A Fresh Look at Online Grocery

Online food retail again tops the agendas of grocers as more shoppers surf the Web to buy fresh foods and packaged products. The leaders “deliver the goods” using smart, customer-friendly strategies.
When e-commerce was first recognized as a sea change in business, many companies tried to enter the realm of online grocery. But many of these pioneers failed when the Internet bubble burst, and in the decade since, online grocery sales have grown much slower than the overall e-commerce market.

For the most part, customers in Western countries continue to shop for their groceries by going to bricks-and-mortar stores. However, the online market is growing quickly in some countries. The United Kingdom has a particularly vibrant market, with Internet grocery sales comprising 4.5 percent of total grocery sales in 2010. In other countries with similar characteristics, however, growth has been slow; the Internet comprises just 0.2 percent of total grocery sales in Germany.

We recently studied the state of the online food retail industry in partnership with the University of Cologne. We found an industry with significant potential for growth. While our research centered on Germany’s online food market, our findings are relevant in markets with high gross domestic product (GDP) and well-urbanized regions (see sidebar: About the Study).

This paper examines the business models for online food retail, discusses why food shoppers are often hesitant to purchase groceries online, and outlines the factors that will help grocery retailers succeed online.

Delivering the Goods

France, Switzerland, the United Kingdom, and the United States all have major online food retailers that offer a full range of groceries. The U.K. market is the most developed, with annual combined online grocery sales of major players Tesco, Asda, Sainsbury’s, and Ocado totaling $4.6 billion, or about $110 per person. Switzerland’s market in 2008 averaged $20 per inhabitant, mostly generated by the two leaders, LeShop and Coop@home. In Germany, where the food retail market is dominated by discounters, online grocery has made only a minor dent in sales.

About the Study

This study of the online grocery industry performed by A.T. Kearney in partnership with the University of Cologne, Department of Business Policy & Logistics included one-on-one interviews with senior executives in the retail grocery industry, and a survey of grocery shoppers in Germany. While the study was conducted in Germany, the results apply to most Western markets.

The survey responses (677) were compiled from May through June 2011, and evenly distributed between online and paper. The questionnaire took less than five minutes to complete to increase the likelihood of response.

Distribution among men and women is nearly identical—48.4 percent female and 51.6 percent male. The age groups are less evenly distributed, however, with roughly 64 percent under the age of 34. All other age groups have between 30 and 87 respondents, making it possible to analyze preferences reasonably accurately. Almost 75 percent of participants already have or aim to achieve a university degree, 20 percent have degrees at vocational college, and 5 percent lack a higher-education degree.

Participants are from 125 cities in Germany, with most in Cologne and North Rhine-Westphalia. The vast majority reside in larger cities. Lower-income earners dominate the responses with almost half earning less than $2,000 per month. However, all income groups are well represented, with each providing between 7.5 percent and 18.3 percent of the total answers.
One reason for the gaps across similar countries is that each country has different food retail markets. Unlike Germany, the United Kingdom and France have highly consolidated food markets, with less price competition and fewer hard discounters. This opens the door for “high-value service” retail concepts such as online grocery. Furthermore, some of the requirements for establishing an online grocery market—large metropolitan areas with fewer grocers, high broadband usage, and lots of online shoppers—vary considerably across countries. Online grocers have to adapt their business models, products, and services accordingly.

For our study, we examined how both traditional retailers and pure online players are setting up operations and reaching customers. Figure 1 shows the two primary ways customers receive their goods, depending on which method is used by which online retailer. Customers either have groceries delivered, or they pick them up at a store or a distribution facility in a “click-and-collect” service. The vertical axis indicates where retailers fulfill the orders for later delivery to customers—either in a shadow warehouse inaccessible to customers or in traditional stores.

