the items (e.g. pitching the differences between $2 and $20 cheese – features and benefits) and the pricing rationality of the category. As a result, online retailers and brands need to work even more closely in curating SKU images and relevant details.

Source: MySupermarket

Content management tends to be another opportunity for improved retailer & supplier collaboration. Most suppliers in the US are adjusting their content to meet the requirements of each retailer, which are not always standardized. For suppliers, getting to uniform content and central repositories (often through 3rd party technologies) is an important step in their content management strategy. This allows suppliers to leverage the content they have, decrease repetition and create more standardization across retailers for consistent branding to consumers.

Digital also improves the transparency available to shoppers and as a result, increases shpopers' expectations. Shoppers expect retailers and brands to provide in-depth product details such as nutritional information, weight, ingredients (allergens), storage information, etc. Collaborating with content management companies in producing SKU pages and product profiles will drive efficiency and help retailers and brands keep product webpages up-to-date.

List Management

Winning list management is the most important strategy for maintaining a loyal shopper base online. After a shopper has developed and edited a standard list, she is more likely to return to that retailer than build a new list at a different retailer. There are many ways list management tools have manifested, beyond saved past orders, that push shoppers to new categories that align with their standard list or ensure they have not missed a key item they typically buy. Through list management, retailers are able to raise the switching costs and essentially create "walled gardens".

- **List Builder**
- **Guess My Order**
  - Creates a list from all previous orders & usage rates
  - Uses "Jumbo List" of past store & online purchases (with loyalty card)
- **Nutrifilter**
  - Highlights products in search/aisles that fall inside nutrition requirements, ex: gluten, dairy, nuts, etc.
- **"Did you Forget" page during checkout**

Source: RNG research & analysis; Peapod

Items that are saved on shoppers' lists are more likely to be re-purchased. For suppliers, making the digital list is one of the first and largest opportunities. There are two ways to achieve this. First, online grocers typically offer targeted promotion opportunities or prompts to influence the list (similar to paid search results) that either suggest that a shopper add a certain product or advertise a certain product alongside items a shopper traditionally buys. Second, brands can assume their own digital marketing strategy that builds awareness and/ or rewards for adding a certain product to an online basket.

Full-basket online grocers have started to leverage online recipes to help shoppers build their initial lists or conduct searches (i.e. shop by recipe). These recipe-assisted features is to reduce friction and increase the ability to advise shopper baskets.

Source: Albert Heijin

Marketing

Fresh is a relatively less developed category in terms of digital marketing, providing a key opportunity for fresh suppliers and their retail partners to increase their targeted marketing strategy. Fresh suppliers could co-offer discounts (e.g. web-only) or co-sponsor free delivery that will help grow the category online. Fresh suppliers could also partner with other suppliers for optimal cross-category shopping (i.e. promoting high-margin items when shoppers add low-margin items to their carts).
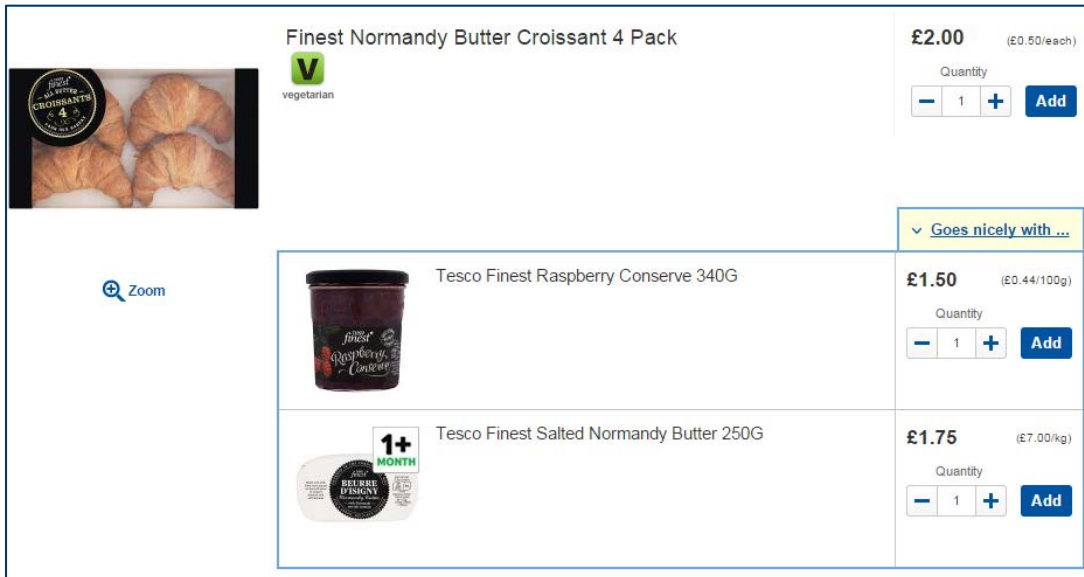
Source: Tesco

