



Retail

RESTRUCTURING THE GROCERY BUSINESS



Fresh off his most recent Super Bowl win, New England Patriots quarterback Tom Brady didn't go to Disney World. However, in early March, the star quarterback did partner with the vegan meal-kit start-up Purple Carrot, which is converting Brady's TB12 nutrition manual and diet recipes into a subscription service that will include delivery of three plant-based Performance Meals to customers' doors each week. Brady and Purple Carrot join grocery stores, dollar stores, other meal-

kit companies, online retailers and delivery companies seeking to grab a share of the more than \$727 billion that U.S. consumers spend on food for consumption in the home. As with many other consumer-facing industries, the grocery and home-food market (such as subscription meal kits) is undergoing a restructuring, and the companies that best align with the Consumer Value Hierarchy will be the most likely to succeed. (*TechCrunch*, 3/7/17)

IMPLICATIONS

- Price wars among grocery chains put pressure on packaged-good suppliers. Until some competitors fall by the wayside, margins fall for all.
- Grocers and food companies make investments in logistics to improve shipping times and reduce delivery costs.
- Companies that provide technology and robotics to the grocery industry and grocers that create efficiencies and improve the customer experience will benefit.

TAKEAWAYS

- Like many other industries, the grocery and home-food market is undergoing a restructuring.
- Many companies are entering the grocery and home-food market, making it more competitive.
- Grocers and meal-delivery companies that excel in at least one aspect of the Consumer Value Hierarchy (such as offering Restraint or Simplicity) have the best chance of success.

Competition

Whole Foods, or “Whole Paycheck” as it is sometimes unaffectionately called, has been one of the grocers hardest hit by the newest wave of competition in the home-food market. For most of the last decade, Whole Foods was one of the biggest beneficiaries as sales of organic foods increased more than 10 percent a year, going from \$11.5 billion in 2004 to \$37 billion in 2015. Over the last few years, however, mass-market retailers have become a source of significant competition, often offering lower-cost organic foods. Whole Food’s executives have had no choice but to acknowledge this new reality. The company’s co-CEO Walter Robb said, “It’s very competitive out there. That’s the world we’re in, and customers have lots of choices,” while its other co-CEO, John Mackey, has acknowledged, “The more conventional mainstream supermarkets have upped their game.”

In 2015, mass-market retailers were responsible for 53.3 percent of organic food sales, and over the last six quarters, Whole Foods has lost as many as 14 million customers, according to Barclays. One competitor is Safeway’s Open Nature store brand, which has grown by 400 percent since its 2011 debut. In 2016, Kroger’s sales of organic and natural food totaled \$16 billion, compared to \$15.8 billion at Whole Foods. During the period, Whole Foods’ same-store sales fell 2.4 percent while Kroger’s grew about one percent. Kroger’s line of organics, under the Simple Truth brand, sells at prices that are about 15 percent less expensive than Whole Foods. (*Vox*, 6/1/16; *Food & Wine*, 11/16; *Washington Post*, 2/9/17; *Business Insider*, 3/27/17)

In the current grocery and home-food market, the competition goes well beyond just organics. Consider:

- Meal-kit services – which deliver fresh ingredients and a recipe from companies such as Blue Apron, Hello Fresh and Plated – made their U.S. debut in 2012 and, as of October 2016, were on pace to generate \$1.5 billion in sales for that year. (*Mother Jones*, 10/22/16)

- In 2016, 20 new grocery stores opened in the Dallas-Fort Worth market alone. Walmart and Kroger, the top two grocers in 2015 in Dallas-Fort Worth, both lost market share, as did Costco, Fiesta Mart, Brookshire, Tom Thumb and Target. (*Dallas Morning News*, 7/29/17)

- Since 2013, the percentage of shoppers who say they have bought groceries from Amazon in the past 30 days has increased by 25 percent, and Amazon now captures **nearly** half of all online grocery trips. Despite Amazon’s growth, in 2016 only 4.5 percent of shoppers made **frequent** online grocery purchases, up from 4.2 percent four years earlier. (*Dallas Morning News*, 7/29/16; *Bloomberg*, 3/20/17)

- German supermarket chain Lidl, which in a company presentation describes itself as a cross between Trader Joe’s and Harris Teeter, is planning to open 150 stores along the East Coast by mid-2018. The company plans to have 1,000 stores in the U.S. by 2021. German discount chain Aldi plans to add 200 more stores in the U.S. over the next two years, bringing its total to 2,500. (*Supermarket News*, 3/21/17)

Some of the effects of the competition are already being felt.