Online food retailers generally use one or any combination of four approaches to distribute grocery orders to customers (see sidebar: Four Retailers, Four Approaches on page 6). Some

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**Figure 1**

**Business models of online food retailers**

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<th>Pickup</th>
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<td><strong>Click-and-collect</strong></td>
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<td>Online shoppers collect goods at grocery stores</td>
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<td>Grocers use existing stores to supply online shoppers</td>
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<td>Warehouse to home</td>
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<td>Online start-ups (and some bricks-and-mortar) deliver from warehouse</td>
<td>Some grocers are adopting this time-saving approach</td>
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Source: A.T. Kearney analysis
retailers, such as Sainsbury’s in the United Kingdom and Colruyt in Belgium, offer more than one approach. Tesco goes even further—already offering both in-store click-and-collect service and home delivery, it has begun investing in shadow warehouses to increase the efficiency of home delivery. The following describes the online grocery approaches of some of the more established retailers:

**Shadow warehouses (pickup).** The shadow warehouse approach already used by companies such as Chronodrive, Leclerc, and Système U has become popular in France. Traditional retailers such as Intermarché and Carrefour are currently in test phases with this approach, and German retailer Real has initiated a test phase in two markets. In the United States, one example of this approach is Farm Stores, a Florida-based online grocer with drive-through pickup.

One major obstacle to online grocery is quite simply that customers are happy with how they get their groceries now.

The advantage of the drive-through pickup is the time savings—online shoppers can often collect their groceries without having to get out of their vehicles. Chronodrive, a sister company of French hypermarket chain Auchan, is currently expanding the number of its outlets to 32 in France and boasts that its pickup process takes less than five minutes. The approach succeeds because of its efficiency; on the other hand, the absence of personal contact can hamper both marketing and customer service efforts.

**Shadow warehouses (home delivery).** Similar to the first approach, home delivery managed from a central distribution center is frequently used by pure online retailers that do not have traditional retail stores. It is common in the United States, where Peapod (founded in the United States in 1989 and now owned by Netherlands-based Ahold), FreshDirect, EfoodDepot, and Netgrocer have made a dent. This approach is moving forward in Europe, too, led by Switzerland’s LeShop, which has partnered with the Swiss postal service for delivery, and the U.K.’s Ocado. Even traditional retailers that offer home delivery, such as Tesco, are opening centralized shadow warehouses to benefit from more efficient picking and delivery.

The efficiency and time-saving features of this approach can be valuable to customers, but the level of customer service involved can also make it comparatively expensive.

**Store-based (pickup).** This business model allows customers to pick up pre-packed groceries from traditional retailer outlets. Publix and Albertsons in the United States have abandoned store-based home delivery in favor of pickup. This approach is easy for traditional grocery retailers to adopt within their existing structures. But customers often see little difference between online and offline channels and, ultimately, may prove unwilling to pay a premium for the service. When moving into the online business, traditional food retailers often choose to offer both click-and-collect and home delivery from their stores.

**Store-based (home delivery).** Traditional retailers entering the online business often take advantage of their retail outlets and pick customers’ products for delivery from their existing stores. The U.K.’s Asda uses this approach, while others such as Sainsbury’s, Simply Market,
Colruyt, and Delhaize offer in-store picking and click-and-collect. In-store picking is waning in popularity among retailers because of delivery inefficiency, costs, and availability. Furthermore, trade chains are encountering local competition; for example, in many countries, including the United States, it is already common for some single-location stores to offer home delivery in two hours.

Shopping Around: It’s All In the Details

After examining the leading business models for online grocery, our survey findings helped identify ways to improve online grocery retail. The improvements fall into three categories: customers, operations, and success factors.

Customers

Our focus turned to how and what online grocery shoppers buy. In general, executives agree that the customer base will widen with the Internet-savvy generation. Busy young professionals who value the opportunity to save time and young mothers seeking to avoid busy supermarkets are the main target group in online groceries. As one young mother puts it, “Online grocery shopping is convenient and it saves time. I do not need to carry heavy bags and I can avoid long lines.”

- **Shoppers are happy with the status quo.** One major obstacle to online grocery is the simple fact that customers are happy with how they get their groceries now. Seventy-three percent of respondents say they do not buy groceries online because they are satisfied with their usual shopping opportunities and cannot see the added value of online food shopping. In addition, some people don’t decide what to buy until they are on their way home from work or even in the supermarket, so online food purchases are not always a viable option. For many, personal contact is important. While only a few respondents blamed a lack of skills or availability for not shopping online, these could also be underlying factors.

There is little margin for error—shoppers do not forgive mistakes made by online food retailers.

