strategy&

January 23, 2016

Discussion

Midwinter 2016

Opportunities and challenges in online grocery

pwc

Context: Has anything changed?

What will customers pay for? What does it cost?

So can we make money?

Implications

Today's discussion

- Online grocery continues to lag other categories
- Structurally more difficult – low value density items
- But consumers are increasingly seeking online offerings – even in our categories
- So there's lots of experimentation and/or innovation as both established and new players seek to "crack the grocery nut"
- Given the challenges it is imperative to understand your economics
  - Cost-to-serve (all-in, marginal basis)
  - Willingness-to-pay
  - Incrementality
- Online sales can drive significant incrementality on a constant customer basis – likely more so for first movers

This time it's going to be different….?

November 1999

Webvan's splashy stock debut may shake up staid grocery industry

December 1999

How webvan conquers e-commerce's last mile

Initial public offering:
$15.00

Opening day peak:
$34.00

Declared bankruptcy:
$0.06

July 2000

Profit delivery stalled, webvan hits new roads

October 2000

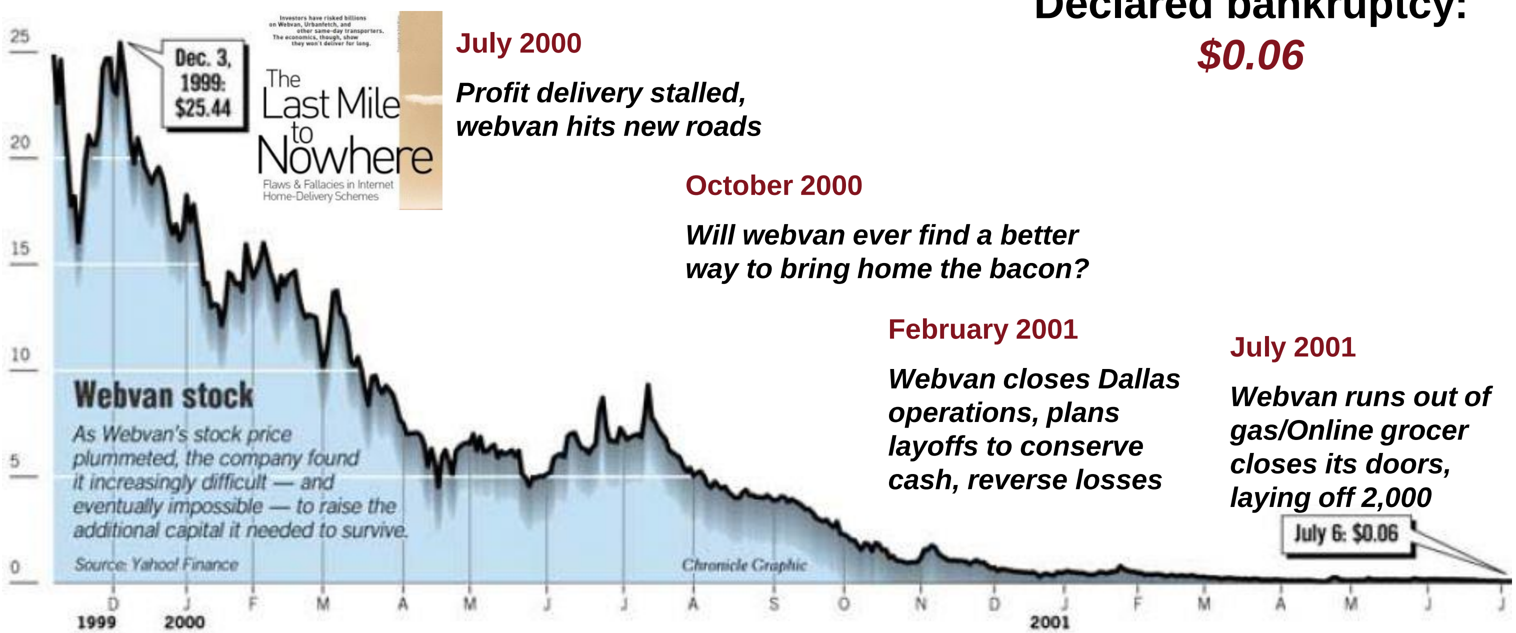
Will webvan ever find a better way to bring home the bacon?

