

MarketLine Case Study

Online grocery sales

Successful revival of a failed strategy

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OVERVIEW

Catalyst

Despite the spectacular failure of Webvan, the US based pioneer of e-groceries, witnessed in 2001, entering the online market today seems inevitable for grocers who do not want to lose the race for market leadership in the omnichannel world. Learning a lesson from Webvan's mistakes, retailers who are experimenting with innovative, more cost-efficient logistics models are successfully reviving strategies that failed before, changing the traditional grocery sales scene.

Summary

- The global market for online groceries is expected to increase at double digit rates towards 2018, as consumers continue to embrace internet shopping.
- Low online penetration and significant pent-up demand create business opportunities for grocers.
- While grocery is the biggest category in retailing, it is also the most resistant to the advance of online shopping, as grocers remain reluctant.
- High delivery costs, low margins and slow profit generation, coupled with the spectacular failure of early business pioneers discourage many potential players.
- Successful online grocers have learned from Webvan's example, turning market threats into opportunities with the use of new technologies and innovative delivery strategies.

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REASONS BEHIND RELUCTANT GROWTH OF ONLINE GROCERY SALES

The global market for online groceries is expected to increase at double digit rates towards 2018, as consumers continue to embrace internet shopping. Online grocery sales have already reached a substantial size in several developed economies, where the retail market in general sees substantial competition. However, even there, the penetration of online grocery shopping is very low, leaving plenty of room for growth.

Surveyed consumers expect to use an online grocery service offering either a click-and-collect option or home delivery, which indicates substantial pent-up demand and opportunities for those able to address customers' needs.

Despite rising customer interest in buying groceries online, many grocers are taking a wait-and-see approach to moving into internet sales, as it is a rather low-margin business, which requires economies of scale before profits can even be achieved. High costs of delivery and picking, as well as a need for flawless service, make the grocery game challenging.

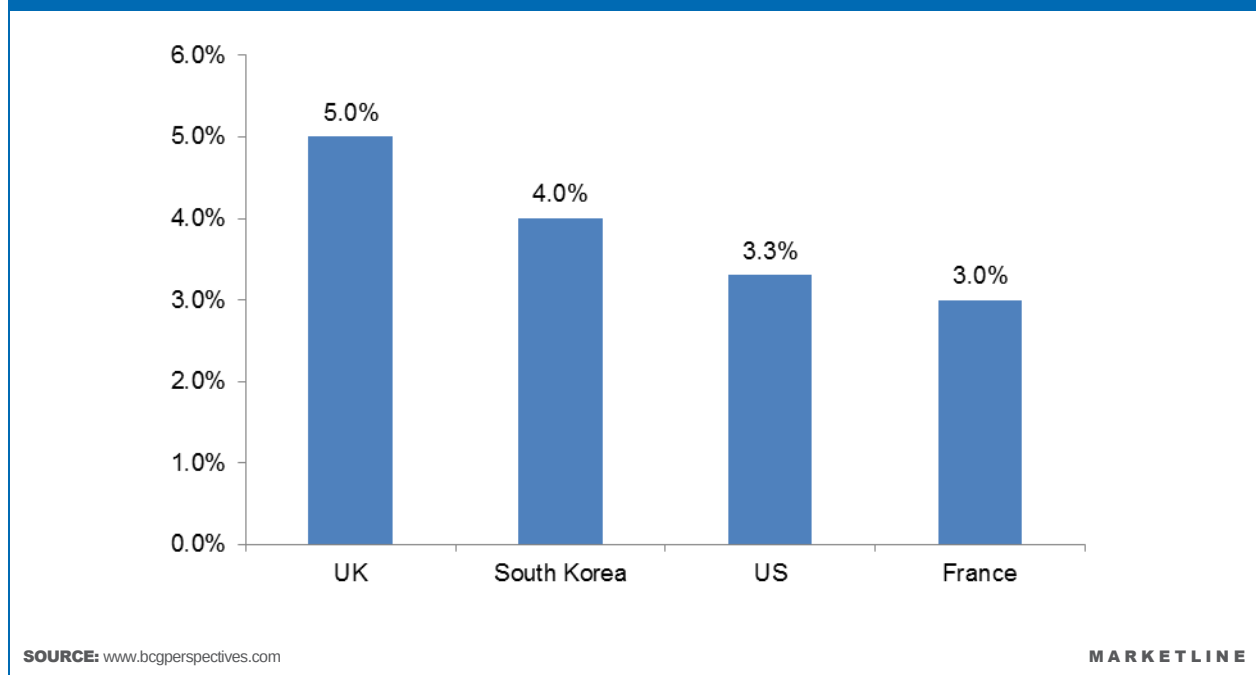
Among pioneers of the online grocery business, there have been spectacular failures, as companies have fallen into its pitfalls. Such failures continue to intimidate many potential followers even a decade after it originally launched, demonstrating the fine line between success and failure.