- In 2015, A&P, whose holdings included the Food Emporium and Pathmark, filed for bankruptcy.

- In 2016, New York-based grocer Fairway filed for bankruptcy, while another New York grocer, D’Agostino, put itself up for sale.

- In 2015, Washington-based grocer Haggen filed for bankruptcy and over the past two years has announced 127 store closings.



Consumer Choice and the Value Hierarchy

Unlike many of the other industries that are undergoing a restructuring and facing stagnant or reduced demand, there are indications that consumers, especially younger ones, place a high value on eating meals cooked with supermarket ingredients. More than one-third of millennials grocery shop two or three times a month, and

another 30 percent grocery shop once a week. In a 2016 study, 30 percent of millennials said that, if needed, they would cut their entertainment budget, and 11 percent would cut their clothing budget, but only eight percent would modify their grocery spending. The teen group was, as of 2016, spending 22 percent of its income on food, up from seven percent in 2005. (*Pymnts*, 6/28/16; *Forbes*, 9/16/16)

As when making other purchasing decisions, consumers are utilizing what we have called the Consumer Value Hierarchy – Restraint, Simplicity, Connectivity and Experience – to make decisions about where and how to purchase food. As the examples below highlight, many food retailers and distributors appear to be attempting to align themselves with these consumer desires.

Restraint

More than a third of millennials describe themselves as “thrifty” shoppers, and 50 percent noted that cost was their driving factor when making grocery purchases, according to a study by Retail. This may be one of the reasons that, based on company filings, *Forbes* magazine estimated that the largest dollar stores (*i.e.*, Dollar General, Dollar Tree and 99 Cents Only Stores) grew their annual sales in the grocery category by just over \$10 billion from 2010 through 2015, from \$18.3 billion to around \$28.6 billion. Retailers are now fighting for these price-sensitive shoppers. (*Forbes*, 5/9/16; *Pymnts*, 6/28/16).

- Walmart is launching a new price-comparison initiative at roughly 1,200 of its U.S. retail locations to test lower price points for a range of products in its grocery business. According to reports from stores in Iowa and Illinois, those price changes are already in effect, with Walmart now undercutting Aldi’s, a reversal from recent positions. (*Pymnts*, 2/27/17)

- Whole Foods is expanding its 365 by Whole Foods brand aimed at “value conscious” consumers. Also, Whole Foods has been dropping prices at its full-price locations and mailing out national discount circulars. (*Washington Post*, 2/9/17)

Simplicity and Omnichannel Retail

This video (<https://www.youtube.com/watch?v=NrmMk1Myrxc>) about the new Amazon Go

(no-checkout) grocery store has been viewed more than 8.7 million times on YouTube. Amazon Go is just one of the ways that Amazon is trying to bring simplicity to the grocery market.

- Amazon Fresh is available in about 20 U.S. cities for those willing to pay \$14.99 a month. Amazon currently has two Amazon Fresh pickup locations in beta testing. Customers can order groceries online for pickup at the site in as little as 15 minutes. If the beta tests work, the company plans to roll out the concept to more markets.

- Amazon Pantry lets shoppers buy crackers, cookies, chips, coffee and nonperishables at a discounted rate for a delivery fee of \$5.99 per box.

- Amazon’s drop-off service, Prime Now, offers items from local grocers in some cities but no major chains – yet.

- Amazon’s stick-on Dash Buttons let people order many household products – including some groceries, although not fresh food – with the tap of a finger.