February 2001

Webvan closes Dallas operations, plans layoffs to conserve cash, reverse losses

July 2001

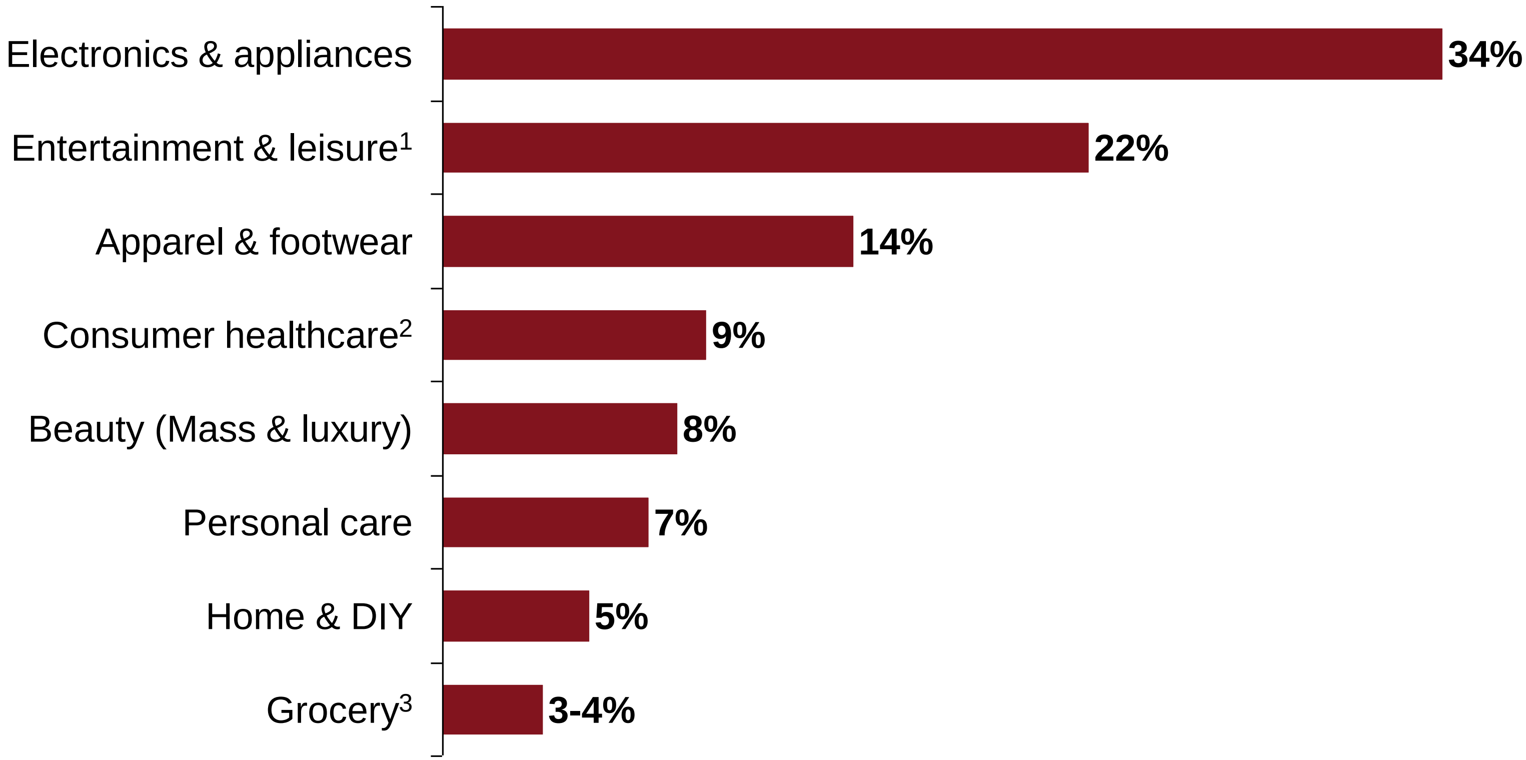
Webvan runs out of gas/Online grocer closes its doors, laying off 2,000



Source: Various public media, chart from SFGATE, July 10, 2001

~15 years on, grocery still lags behind most other categories in online sales

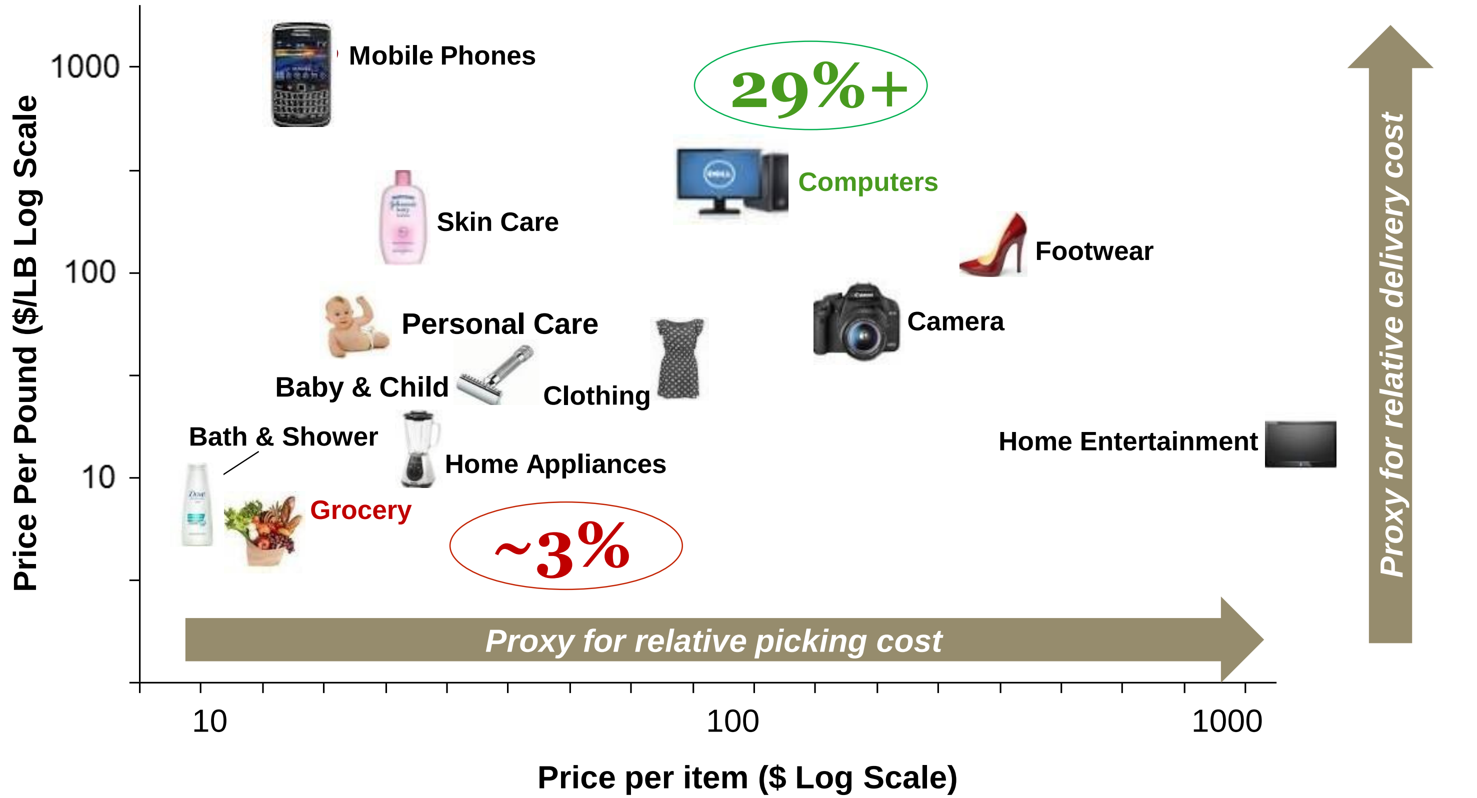
eCommerce penetration by category 2015 estimates for the U.S.