Great growth potential as online sales are only a fraction of grocery business

Online grocery shopping has already reached a substantial size in several countries; most of all in the developed economies, where the retail market in general sees substantial competition. As competing grocers are looking to incorporate new sales channels into their distribution system and necessary infrastructure is already in place, they are investing in building and marketing their online offerings. Any market in which two or three grocers engage in an online fight for customers sees a substantial rise in online penetration.

However, even in developed economies, where online retail is in the furthest stage of growth, the penetration of online grocery shopping is very low and only accounts for a small percentage of total grocery sales.

Figure 1: Share of online shopping in total grocery sales in selected countries, 2013 (%)



For example, in the UK online grocery market, which has more online grocery shoppers than anywhere else in Europe, it accounts for only 5% of total grocery sales, even though the country is the trailblazer of the European online grocery market, according to BCG. Shoppers here buy food online once a month and spend a surprising five times more money than in-store.

In other countries with developed online grocery spending, the situation looks similar. In the US, online grocery sales account for only 3.3% of grocery sales, in France 3% and in South Korea 4%. This means, there remains a huge potential for further growth.

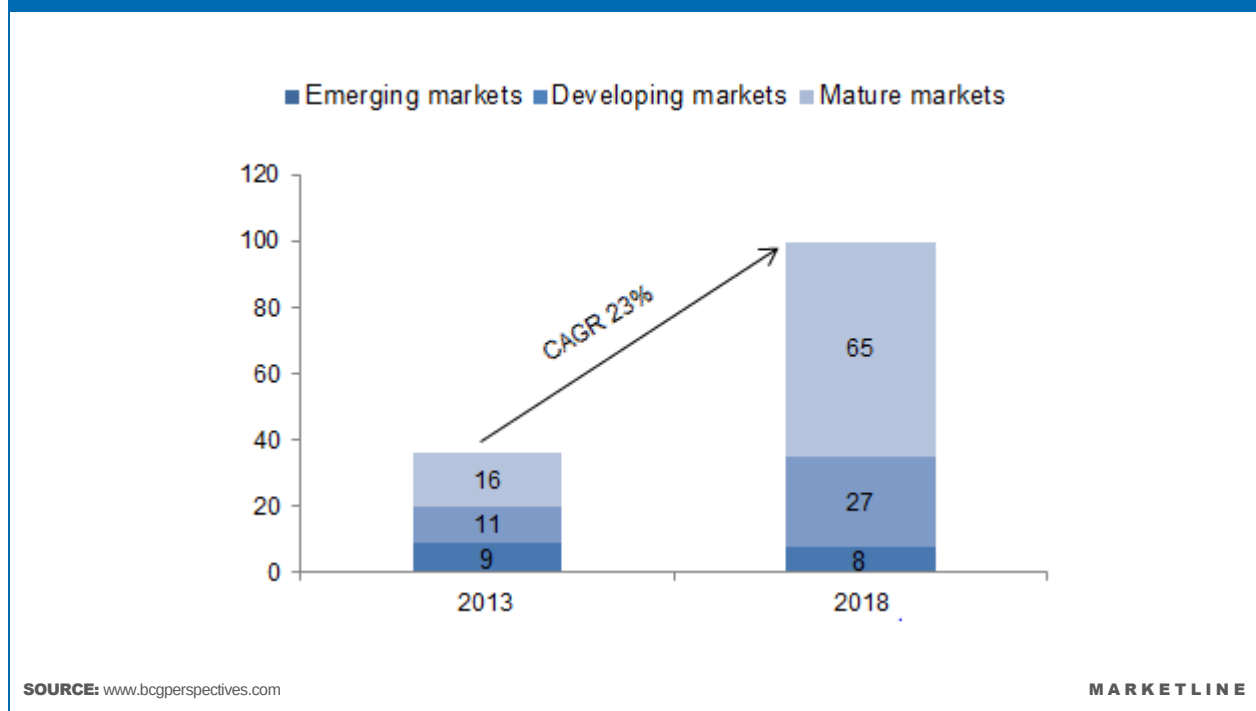
According to BCG, the online share of grocery shopping is growing at rates of 20% to 50% per year in leading markets and should double in many markets, including UK, France and Germany, by 2016.

In markets where there is significant pent-up demand, companies can grow more aggressively. However, there may be a need to make substantial upfront investments, primarily in infrastructure, which proves costly.

Online grocery market expected to reach \$100bn in 2018

The global market for online groceries in 2013 was worth \$36bn in 2013, according to the Boston Consulting Group (BCG).

Figure 2: Global online grocery sales, 2010-13, (\$m)



The global online grocery segment is expected to reach \$100bn by 2018. This represents a compound annual growth rate (CAGR) of 23%. The market is expected to increase as consumers continue to embrace internet shopping.