Analytics and the ability to narrow data is critical for growth. Tracking online orders is imperative for marketing success. For instance, if a shopper always orders the same deli orders (i.e. a pound of honey ham and .5 pounds of salami) every week, there is an opportunity for retailers to provide targeted recommendations, facilitate list management, increase the ease of repeat orders, or potentially even offer subscription services based on her shopping behavior that brands can participate in.
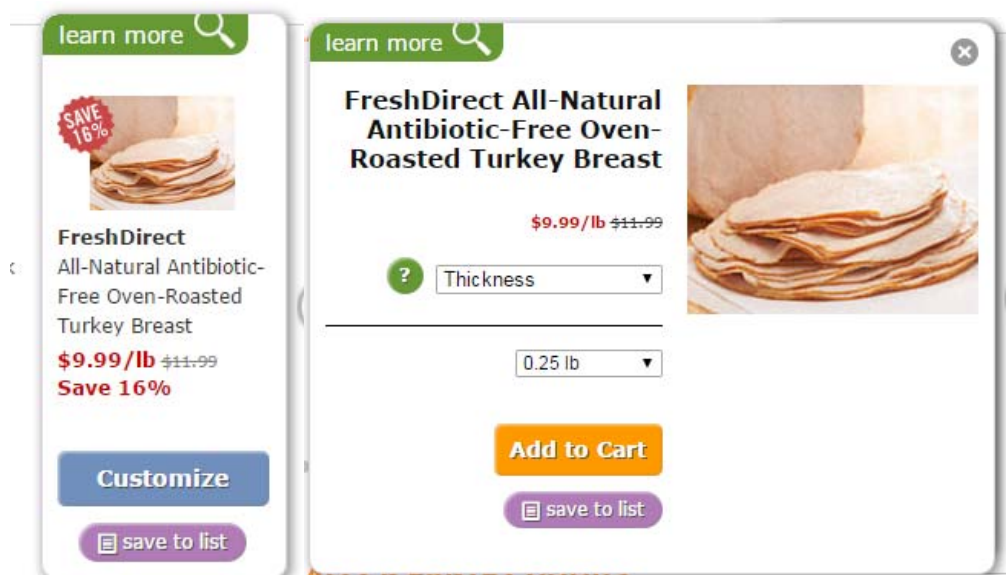
Source: AmazonFresh

Supporting Top Line Growth – Minimum Order Fee

A key driver to larger online basket sizes is the minimum order fee. As competition in the online grocery space intensifies – and scale enables logistics efficiencies – minimum order fees will come down, reducing the average basket size. Evidence for this is seen in the UK where intense competition for online grocery delivery has driven fees down and reduced average basket sizes.