- Subscribe & Save offers discounts to Amazon customers who sign up for periodic delivery of laundry detergent, toothpaste, diapers, paper towels and other items frequently purchased in grocery stores. (*Pymnts*, 3/29/17; *Bloomberg*, 3/20/17)

Other companies either are already benefitting from consumers’ desire for simplicity or are experimenting to improve their offerings in that regard.

Meal Kits

- As of April 2016, Blue Apron was selling eight million meals per month, up from three million meals per month in the summer of 2015. Stop & Shop and Giant recently introduced seasonally changing meal-delivery kits with store-branded products and produce. Whole Foods and Stew Leonard’s have meal kits in development as well. (*TechCrunch*, 3/30/17; *Food & Wine*, 11/16)

Omnichannel Retail

- Over the last year, Walmart expanded its click-and-collect model, which allows shoppers to buy groceries online and pick them up at a store location, to more than

100 markets in the U.S. The retailer now has more than 600 locations offering the service. (*CNBC*, 3/24/17)

- In 2015, Kroger debuted ClickList in Cincinnati, enabling online grocery ordering with in-store pickup, then quickly rolled it out to 23 more markets. In 2016, Kroger more than doubled the number of stores it uses to fulfill online orders, to 640. (*Internet Retailer*, 3/27/17)

- Kroger is experimenting with home delivery handled via a local Uber driver, while Stop & Shop and Giant are exploring same-day fulfillment by partnering with services such as Instacart and Google Express. (*Food & Wine*, 11/16; *Internet Retailer*, 3/8/17)

- Family Fare Supermarkets will soon begin testing a click-and-collect model that will allow shoppers to have their online orders delivered to their cars at a store location. (*Internet Retailer*, 3/27/17)

In-Store Technology

- Stop & Shop lets customers use their phones as scanners to check out. (*Food & Wine*, 11/16)

- Kroger's app reminds customers what they last ordered online and where they can find those items in the store. (*Food & Wine*, 11/16)

Connectivity and Experience

Connecting with others and seeking experiences are the two most desired components of the Value Hierarchy. While going shopping at the grocery store has not historically often met these values, grocery stores are experimenting to figure out how to satisfy these consumer desires.

- Whole Foods' new store in Dallas-Fort Worth has 16 beer taps and indoor/outdoor seating for 150 people. Some are calling these types of stores "grocerants"—

hybrid stores that include bars, restaurants and groceries. (*Dallas Morning News*, 7/29/16)

- Nine Publix stores throughout the Southeast have hands-on cooking schools, and nearly all 1,100 of their outlets feature demo kitchens, where chefs show customers how to make the dishes they market through their Aprons Simple Meals-branded recipes and meal kits. (*Food & Wine*, 11/16)

- Many of Chicagoland's Mariano's markets have oyster and wine bars as well as sushi and barbecue locations. They also have locations that will cook meat just purchased in-store. (*Food & Wine*, 11/16)

- In February 2016, Kroger debuted Main & Vine in the Seattle suburbs, with a central show kitchen and a tailored assortment of prepared and fresh foods. (*Food & Wine*, 11/16)

Kroger recently bought a former Macy's space at Kingsdale Shopping Center in Upper Arlington (OH), Wegman's Food Market is leasing 194,000 square feet of space vacated by JCPenney at the Natick Mall in Massachusetts, and 365 by Whole Foods is set to open this year at College Mall in Bloomington (IN). Mall operators recognize that many people still actually go to physical grocery stores, even if they no longer patronize many of the retailers they have traditionally hosted. However, those grocery stores are now in an extremely competitive environment. There are 38,000 grocery stores in the U.S., meal-kit start-ups have drawn \$650 million in venture capital over the last four years, and dollar stores, big-box retailers and online retailing giants are attempting to grab a larger share of consumers' grocery dollars. Over the next few years, many companies in this sector will experiment in an attempt to figure out what the consumer wants and how they want to receive it. The companies that are best able to offer what consumers value – Restraint, Simplicity, Connectivity and Experience – will be the ones to succeed in the grocery and home-food market. Bankruptcy and consolidation will await the industry after winners have emerged in this industry's restructuring. (*Washington Post*, 3/10/17)