Once markets become more competitive and service levels rise, profitability is expected to become more challenging as more players enter and competitors engage in price wars. However, companies that target realistic returns have a chance to succeed, even in more advanced markets. Furthermore, with the popularization of online grocery shopping, product prices should go down, which in turn should bring more business.

Customers switching to online grocers spend 30% more

According to BCG, customers who switch to online grocery shopping spend 30% more than those who shop in-store. The reason behind this phenomenon is largely the nature of what makes them go online –planned purchases for restock and replenishment. Online forms of buying groceries are most appealing to young families and affluent couples, who, once they move online, are likely to spend far more across all channels than they would have done by shopping only in the traditional, in-store way.

Time saving and convenience remain the most important reasons for buying groceries online, according to a report by media analysts and advisor Kantar Media Group.

Figure 3: Top 5 reasons for buying groceries online



SOURCE: www.kantarmedia.co.uk

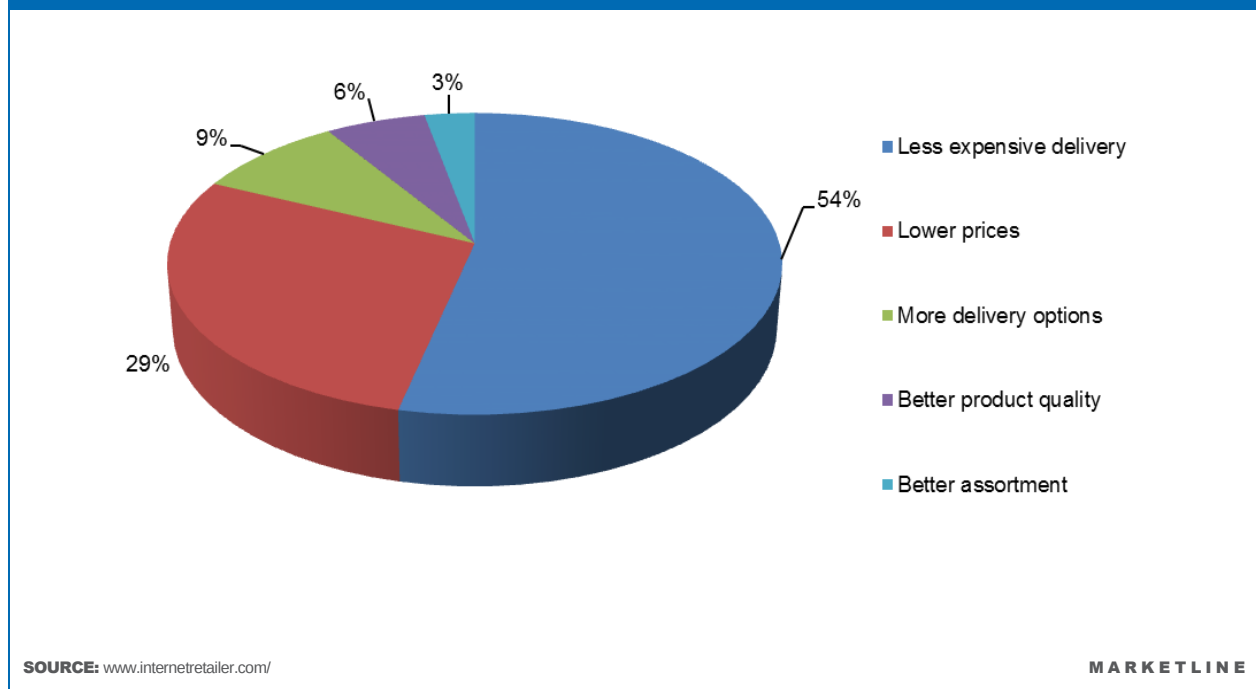
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According to the Financial Times, internet shoppers tend to be more loyal than traditional ones. For example, online shoppers at Tesco spend 46% of their total grocery budget with the retailer, while the average offline Tesco shopper spends just 29%.

Surveyed consumers in developed online grocery markets, expect to use an online grocery service offering, either a click-and-collect option or home delivery, an average of 13.5 times a year—more than once a month. Consumers in South Korea, France, China, Portugal and Spain spent twice as much online compared to physical shops and in the UK about five times. In some markets, such as Brazil and China, consumers would shop for groceries online nearly twice a month. In the United States, approximately half of the respondents said that they would try home delivery or a click-and-collect service. This shows substantial pent-up demand meaning opportunities for those able to address the needs.

According to a study completed in 2013 by Etailing Solutions, an e-commerce consulting firm, factors that would encourage more reluctant shoppers to buy more groceries online include most of all lower cost of delivery (54%) and lower prices of online groceries (29%).

Figure 4: Factors that would encourage more shoppers to buy groceries online, 2013



Other factors include more delivery options, better assortment and better product quality.