- **Online shoppers are not online food shoppers.** Frequent online shoppers are more likely to try buying groceries online than others, with almost one-third of Web grocery shoppers saying they shop online at least once a week for other products. But they do not purchase groceries online as often as other products. Fewer than 10 percent of shoppers say they have bought non-perishable groceries online, and only 2 percent have bought fresh food from a website. And of the 60 percent of shoppers who buy something online at least once a month, only 1 percent log on to buy groceries every month.

While some customers happily accept home delivery charges, most are not willing to pay for just the assembly of the order. Sixty percent of respondents say they would pay between $1.30 and $6.50 (€1 and €5) for home delivery, and 17 percent stated they would pay up to $13 (€10). On the other hand, few are willing to pay extra when they pick up, either at warehouses or supermarkets.
Operations plays a major role when determining the best approach to developing and implementing a customer-friendly strategy. The top companies focus on providing high-quality service, whether delivery or pick up.

*Get the service model right.* Many consumers today see value in home delivery, which may make it the dominant approach as online food retail matures. But home delivery has its challenges; the supply chain for online food retail is completely different from all other online products. Each order consists of multiple products, some of which may require cooling, and delivery accuracy is important. A wide product selection, particularly of fresh foods, may prove difficult.

Pickup service might alleviate shoppers’ hesitation in buying fresh food online, as they can check the quality before leaving the collection point. But, of course, pickup service does not offer the same time saving or convenience as home delivery. And, to date, most customers

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**Four Retailers, Four Approaches**

Following are case examples of four online retailers successfully using four different approaches in their online grocery concepts:

**Chronodrive excels.** French retailer Chronodrive started its click-and-collect service in 2004, and revenues reached $25 million in 2009. By 2010, it had 130,000 regular customers, averaging 40 items per purchase. The grocer offers 8,000 items on its website and promotes a convenient, time-saving, user-friendly experience. Customers can access their saved shopping lists, or use a recipe function that drops all of a meal’s ingredients into the shopping basket. Ordering is faster through a smartphone app used offline (until final purchase) that often reduces processing time for pickup from 90 minutes to 30 minutes. Shoppers pick up orders from 8:30 a.m. to 8:30 p.m., free of charge, without leaving their vehicles. Within five minutes, they pull up to the terminal, dial in their order code, pay, and a sales assistant loads the groceries into the car.

**LeShop delivers.** Switzerland’s LeShop started operations in 1997 and became the second European online food retailer after Tesco to break even in 2006. LeShop reported annual sales growth of 15 percent in 2010, with revenue of $166 million (CHF 151 million) in 2010. In 2003, LeShop joined forces with Migros, adding approximately 6,000 private-label products to its virtual shelves. Customers receive their groceries between 5 p.m. and 8 p.m., with an unbroken cooling chain assured by transporting perishable food in a cooling box, or by home delivery leaving groceries on the stoop or with a neighbor if no one is home. Depending on the delivery time slot, customers pay between $8 and $18 (CHF 8 and CHF 16) with extra fees if the cooling box is not 75 percent filled.

**Asda discounts.** Asda added home delivery to its hard discounter role. To keep prices low, its website is strewn with advertisements touting promotions, special deals, and weekly offers. Online prices are at least 10 percent lower than retail with additional savings for agreeing to eight-hour delivery windows at a cost of about $4. The model is working well. Asda’s annual online grocery sales are $1.4 billion compared to $1.7 billion for rival Tesco.

**Albertsons’ shoppers pick up.** Albertsons customers can shop online or in store and buy the same products, and they can pick up their groceries the same day for orders placed before 10 a.m. The service is not as convenient as others—no drive-throughs, no designated parking, no sales assistants to load the groceries in the car. Instead, shoppers pick up grocery orders at the service desk. At $5.95 per transaction (compared to $7.99 at Publix), online shopping at Albertsons costs as much as competitors’ home delivery.
appear to have little interest in pickup stations, afraid that they will not be able to examine the products or, in the event of a problem, address it directly.

- **Get the picking approach right.** While pure online players use semi-automated shadow warehouses to pick groceries for customers, some traditional retailers also run store-picking systems. Shadow warehouses provide almost triple the efficiency of traditional stores.

Today’s shadow warehouses are mainly located close to urban areas. Traditional food retailers often start with store-picking systems to keep costs low and build the shadow warehouses as the market grows. Once again, these findings show the trade-off between seeking upfront savings and investing in the benefits of long-term efficiency.

**Success factors**

These factors focus on how to succeed in the online grocery market.