1) Includes books, music CDs, hobby goods, etc.
2) Does not include prescription drugs.
3) Includes cleaning/household supplies, packaged food, produce, and beverages (including alcoholic beverages).
Source: U.S. Department of Commerce, Euromonitor, Datamonitor, Forrester, eMarketer, Gartner, Morgan Stanley, Strategy& analysis

The fundamentals haven't changed – picking and shipping is still much more costly for grocery items

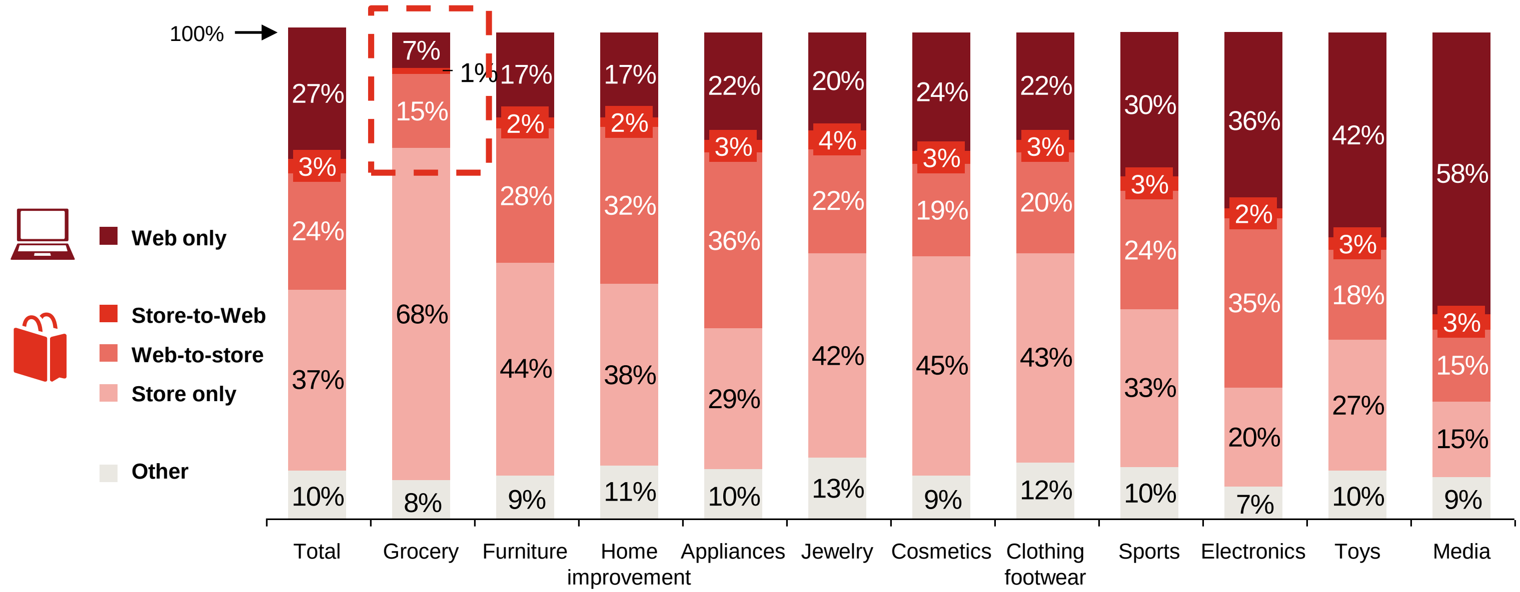
Product characteristics



Note: Dimensional weight -- low density, bulky items assigned a shipping weight based on 160 cu inch/lb
Source: Amazon.com, Strategy& analysis

But consumer preferences are shifting towards online engagement – even in grocery

Preferred customer journey for U.S. shoppers[1]



Preference for in-store interaction across categories

SHOP

63%	85%	74%	72%	68%	67%	67%	66%	60%	57%	48%	33%

Highest preference **Lowest preference**

1) PwC total retail study 2014

And a vast array of players are trying to meet that need (1 of 2)

NOT EXHAUSTIVE

eCommerce proliferation – Coverage vs. product assortment

Source: Strategy& research and analysis

And a vast array of players are trying to meet that need (2 of 2)

ILLUSTRATIVE

eCommerce proliferation – End consumer price and convenience

Source: Strategy& research and analysis

So players are innovating, particularly in fulfillment…

NOT EXHAUSTIVE

Trends/Innovation across eCommerce value chain

Present | Future

Discovery	Purchase/order	Fulfillment
Social shopping *Mimicking physical store interactions online*	**Packaging/size innovation** *eCommerce driven package innovation and sizing*	**Amazon predictive shipping** *Sending items to local markets for next day ordering*
Geolocation marketing *Real time location based marketing, (in and near store)*	**Specialty subscriptions** *Subscription models based on demographics or life stages*	**Crowd sourced delivery** *Using on-demand labor to expedite last mile*
Omni channel experience *Table stakes for building digital relationships with consumers*	**Dynamic shopping** *Influencing customers to build efficient ecommerce baskets*	**Mini distribution centers** *Smaller DC's to position product closer to demand*
Content & personalization *Manufactures must find ways to stay close to the consumer*	**eCommerce marketplaces** *Platforms to help small businesses build scale online*	**Evolving click + collect** *Retailors are using best fit C+C models for their use*
Virtual reality *Virtual in-store shopping experiences*	**Automated purchasing** *Connected "smart homes" reorder household staples*	**"In Route" fulfillment** *Taking same day orders remotely from last mile route*
		Automated delivery *Using drones or autonomous vehicles to deliver last mile*