Supporting Top Line Growth – Mobile

Mobile has become the high growth platform for the digital shopping experience. Mobile apps and shopping are essential for list management throughout the week, but also increasingly a source of revenue for full basket retailers. UK-based full-basket retailer Ocado reported 48% of its sales are now being transacted via mobile devices.[2] In the US, 40% of Peapod's total web sales are estimated to be mobile. Shopper data suggests that people who use mobile with a PC tend to spend $10 higher than those who use PC alone.[3]

Mobile Apps & Online Grocery Shopping – Ahold US Example

- 40% of sessions are Mobile
- When customers use mobile with a PC then the average order is $10 higher than PC alone
- There is an average 10-14 day gap between a consumer places an order and when it is delivered when consumers can go back and add to/refine the initial list

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[2] https://www.internetretailer.com/2014/09/26/happy-25th-birthday-peapod
[3] http://www.runtri.com/2013/03/mobile-commerce-results-30-of-total.html

To increase mobile-driven sales, Peapod launched a 12-week campaign of setting up more than 100 virtual grocery stores at commuter rail stations in the East Coast. These virtual stores enabled shoppers to shop while they were on-the-go using the Peapod mobile app to scan items and add them to a digital basket. The retailer partnered with national CPG brands such as Barilla, Coca-Cola, Kimberly-Clark, Procter & Gamble and Reckitt Benckiser in launching this virtual store initiative.[4] This initiative was reported to generate a 90% reorder rate among people who scanned the ads.[5]

Source: Peapod

Supply Chain

Retailers and suppliers need to collaborate on a supply chain that will be able to accommodate the consumption cycle of the fresh categories online. Achieving supply chain efficiency is challenging but critical to overcoming barriers in fresh categories.

Different picking models have distinct implications to the supply chain. Retailers in the warehouse pick model benefit from accurate forecasting, as they know exactly how much order has been placed for a particular day's deliveries. They also have centralized production facilities for prepared foods. All these commissary items are made daily every morning. Accurate forecasting enables retailers and suppliers to offer digital shoppers freshness in their orders and eliminate waste. Store-pick models offers retailers forecasting benefit on online orders, but these retailers receive additional pressure on store labor and resources. With store-pick model, retailers often handle the orders all at once during the dead times of the stores. This could potentially lead to out-of-stock incidents and will require an additional storage area to keep perishable items fresh. In both settings, suppliers need to coordinate with retailers to determine how to support the supply chain efficiency in transportation and order assembly.

In fresh categories such as deli, dairy, and bakery, consumers are most concerned with freshness and shelf life. To sustain product freshness in online grocery, suppliers must handle products in small quantities and deliver

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[4] https://www.ahold.com/Media/Peapod-virtual-grocery-stores-pop-up-in-unexpected-places.htm

[5] http://techland.time.com/2012/05/07/smartphone-friendly-grocery-store-adorns-walls-of-chicago-l-station/

more frequently. Suppliers, along with retailers, also have to ensure shelf life corresponds with consumers' consumption lifestyle after the purchase / order pick-up date (i.e. milk – one week of consumption).

Partnerships

One example of retailer and supplier collaboration is the recent partnership between Peapod and Barilla. In 2014, these two companies partnered to offer new Peapod Meal kits built from Barilla recipes. All ingredients for a pasta dinner – salad, pasta, meat, cheese- were pre-measured and packaged for easier ordering online. Each recipe was adjusted to be prepared in 30 minutes or less and cost less than $5 per serving. As of February 2015, the kits are only available in the Chicago area.

Source: Barilla Group

ADDITIONAL SUPPLIER GROWTH OPPORTUNITIES

For categories that are underdeveloped online, suppliers will first need to be category focused in promoting the overall category growth versus only the specific brands (i.e. sponsor programs, coupons or landing page ads that promotes "Deli" instead of a particular brand). Outside the traditional online full-basket business models, there are several growing areas of opportunities that suppliers need to be aware of and think of ways to be a value-added participant in leveraging these food trends.

B2B / Catering

B2B / Catering models are a large growth opportunity for online grocers and a core driver of online grocery. Some online grocers have significant B2B businesses online that boost B2C sales and help build shopper trust with online grocery. When an individual becomes familiar with online grocery through B2B orders, they are more likely to adopt the service for their own personal needs.