Grocery retailers are reluctant to move online

The grocery industry has evolved from mom-and-pop stores to mega-markets and finally to online grocery buying, with many different forms along the way. However, while grocery is the biggest category in retailing, it is also the most resistant to the advance of online shopping. The difference between the leading countries and the countries in which online grocery shopping has yet to establish a significant presence has a lot more to do with the reluctance of retailers than the desires of consumers.

Many grocers are taking a wait-and-see approach to moving online. At present, brick-and-mortar chains are cheaper than Internet grocers, in part because they have economies of scale. Selling groceries, online or not, is a famously low-margin business, which means that economies of scale are needed before profits can even be hoped for.

The perishable nature of the product and relatively low profit margins achievable in the groceries segment, raise concerns amongst grocers, that online commerce will shrivel sales in stores, but not the costs associated with them and that they will also lose impulse buys when shoppers move online. However, it should be noted, the notion of the internet taking spend away from bricks and mortar stores seems to be a misconception. Having an online offering helps retailers to secure additional revenue.

While the grocery industry is huge, only a tiny fraction of that market is attractive as a place to operate an online grocery business and finding those micro-segments is a crucial element of a successful strategy, according to Amazon. Plenty of players struggle to hit volume and profitability targets.

High delivery costs and need for excellent service provide challenges

The need for excellent logistics chains and an ability to deliver swiftly provide a great challenge. It is hard enough to deliver goods to the home in one day or less; it is significantly more difficult when those goods are perishable. Online grocery virtual shopping-carts contain dozens of low-value items, which must be stored at different temperatures. Picking and packing of orders, combined with the need for flawless execution to keep customers coming back, may also prove challenging.

Retailers can get in-store staff to pick them off the shelves, which becomes disruptive once volumes rise, or build dedicated warehouses, which is costly. Home deliveries are also generating high costs; even in densely populated countries like the UK, every home delivery costs grocers around £10 (\$15.6), but shoppers typically pay little more than £3 (\$4.7). In the US, consumers are willing to pay from \$5 to \$10 per delivery, while the actual cost to grocers can run as high as \$20 per delivery in low-penetration areas. Additionally, home deliveries also take away key levers for controlling when customers book their deliveries, an important key to managing delivery costs.

Moreover, success in this business heavily depends on reliable suppliers. Establishing a strong link between the online operations and the company's existing supply chain is critical, as it is the key to providing fresh products through the online channel.

Online grocery shoppers harder to satisfy

Grocery shoppers tend to be even more demanding online than in the store. They look for grocers to meet their basic expectations: satisfactory range and quality of products; low rates of substitution and high levels of freshness, consistent and punctual delivery of the expected goods in convenient time slots, as well as ease to use service and website.

A significant percentage of customers try out online grocery offers once and once only; if the experience disappoints, they do not return. Ordering groceries online is often a time-consuming task, placing an order can take up to an hour, and consumers who must wade through too many products online often become exasperated and abandon the process. Therefore delivering flawless service to all first-time customers, especially in the startup phase, is essential in this business. Quality of the product is also at the top of the priority list.

According to David Shukri of the Institute of Grocery Distribution in London, consumer satisfaction is harder to achieve in the online groceries segment. Many shoppers try grocery websites but get discouraged. Grocery shoppers want to examine fresh produce before they buy it. They are not happy when online grocers deliver "substitutions" instead of what they ordered or if they find that they have not received all the ingredients ordered. It does not take many such frustrations before they decide to abandon the idea of buying their groceries online.

For a large and growing share of online shoppers, especially younger ones, the digital experience is becoming increasingly mobile based. The reasons include the maturing of the Millennial generation and the fact that the majority of the global population lives in developing markets. This trend should be addressed by companies planning online grocery operations, if they want to tap into the market of new generation shoppers.

Big failure of a pioneer intimidates potential followers

Among pioneers of the online grocery business, there have been spectacular failures as companies have fallen into its pitfalls.

One example of a company that tried and failed is California's Webvan, an online "credit and delivery" business set up in 1999, raising \$375m in its November 1999 initial public offering and achieving a peak stock market value of \$1.2bn.

Webvan, whose idea was to revolutionize American grocery retailing, expanded at breathtaking speed, bragging about its 26-city expansion plan, and signing a \$1bn Bechtel contract to build high-tech warehouses, each worth \$30m.

It pampered customers with various services, including access to 24-hour-a-day, seven-days-a week online grocery ordering, home delivery within half-hour slots and quickly became popular. However, the money spent on infrastructure far exceeded its sales growth and the company lost control of its costs and collapsed in 2001, having posted a net loss in excess of \$450m the previous year. In 2008, Webvan was named by CNET, American interactive media and marketing company, “the largest dot-com flop in history”.