Source: Strategy& research and analysis

...as they search for the right balance between consumer convenience and price/cost

Convenience		Price/cost
• Consumer expectations for expedited delivery at minimal or no cost – perceived vs. actual • Consumers demanding flexibility in fulfillment/delivery options	*eTailers facing margin pressures as they try to balance these often conflicting interests/objectives*	• Price continues to be primary driver of online purchases and consumer choice of etailer • Increasing eCommerce competition leading to unsustainable online prices to win share and gain traffic

Fulfillment innovation focus areas

Drive down fulfilment costs

Expedited delivery / fulfillment

Other convenience drivers

Non-perishable, stock up occasions are probably most vulnerable to online disruption

Shopping occasion and product type mix 2012
(% sales)

	Perishable[1]	Non-perishable	
Stock up	***10%***	***40%***	50%
Top up	***32%***	***18%***	50%
	42%	58%	

Harvard Business Review

"Consider the job of buying dinner…shoppers typically don't decide what they're going to buy until they're at the store…they want to examine the perishable ingredients… Customers turn to supermarkets, farmers' markets and corner stores to get the job done. The convenience of online retail is simply not enough

Shoppers stocking up on branded non-perishables…know what they want and generally don't require it immediately. …This the job most susceptible to disruption by online grocers."

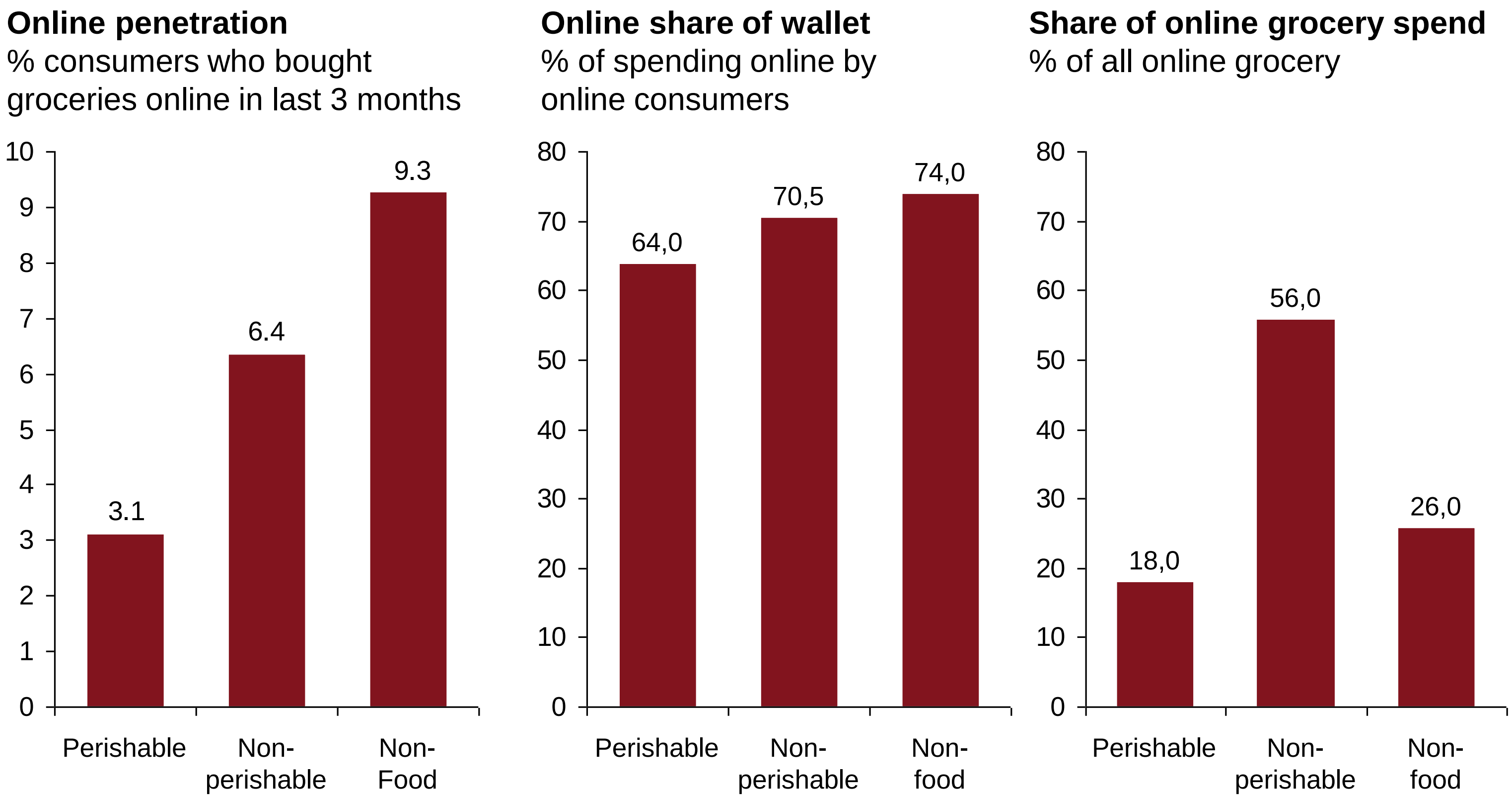
Surviving disruption by Maxwell Wessel and Clayton M Christensen, HBR December 2012

Note 1): Perishable Includes frozen, in-store bakery, deli, etc.
Source: Category sales data, Strategy& analysis

Certainly, today consumers are more willing to shop online for non-perishables and non-food

ESTIMATES

Online grocery spending



Less than 20% of online grocery spend is perishable

Source: Strategy& consumer survey

Context: Has anything changed?