- Peapod: B2B is 6% of sales
  - Testing direct sales program
- Ahold: In the Netherlands, 33% of online sales are B2B
- Coborn's: 40% B2B in Minneapolis
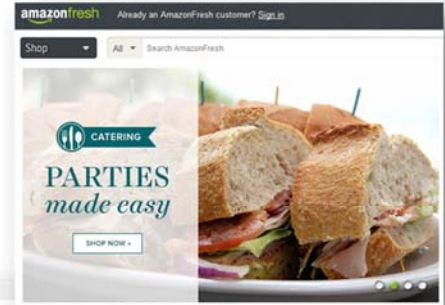
For many Grocery retailers that do not operate a full-basket online model, a catering model helps to test and learn more about the online grocery shopper. Though catering is an occasion shop, retailers and suppliers can learn a lot from the way shoppers interact with fresh categories online.

Subscription Services

Companies such as Blue Apron and Hello Fresh offer ready-to-cook meal kits to the consumers, another key growth opportunity for suppliers to capture. Shoppers are interested in experiencing food in new ways and for Millennials in particular, these models provide instruction beyond the typical recipe that adds value and facilitates loyalty. Each meal kits could feed two to six people at a cost of roughly $10 per person per meal. Blue Apron was reported to sell one million meals each month.[6]

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[6] http://techcrunch.com/2014/11/12/blue-apron-blows-past-1-million-meals-sold-each-month-looks-to-ecommerce

	Blue Apron	Hello Fresh	plated
Funding	$8M	$17.5M	$1.4M
Geographies	West Coast, East Coast States	East Coast & Midwest	Northeast & Midwest
Target Customer	Most trend towards urban, upper/middle class with a focus on fresh ingredients		
Cost	$9.99 per person per meal	$8+ per person per meal	$10+ per person per meal

Source: RNG Research & Analysis

IMPLICATIONS TO PRODUCT ASSORTMENT

Labor is much more expensive and demanding for in-store presentation of perishable categories, offering a key opportunity for suppliers & retail partners to help retailers save money by moving a higher share of these categories online with improved product assortment. Suppliers need to provide an assortment that fits consumer and retailer needs, identifying optimal packaging and pack sizes that maximize order demand and freshness.

Packaging

For success in online grocery models, packaging must be optimized for ease of picking and product freshness. Picking and packaging of items are especially important in fresh categories, as shoppers are more sensitive to the quality of these products. Traditionally, retailers have handled the majority of product packaging and display though suppliers could help with new & improved models based on the tastes of their consumer. Pre-packed is an option that enables improvement in logistics, though it will need time for US shoppers to adjust. UK grocers have already seen shoppers shift their expectations and embrace pre-packed goods, particularly for prepared sandwiches.

Pack Sizes

Designing and testing new pack sizes will be crucial to producing warehouse efficiencies. Along these lines, customization matters greatly to shoppers in deli and bakery categories as consumers seek a high level of personalization in the thickness of their meat or bread. Retailers could offer customization of items by size or weight (e.g. 0.5 lb. of cheese vs 1 lb. of cheese) and organize them as different SKUs.

Taking all the key learnings into account, the new product assortment should support a supply chain that fits consumer lifestyle and needs, packaging that provides variety and security, and pack sizes that mimic a store-based shopping trip.

CONCLUSION

The traditional in-store grocery experience is fragmenting and online grocery models are proliferating, driven by advancements in digital technology and shifting consumer preferences. With the success of Click & Collect in the UK, the Drive model in France, and the launch of these models in the US, full-basket online grocery is poised for growth. Delivery will always be a prevalent online grocery model in key metro areas, though it will have its challenges around last mile logistics (maintaining temperature zones, managing peak delivery hours, etc.). Click & Collect and Drive models better leverage existing physical assets to provide more attractive economics for retailers and suppliers.

Similarities between US metros and European markets suggest that Drive, in particular, will experience a rapid rollout in the US over the next 5-10 years. There are trade-offs for retailer and consumers between Click & Collect and Drive both models, but no one model will replace the other as each meets different needs in a fragmented retail landscape.