Table 1: Webvan – selected key financials, 1998-2000 (\$m)

	1998	1999	2000
Sales		13,305	178,456
Total operating expenses	12,895	155,909	526,408
Net loss	-12,004	-144,569	-453,289

SOURCE: www.rocketfinancial.com

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Webvan had \$178.5m in sales in 2000, but that revenue was swamped by \$526.4m in expenses. Its business model was simply not economically viable, with its high-cost warehouses, fleet of vans and its labor-intensive delivery system that could not compete. The company's initial capital investments were enormous. Its 300,000-square-foot distribution centers were the most automated in the world. However, the company could not get enough sales to make these investments pay. This spectacular failure intimidates many potential followers even a decade later, showing that regardless of how innovative a company is, if it costs too much to do what it wants to do, the business will likely fail.

Figure 5: Webvan – largest dot-com flop in history



SOURCE: Webvan/CNN

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Online grocery skeptics can also point to the fact that even today; numerous players still struggle to hit volume and profitability targets. Established competitors in developed countries like the UK or US, have yet to make much money in the online grocery business.

Most big retailers claim their online grocery operations are profitable, “but rather murky” accounting is used for the cost of stores, where much of the produce is picked”, according to Andrew Gwynn of Exane BNP Paribas, an investment bank. Profits- one of the biggest unanswered questions in the grocery business – are covered with a shadowy veil.

In most instances, an online grocery operation is a much lower-cost growth option. However, it also has its pitfalls, which can be deadly to the business, as shown by example of those who failed after a rapid start.

SUCCESSFUL FOLLOWERS LEARN FROM FAILED COMPANIES, DEVISE STRATEGIES ACCORDINGLY

Despite Webvan-induced fear, decade on from its failure, big players in developed online markets are becoming increasingly interested in entering the online grocery game.

Significant scale economies give large supermarkets a competitive advantage; however competition is also arising from non-traditional players, including specialist e-retailers and online marketplaces. With the rise of omnichannel retailing the need for interaction between consumers and retailers anytime and anywhere is the most significant trend shaping the retail industry and grocers will not be spared its impact.

Learning a lesson from Webvan's failure has allowed a few players to build a successful grocery presence. Innovative delivery models and technology advancements, such as dedicated fulfillment centers, are used to lower the costs of operations and gradual expansion in dense areas proves a less investment-intensive option. The key to success is also finding the right tradeoff between the attractive range of products and fast delivery.

Significant players experimenting with innovative business formats have sufficient scale to transform the market, which has been observed within the last decade.

Learning a lesson from companies that failed

Significant players experimenting with different online formats have sufficient scale to transform the market, which has been observed within the last decade. It is expected that their grocery programs will also provoke smaller grocery chains to step up their online programs. Some players managed to learn a lesson from their competitors' failed strategies and build a successful grocery presence.

One example is Amazon, which started its online grocery operations, AmazonFresh, in Seattle, US in 2007, offering grocery items for sale, as well as a subset of items from the main Amazon.com storefront. Items ordered through AmazonFresh are available for home delivery on the same day or the next day, depending on the time of the order and the availability of trucks.

The company hired Doug Herrington, Peter Ham, Mick Mountz and Mark Mastandrea – former Webvan executives responsible for its spectacular failure. It may seem a risky move; however, they certainly came with deep knowledge of the business and plenty of experience. It seems to be working for Amazon, as "these four Webvan executives have thought about what they did wrong, and are eager to prove that they can apply the lessons learned to revive their reputations", according to Forbes.

Omnichannel competition forces big retailers to join online grocery race

Webvan's failure did not prove that online grocery-shopping cannot work. It proved only that capital must be patient. Despite Webvan-induced fear, a decade on from its failure, big players in developed online markets are recognizing the lucrative business opportunities and already generate a portion of their overall grocery sales through online purchasing. For example, Tesco in the UK sells 8% of groceries through its online store. ASDA, one of the UK's leading grocers, invested £700m (\$1,094.3m) in 2013, much of it in the company's online grocery operations.

In the US, Safeway and Ahold supermarket chains have the most substantial online grocery presence. Walmart, the world's biggest retailer, was pretty late to the game, only joining in 2014, questioning whether its budget-minded customers want groceries, as opposed to bigger items, delivered. To develop its online grocery operations, Walmart Labs in Silicon Valley has imported many of the people who developed the online-grocery business at ASDA, its British subsidiary, to speed up Walmart's quest to dominate the American market.

There is also rising competition coming from non-traditional players, including e-retailers such as Ocado (British online-only supermarket), Fresh Direct, and online marketplaces, such as Amazon.com and Soap.com, which sell ambient, or nonperishable, goods and have also been expanding their fresh-food offering.

Figure 6: Popular online grocers



In large and competitive grocery markets, including the US and Germany, rivalry is becoming more and more intense, and is also limiting the ability to grow a business by adding new physical stores. Therefore establishing profitable online grocery operations is not only possible, it is essential for those that want to continue to grow and maintain market leadership.