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Implications

To respond effectively grocers must understand the cost-to-serve versus willingness-to-pay of the last mile

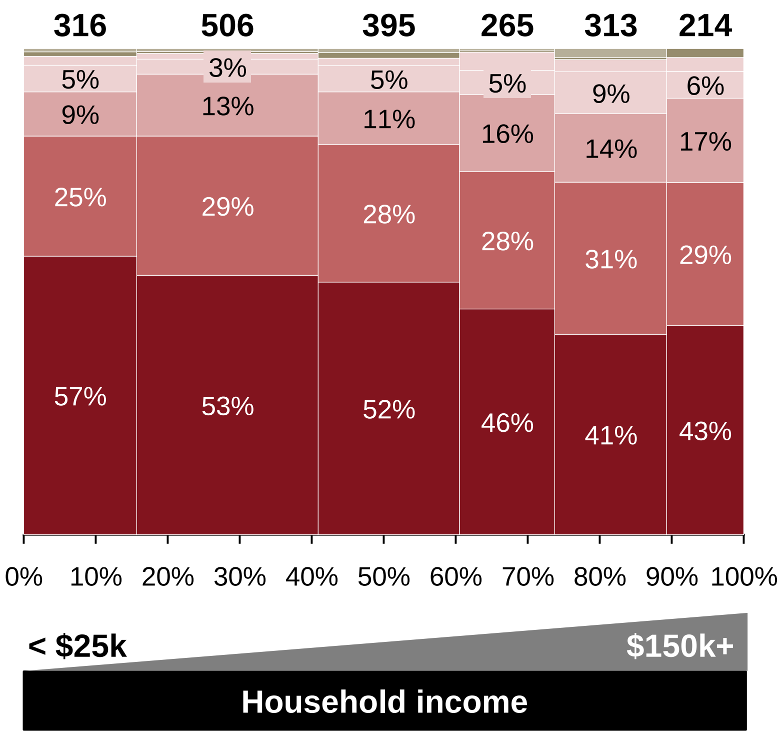
Delivery models and cost drivers

Delivery type	**In-store buy & take home**	**Order online, store pick-up**	**White glove delivery**	**Personal shopper**	**Ships from store**	**E-commerce: click + deliver**
Cost driver	• Large scale • Warehouse space • In-store staff labor • Pick-up kiosk/ infrastructure	• Large scale • Warehouse space • In-store staff labor • Pick-up kiosk/ infrastructure	• Labor intensity • Trucks • Lost/damaged fees • Delivery fee	• Labor intensity • Trucks • Delivery fee • Manual pickup • Smaller shipment sizes	• Inventory space • In-store staff labor • Trucks, delivery infrastructure	• Short lead time • Fully automated DC/warehouse • Automated picking • Complex logistics
Type of purchase	• Durable goods • Fashion • Replenishment staples • Instant gratification	• Durable goods • Fashion • Replenishment staples	• Durable goods • Large, complex products	• Durable goods • Fashion • Replenishment staples • Instant gratification	• Durable goods • Fashion • Replenishment staples • Instant gratification	• Durable goods • Fashion • Replenishment staples • Instant gratification
Examples	**Most retailers**	Walmart ToGo, Target, Best Buy, Macy's, Sears, Stop&Shop	Best Buy, IKEA, Crate&Barrel, bloomingdale's	envoy, ebay now, Uber, Instacart, Postmates, DoorDash	Macy's, Jos. A. Bank, Safeway, Nordstrom	1-800-flowers.com, good eggs, Zappos, amazon fresh, sprig, PrimePantry, Munchery, amazon, jet, Gilt

Nearly all consumers seek value – so charging for delivery is a challenge

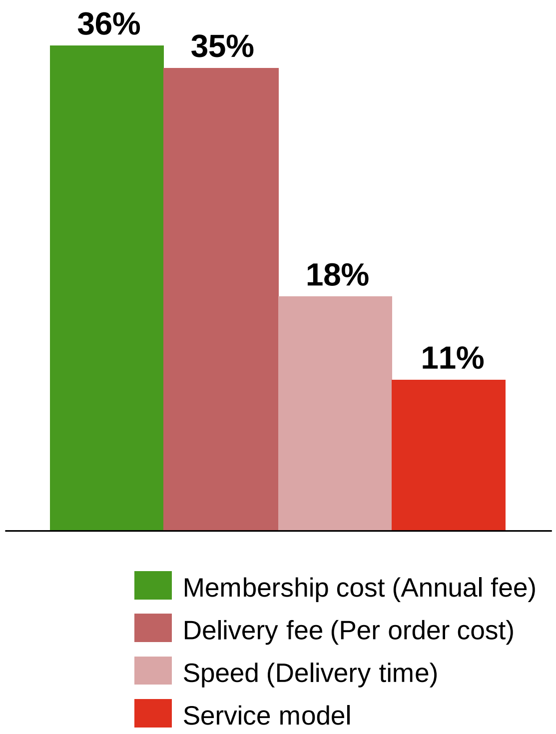
Shopping preferences/tendencies

When shopping both online and in-store, I always look for the best value



Utility weightings from conjoint

Importance by attribute



Note: Detailed income categories are <$25k, $25-49k, $50-$74k, $75k-99k, $100k-149k and >$150k.
Source: Strategy& analysis

So premium, "full-service" models are particularly challenged

Amazon.com Prime Pantry

- 3 Day lead time
- No out of stock
- 3 Damaged

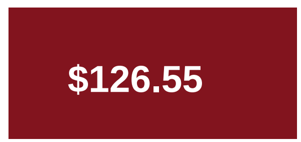
Total cost:

- $99 Membership
- $5.99 delivery fee per box


relay foods

- 15 Hour lead time
- 1 Out of stock
- None damaged

Total cost:

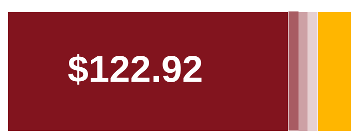


- No membership
- Free pick-up

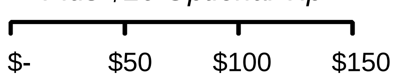
Instacart

- 2 Hour lead time
- 4 Out of stock
- 1 Damaged

Total cost:



- $3.99 x 3 (w/o promo)
- Plus $20 Optional Tip

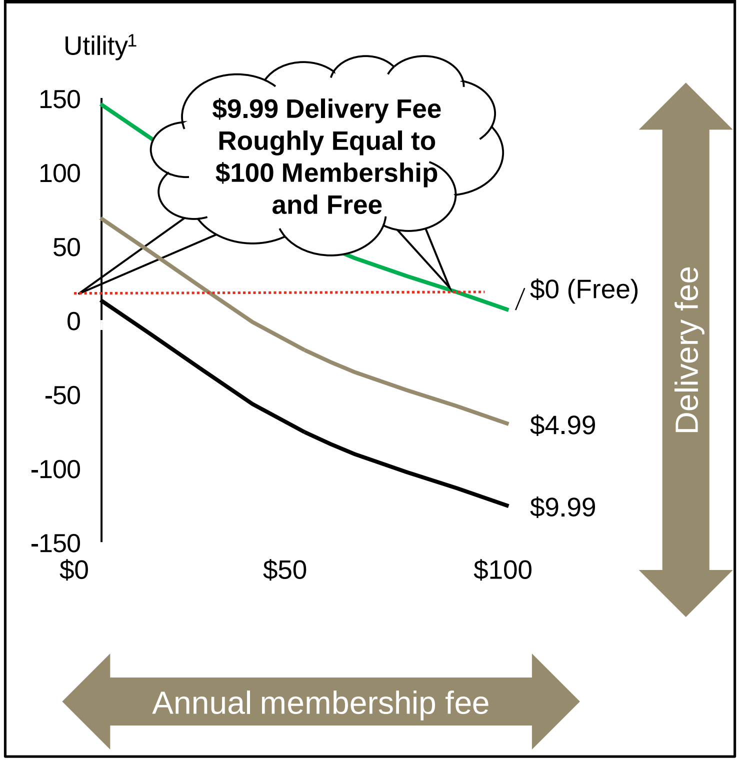




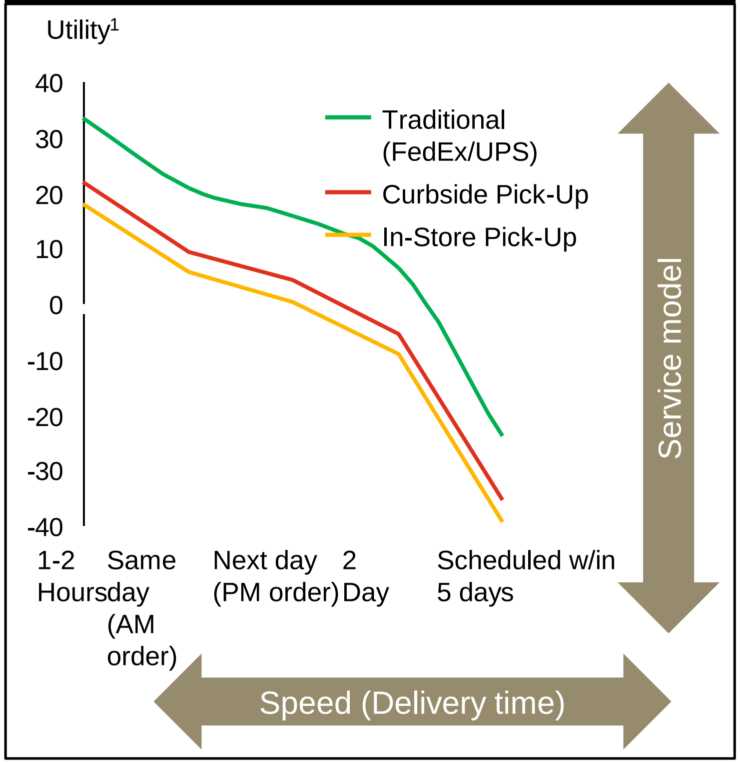

Consumers value speed but may not be willing to pay for it

Non-perishable grocery: Consumer preference trade-offs

Membership fee vs. delivery fee



Speed (delivery time) vs. service model

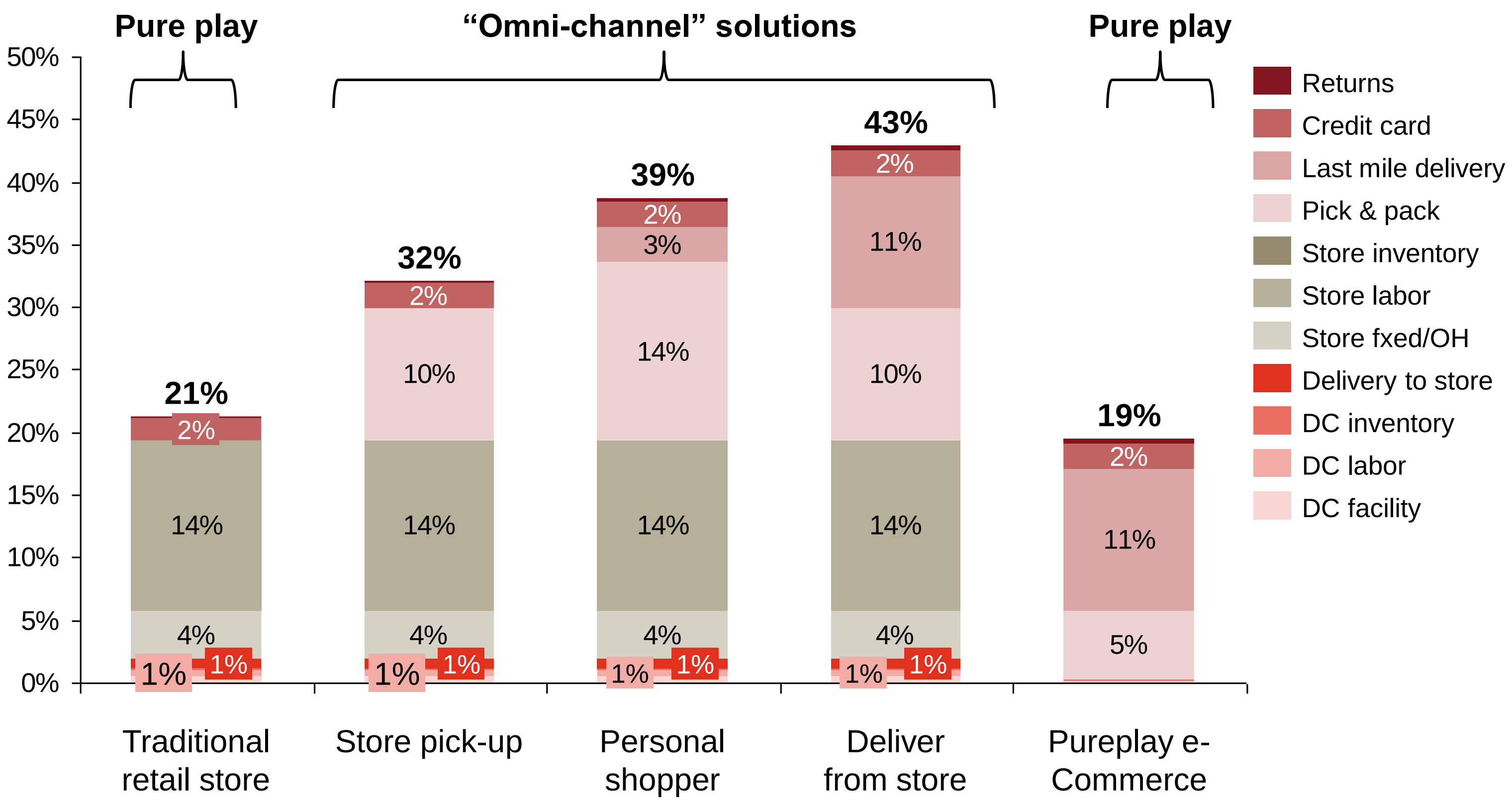