Online grocery drives loyalty as well as increases the share of the consumer's wallet. However, it may end up being more of a necessary strategy for retailers to retain share of household requirement within a retailer's network versus to acquire new spend. For store based retailers, there will be the risk of taking share from their existing stores and deleveraging those boxes. While the US is still underpenetrated in online grocery today, if the market were to shift to over 10% of grocery spend shifting online, sales cannibalization could affect store based retailers' profitability, which would depress industry ROIC, and devalue retailers' fixed assets such as real estate. With this in mind, retailers and suppliers must work together to improve the logistics and supply chain for online grocery, in turn improving the economics. Beyond that, there remain further retailer and supplier collaboration opportunities in digital merchandising, content management, marketing and pricing & promotion.

Suppliers must also assess for themselves whether they have the right assortment to win in each of the different online grocery models. A greater assortment of pre-packed products will help retailers reduce labor, maintain freshness, and build consumer trust with online grocery. New and improved pack sizes may also provide a key opportunity for retailers and suppliers to capture personalization and differentiation in this space.
A leading online strategy clearly identifies ROI, identifies and understands the target shopper, and continuously innovates to stay ahead of the curve. Perishable categories have been slow to develop an online strategy, however, continued online growth in grocery and adjacent categories reinforces the need for this action. The online grocery consumer is highly receptive to product, packaging, & marketing innovation, and presents an innovation opportunity for future growth of perimeter categories.

Readiness for Ecommerce – Where Are You?

On the Sidelines

- Ecommerce is primarily defensive
- ROI of digital initiatives is unclear
- Ecommerce is resourced tactically
- Customers not tiered
- Distribution, pricing, supply chain, & funding policies loosely defined
- Little or no e-retailer engagement model

Ready

- Ecommerce is a strategic priority
- Dedicated resources are available but not yet fully deployed
- Distribution, pricing, supply chain, & funding policies are defined tactically
- Channel-agnostic strategy is lacking
- Decision rights aren't clear and well-communicated from corporate to store level

Leading

- Model for driving e-ROI is clear
- Customers are segmented & tiered by scale, volume, and alignment
- Digital is a center for Innovation
- Structure, systems, and capabilities support a clear strategy
- Funding model is clear
- Need to stay ahead of the curve

Source: RNG Research & Analysis

GLOSSARY

B2B	Transactions between retailers and other businesses, not meant to be received by an individual household/ consumer.
B2C	Transactions between retailers and individual households/ consumers.
Capital Expenditure (Capex)	Money invested to acquire or upgrade physical, non-consumable assets.
Click & Collect	Online grocery business model where consumers place their grocery order online, then travel to a store or distribution center to pick-up.
Distribution Center (DC)	Warehouse that stocks products temporarily before inventory is delivered to the store or out for individual online grocery delivery orders. Distribution centers sometimes function additionally as a pick-up area for Click & Collect orders.
Delivery (HD)	Online grocery business model where consumers place their grocery order online, then receive their basket at their home or business. Also known as HD, which stands for Home Delivery.
Drive	Online grocery business model where consumers place their grocery order online, then drive to a dedicated standalone warehouse location, and pick-up orders by pulling up into a parking spot and having the order delivered to their car.
GM vs. Full Basket	GM (general merchandise) online grocery orders do not contain any fresh/ perishable SKUs. Full Basket online grocery orders contain some amount of fresh/perishable SKUs and may also contain GM.
Gross Margin Return on Investment (GMROI)	The ratio of a business' ability to turn inventory into cash above the cost of inventory. It is calculated by dividing the gross margin by the average inventory cost. Also known as Gross Margin Return on Inventory Investment (GMROII).
Millennial Generation (Gen Y)	Generation following Gen X, born between 1980 and 2000. Also known as Gen Y.
National Ship	Retail industry term for home delivery of general merchandise (GM) only.

Population-weighted Density	The number of people per unit of area, either square kilometer or square mile.
Return on Invested Capital (ROIC)	The return generated for those that provided capital to a business. The measure is calculated by divided net income after tax by invested capital.
3P	Either stands for third-party service (i.e. Instacart) that provide a technology that retailers decide not to build themselves, or for third-party marketplace, where goods are sold on a platform by many different retailers and individuals (i.e. Amazon 3P).