A false sense of security about the strength of a company's current position in the market can lead to underestimating the threats from both traditional and nontraditional competitors and negatively affect a company's market share and competitiveness in omnichannel sales. For example, Morrisons was the last of four big grocery retailers in UK to move into the online grocery business in 2013. While its competitors: Tesco, Sainsbury and ASDA were selling groceries online, the company, which at first saw e-commerce as a profit-sapping distraction, found itself losing market share.

With the rise of omnichannel retailing the need for interaction between consumers and retailers anytime and anywhere is the most significant trend shaping the retail industry and grocers will not be spared its impact.

Gradual expansion in dense areas safer than rapid growth

Many traditional grocers are testing online grocery shopping through trials in almost all major markets, before launching a full scale operation. Using existing infrastructure assets, for as long as possible, while growing at a more moderate pace, is a cost conscious strategy, especially in the initial phase of operation. Gradual expansion into specific neighborhoods and deliveries to lots of homes in those specific, densely populated areas, rather than starting the business in many different areas at once is another lesson learnt from Webyan failure by players like AmazonFresh or Fresh Direct.

AmazonFresh was first initiated in Seattle and by 2013 had spread to a limited number of Los Angeles zip codes, offering "free same-day and early morning delivery on orders over \$35.

The service became available in San Francisco in December 2013. In July 2014, it expanded into the San Diego area, became available in certain areas of Brooklyn, New York in October 2014 and in select parts of Center City Philadelphia, PA in November 2014.

According to Mike Moritz, a Webvan board member and partner at Sequoia Capital, "Webvan committed the cardinal sin of retail, which is to expand into a new territory — in our case several territories — before we had demonstrated success in the first market. In fact, we were busy demonstrating failure in the Bay Area market while we expanded into other regions."

Similarly, Fresh Direct (a US online grocer launched in 2002), decided to start in the densely populated metropolitan areas of New York City and Philadelphia. As of 2013, the company has hundreds of thousands of customers and delivers fresh foods and grocery items to homes and offices in Kings, Queens, Bronx, Nassau, Suffolk and Westchester counties in New York, as well as Northern New Jersey, Connecticut, and Pennsylvania. It had 250,000 customers in 2013.

Innovative delivery models change online groceries game

Another lesson to emerge from the Webvan failure is to avoid the costly last mile delivery. Consumers are generally not willing to pay delivery fees that are high enough to cover the last-mile cost of a new entrant. While delivery fees add to the cost of online ordering, new logistic models are changing the game. Where internet grocery is still immature, experimenting with a new business approach is proving successful.

A less cost-intensive option than home delivery is starting out with the "click and collect" model, in which a customer chooses goods online and then picks them up at a store or a dedicated facility, and adding home delivery in selected areas only after sufficient local scale has been achieved. This strategy is being implemented by most retailers with significant online grocery presence. For example, ASDA in the UK introduced a same-day click-and-collect service in 2014. Such services are gaining popularity in many markets, particularly where home delivery proves costly and problematic.

In France, the largest market for click-and-collect, in terms of sales, grocers took the service a step further to make click and collect even more convenient and established more than 2,000 physical sites where shoppers pick up groceries from drive-through supermarkets. They have fueled online-sales growth of 50% per year for the past several years. With this service, France is set to overtake the UK as the largest online grocery market by 2016.

Some companies have also started combining multiple deliveries in locations convenient for both the grocer and its customers, such as office buildings, to help reduce last-mile delivery costs. Executives of Wal-Mart Stores have said that a crowd-sourced solution may be possible within a year or two, with customers taking on the task of delivering to others in return for a discount.

Meeting customers' delivery expectations with regard to timing is one of the most challenging aspects of online grocery operation. More innovation in delivery models should be seen going forward, as grocers in most markets are likely to pursue the click-and-collect model in the near future.

However, as major players experiment with new models, home delivery will also continue to develop. For example, Google is testing same-day home delivery of groceries with various partners in the San Francisco Bay area, US. Together with Instacart, Google also started Shopping Express service and delivers food from existing supermarkets instead of their own warehouses, which minimizes capital costs and makes it easier to expand. Instacart also has a network of independent drivers who own and pay the costs for their own vehicles, so it does not have fleet costs to manage. The venture, which started in San Francisco in 2013, expanded to both Chicago and Boston in the last few months of 2013 and has since expanded to New York, Los Angeles, Chicago, Boston, and Washington, DC.

Distribution centers in cheap areas are lower-cost growth option

Click-and-collect services are cheaper to operate at low volumes. As volumes of sales rise and in-store staff picking becomes disruptive, online grocers shift to "shopperless" dark stores and to automated, super-efficient fulfillment centers. Web retailers like AmazonFresh or Ocado, have an advantage in this field, as they already have warehouse infrastructure in each city where they operate.

Distribution centers located in cheap areas consume less capital than urban stores and provide a much lower-cost growth option. This strategy allows online grocers to earn a decent return on capital even with the thin operating margins typical for grocery business, according to Exane BNP Paribas analyst Andrew Gwynn.