1) Utility is a quantification of a respondent's internal preferences for a given product's attributes. The conjoint survey derives this value by repeatedly asking respondents to choose between different version of the same product to tease which of the product's attributes most contribute to a trade-off decision.
Source: Strategy& analysis, survey sample size was 2009

In contrast, pure play e-comm is marginally lower cost than a self-serve store. "Omni-channel solutions" are significantly more costly

Cost-to-Serve: Non perishable items

% of sales



Source: Strategy& analysis

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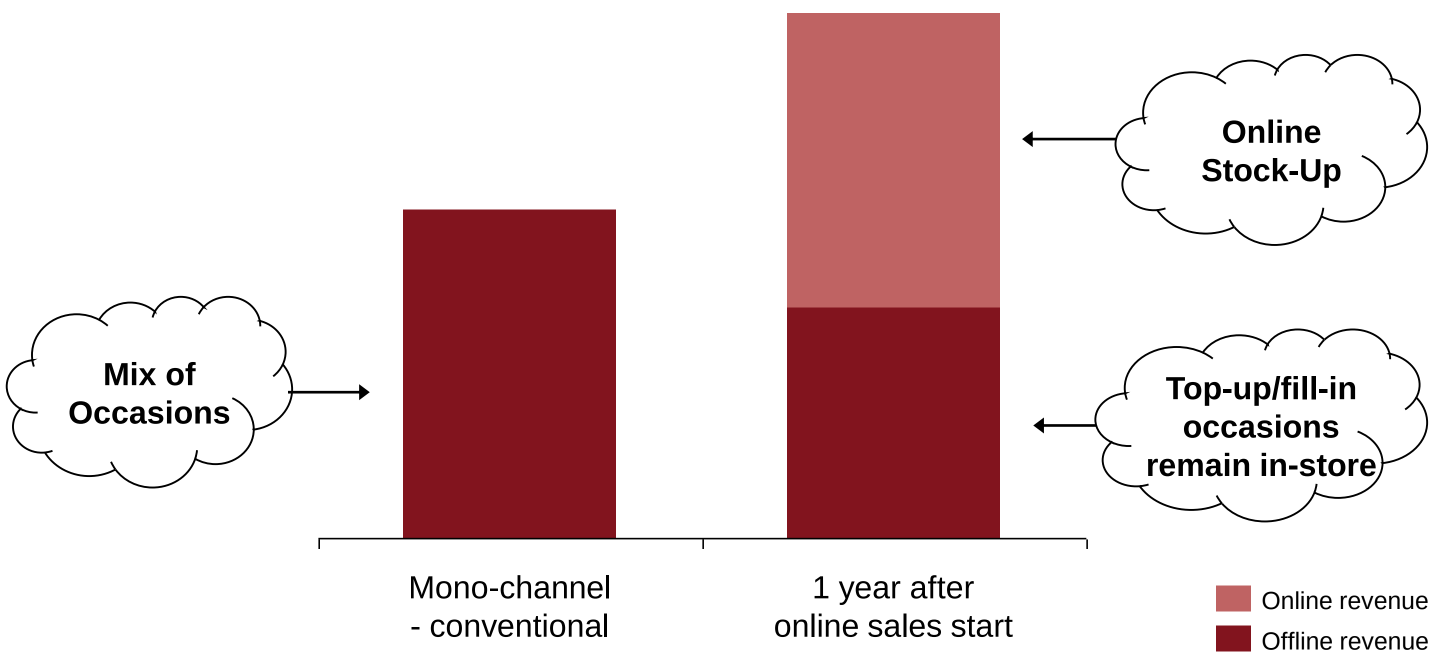
Two key questions for incumbents