- **Educate customers.** One striking finding from our study is how many shoppers are not even aware that online grocery service exists. Eighty-two percent of our respondents have no experience with online food retailing, and only 1 percent say they buy groceries online on a monthly basis. Many online grocery stores are difficult to find online, and traditional retailers haven’t yet aggressively advertised their online shopping efforts.

  Additionally, many online food shoppers use the Internet to obtain a few select products—almost always dry goods—that are cheaper online, difficult to find elsewhere, or more convenient to have shipped. While these customers are easy to target, massive marketing and communication is required to convince them to buy more groceries online.

- **Develop a unique selling proposition.** A successful business normally stands out by offering something unique to customers. Online food retail still struggles with this. Most players assume that the unique selling proposition is the time saved through home delivery or store pickup, and our study findings support this view. As one online shopper explains it, “I can order at any time and it gets delivered to my flat when I am home.” As a result, current online retailers say they target customers with time constraints. Tesco’s Home plus has succeeded in this area (see sidebar: Groceries, a Smartphone, and the Subway). However, product selection is also important, as more than 40 percent of our survey participants say they shop online to obtain a product they cannot easily find elsewhere (see figure 2 on page 8).

**Groceries, a Smartphone, and the Subway**

Tesco’s South Korean subsidiary, Home plus, introduced an innovative approach to online grocery shopping. As the number two bricks-and-mortar food retailer in South Korea behind E-mart, Home plus wanted to be number one, and to do so without adding any new stores.

Following in-depth studies of the South Korean market and buying preferences, Home plus identified time savings and mobile commerce as main selling points. Its concept went well beyond a typical online grocery strategy to focus on “bringing the store to the people,” by setting up virtual stores in subway stations and other non-traditional locations. Shoppers use their smartphones to scan codes from displays and automatically drop products into their online carts.

The boost for Home plus’s online presence has been remarkable: In two years (2009-2010), the company marked a 76 percent increase in newly registered shoppers and a 130 percent increase in online sales. Home plus is now number one in online grocery and closing in fast on E-mart for number one overall.
Win their trust. Customer retention is a major challenge for online retailers, and turning this problem around starts by minimizing mistakes—which already-skeptical consumers may not forgive. Because customers are not able to touch online products, they cannot be certain about the quality and are often wary of the inconvenience of getting a refund for defective goods. One person in our survey says, “I do not shop online regularly, first because I have to plan ahead to take the delivery, and second, when I shop online, I often do not get the items I order.”

Because shoppers are generally satisfied with traditional food retailing, online shopping must offer additional value while also upholding (or surpassing) traditional standards. This might mean higher operating costs during start-up to ensure excellent picking operations, or a higher rate of spoilage because of selecting only the freshest goods.

Smart Shopping, Smarter Delivery

In most Western countries, the online food market is still in its infancy and a niche segment. One reason is that initial investments are high, with outlays required for infrastructure (mainly new or upgraded operations), software, and marketing, among other things, and potentially higher operating costs. The investments also come with higher risk because of market
uncertainties. A well-balanced assortment is vital for sustainable growth as profitability, logistics requirements, and costs differ significantly across product categories (for example, canned food versus fresh food).

Pure online grocers find it difficult to enter the market on a broad scale, because of fierce price competition and start-up costs. They are more likely to operate as niche players in large metropolitan areas working with logistics and shopping partners (such as Amazon) to provide home delivery services. They primarily sell small assortments of premium fresh products geared to less price-sensitive shoppers.

Traditional grocery retailers will not enter until they have looked at the risks and rewards of being an online-food retail pioneer. Those struggling under competitive pressure are most likely to enter as part of a differentiation strategy, offering an online channel as an additional service. Any competitor that goes big into online retail will entice others to follow. Traditional grocers will need to decide between staying traditional and risk losing long-term market share, or investing now to gain an edge in a promising market.

Whether talking to a niche online grocer or a traditional grocer with an online presence, both understand the importance of providing customer-friendly delivery plans. Most online grocery shoppers prefer (and are willing to pay for) home delivery over pickup. But, they are neither willing to stay home all day to wait for their groceries, nor are their homes set up for grocery drop-off, especially fresh goods that require cooling.

In many ways, smart delivery solutions are the tipping point for online grocery success.

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