While starting with click and collect and moving into home deliveries is usually a preferred option, there are also examples of successful reverse strategy. For example, Tesco started from home delivery and expanded into regional-warehouse picking and a click-and-collect model, once it had built sufficient scale.

In the early stages of building the business, it is especially important to select one delivery channel, or one channel in each region of operation, in order to build volume quickly without fragmenting sales between click-and-collect services and home delivery. No matter what model a grocer begins with, they will still need to evolve over time, together with the market and customer base.

Technology advancements slash costs of online grocery business

Significant advancement of technology has also allowed the costs of running online grocery operations to come down within the last decade.

Automated picking systems enable some dedicated fulfillment centers to operate at a cost well below 10% of sales; a few even approach 5%. Better routing and delivery software allows fuel savings and optimal fleet utilization, which translates into lower delivery costs.

Amazon has recognized the opportunities arising from the use of technology advancements and in 2012 acquired Kiva System for \$775m for its AmazonFresh operations. This was one of its largest-ever acquisitions. The system was built and based on ideas and technologies originally developed at Webvan, and is a key part of AmazonFresh's strategy.

"When I saw Kiva's product in action, I was blown away. It consisted of huge Frisbee-shaped robots that could be steered via a grid of floor magnets. The robots picked up the warehouse rack containing the item in the customer order and delivered it to the operator. He picked the item from the rack; scanned its barcode to verify that it was correct; and put the item in a cardboard box with that customer's shipping label." commented Mick Mountz, former Webvan official.

At the same time, consumers are growing more accustomed to shopping online, websites and mobile applications are easier to use and online payments are more secure. Technology advancements also allow creation of easy-to-use websites and encourage impulse buying. Dynamic, innovative websites that collect information about customers profile and shopping behavior allow retailers to make a small number of relevant product suggestions during the check-out process, which may boost spontaneous purchases.

Influencing customer behavior through use of clever pricing

Differentiation of delivery pricing is a strategy already used by some retailers in order to increase customer loyalty.

AmazonFresh in the US is one example. It offers benefits such as free grocery shipping in return for an annual subscription fee of \$299. The company also launched the Big Radish customer-recognition program, which sets spending thresholds and order minimums to qualify for free delivery. Similarly, Ocado has its Smart Pass program, which offers benefits including free delivery and product discounts, as well as a pricing structure that rewards customers for placing their orders midweek instead of on weekends, which involves lower servicing costs and ease of getting necessary supplies.

As companies are looking to expand the use of pricing to influence customer behavior to benefit the economics of their business, personalization of service is also likely to continue increasing.

Finding right tradeoff between attractive range of products and fast delivery

Retailers reviving the business model that failed for Webvan are constantly looking for ways of improving their customers' shopping experience and satisfy all demand drivers.

As delivery is one of the most important factors of customer satisfaction, most successful companies offer short delivery windows (of an hour or two). FreshDirect guarantees its customers that if they are not happy with the look of the fresh food delivered to their door they can send it back and claim a voucher. Time-constrained discounts or digital coupons can shift order volume from busy to slower periods in stores or fulfillment centers. LeShop, one of the leading Swiss supermarkets, has developed special packaging that helps keep fresh and frozen foods cool to allow for delivery when no one is home. Waitrose, one of the UK's leading supermarkets, launched temperature-controlled delivery lockers for click-and-collect customers both in stores and at remote locations. Peapod (Ahold brand) introduced a mobile shopping service for rail commuters in Philadelphia. Customers use their smartphones to scan product codes on train station billboards and have the groceries delivered to their homes later that day.

Grocers are also trying to reduce order time. One important factor is building a website that is easy and intuitive to use, as it is a strong tool for creating customer loyalty and steady-state level of customers a business will support. Some companies offer suggested shopping lists for families based on criteria such as the number and ages of children. Others, like Ocado, even allow customers to import shopping lists from competitors' sites. Maintaining loyalty-card records of previous shopping visits and giving customers overviews of both online and offline purchases has the added benefit of allowing companies to combine customer insights from both channels, while speeding up the buying process for the consumer. Most online grocers also offer mobile apps to facilitate shopping with the use of mobile phones and tablets.

As consumers like choice, adding variety normally boosts sales. However, while it is easy to offer an almost endless selection online, the success of providing groceries also depends much on efficiency. Increasing available selection too much significantly raises the cost of stocking and picking a large range of products. It is therefore crucial to find the right tradeoff between offering an attractive range of products and providing fast delivery.

One example of such a strategy is LeShop, which offers a full range of products from Migros, Switzerland's biggest supermarket chain. The company uses the Swiss post-office fleet during downtimes, from approximately 6:00 p.m. to 8:00 p.m. on weekdays and 7:00 a.m. to 1:00 p.m. on Saturdays, to handle deliveries.