Will online grow my business?	• What customer segments are most likely to choose an online offering? • Will your sales to these customers be incremental or simply switching channels/formats within your banner? • Note: NOT sufficient to say “customers who use mybanner.com buy 2x more from me than customers who don’t” (as many multi-channel retailers do…)
Will online grow my bottom line?	• Given that I have my stores, what if I sell online as well, am I going to be making more money or less money than before?

Done right, an online business truly drives incremental sales…

CLIENT EXAMPLES (BLENDED)

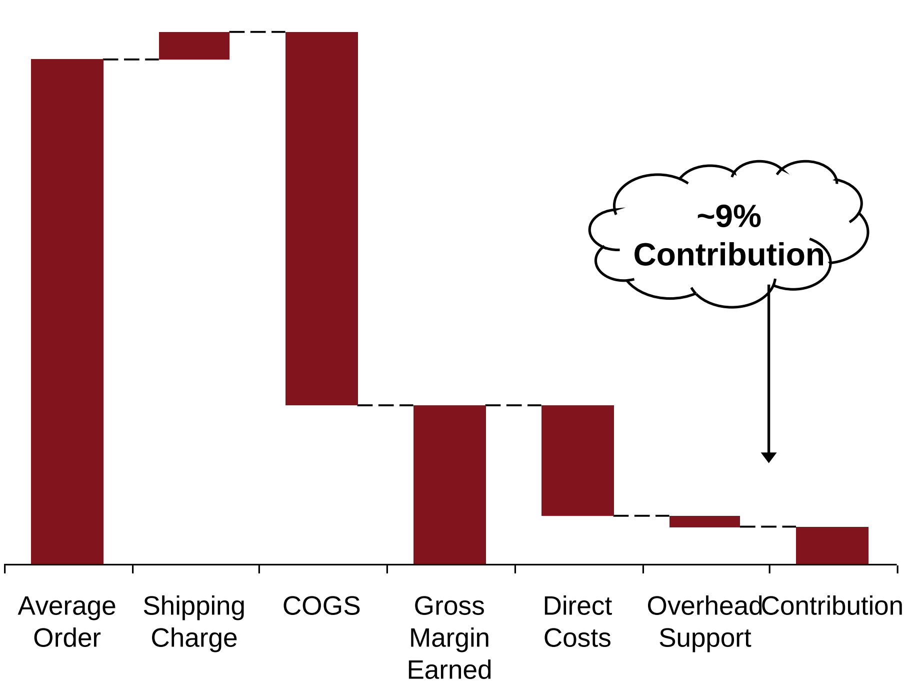
Impact of adding online channel: Constant customer
(Indexed)



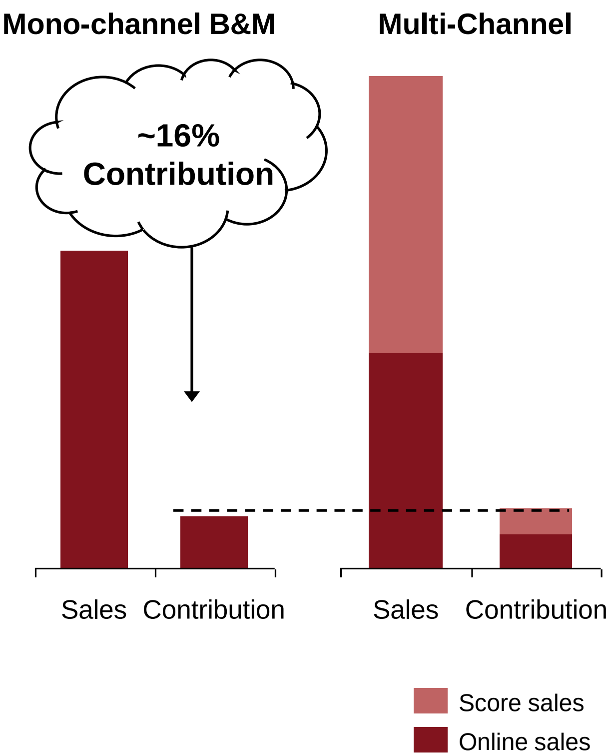
With these uplifts, and typical margins, an online business can be modestly accretive to the traditional business

CLIENT EXAMPLES (BLENDED)

Typical online order economics
($/Order, shipped to store to home)



B&M vs multi-channel contribution
(Indexed, constant customer)



Source: Strategy& analysis

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Takeaways and implications

Emerging market	Implications
• Frenetic activity – innovators trying to crack the grocery nut • Some evidence of material progress in market-share terms – particularly in non-perishable (and within that non-food) • Future growth most likely in non-perishable, stock-up trips • Consumers remain unwilling to pay much for delivery – disadvantaging express services in particular • Pure-play models modestly advantaged on an all-in cost basis… • …but online models generally disadvantaged on a marginal cost basis (high variable costs per order)	• Online sales of perishable items – still early days • More generally, online sales generally have lower *contribution* margin (i.e. sell through %) but are profitable on a marginal cost basis… • …so NEW customers are a good thing • However, simply switching EXISTING customers without increasing SoW is very likely earnings dilutive • Our experience suggests that the best online offerings DO increase SoW – potentially by quite a lot… • …but only for those who can capture share

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