Like any other business, successful online grocery operations need to attract customers, build their trust, keep them happy and make them come back for more. To build the trust of online customers, it is vital to invest in the drivers of online satisfaction and elements of the customer value proposition that will be attractive for shoppers, while keeping a careful eye on the economics of execution at the same time. These drivers of demand should be satisfied on a continuing basis.

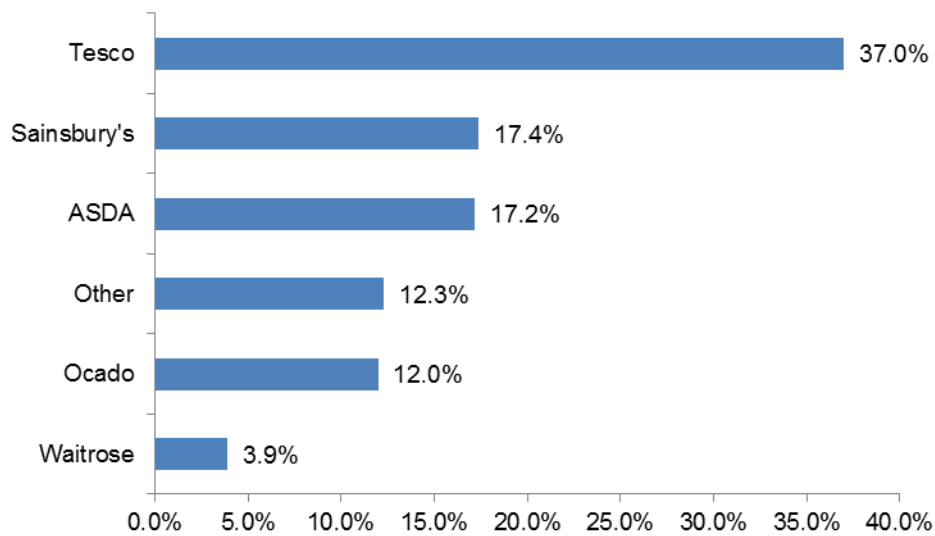
Early bird catches the worm

The online grocery market is still in its early stages, with plenty of space for growth. Early movers have a chance to seize a significant competitive advantage over those that come late to the online grocery game. It is hard to assess whether online grocers today are profitable or not, as most of them do not disclose results from the online business alone.

One successful example is FreshDirect. The company had to wait four years before it turned its first profit in 2008, generating an estimated \$230m, followed by \$250m in 2009. As of 2013, it has 250,000 customers, makes more than \$400m in annual sales and claims to have been profitable for the last couple of years.

Another example, Tesco's 17-year-old online grocery business, has revealed it made £127m (\$198.5m) of trading profit in its UK online grocery arm in 2013.

Figure 7: Online grocers' market share in the UK, 2012 (%)



SOURCE: www.uk.kantar.com

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By 2012, Tesco's market share in the UK online groceries market reached 37%, showing that the company is way ahead of its competitors. Sainsbury's and ASDA came second with market shares of 17% each. Ocado, the specialist e-retailer managed to secure 12% of the market.

Entering the market in its early stages gives first movers the ability to increase share aggressively, develop customer loyalty and gain the most attractive customer segments. Early movers can climb the learning curve ahead of their competitors, building scale and improving service, operations, and marketing.

CONCLUSIONS

Grocery business is up next for disruption

As consumers continue to embrace internet shopping, the global market for online groceries is expected to increase at double digit rates, providing significant business opportunities. Additionally, the penetration of online grocery shopping remains very low, leaving plenty of space for growth.

Webvan's failure did not prove that online grocery shopping cannot work, as the company gained popularity amongst consumers quickly; however it showed that it has its pitfalls, which can be deadly to the business if overlooked. Learning from Webvan's lesson, substantial grocers are experimenting with innovative, cost-efficient delivery strategies, disrupting the traditional grocery sales scene and successfully revamping a business model that failed before.

It still remains to be seen whether anyone can make a real profit from e-groceries, as margins are low in this business and profit generation is slow. However, regardless of whether a grocer does not believe that it can drive big profits through an online service, it still needs to take a leap or risk losing the race for market leadership in the omnichannel world, as early movers will seize a significant competitive advantage over those that come late to the game. The experience of companies such as Tesco, LeShop, and AmazonFresh or Fresh Direct demonstrate that online operations can help establish strong market positions and bring profit within a period of a few years.

Knowing what web shoppers want will factor help dictate online grocers' success. The focus is on finding the right tradeoff between an attractive range of products and a fast delivery service. There is no single model that is right for all companies and situations. Efficiency depends in large part on individual market circumstances and where a grocer stands on the online growth curve. Smart grocers moving online will let the market, customer base, and the speed at which they can develop their own capabilities dictate the pace of their evolution.

APPENDIX

Definitions

Online grocery market is defined as the online sales of food and drink for in-home consumption.

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