Food for thought

Rethinking grocery strategies in the digital age

Consumers have been migrating their shopping online for years in categories like books and electronics, and they are shifting their grocery spend as well. Given the pace of change and the economics of the industry, adapting to this new environment is not simple for grocers to do. While leveraging advanced analytics in all aspects of the operation was once a unique strategy for a few elite players, it is now a critical tool for all players in driving profitable growth.

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Rethink strategic approaches now

Digital disruption is at it again. This time it's upending the retail grocery industry as shopping online for groceries gains traction, leaving traditional brick-and-mortar retailers scrambling to keep pace amid a new and rapidly unfolding landscape.

In the last year alone, consumer interest and adoption in online shopping for groceries has made a sizable jump. In fact, according to KPMG's 2018 Grocery Retail Consumer Perception Survey[1], 48 percent of consumers currently do some, or all, of their grocery shopping online and 59 percent plan to do so in the future.

Given the structural economics of the industry, grocery retailers already saddled with thin margins are being further challenged to counter the digital advantages of their tech-savvy counterparts. While there is no one cookie-cutter solution for success, grocers that focus on the consumer segments they serve, innovate their in-store model, and seize the advantages of new tools and technologies will be better positioned to move forward.

In this paper, we'll share results of KPMG's annual grocery survey and critical insights on how consumer behavior is changing. We will also offer strategic insights on the why, what, and how grocery retailers will need to incorporate new strategies for growth. And we will reaffirm that one thing is for certain…the time to act is now.

Methodology

[1]KPMG's 2018 Grocery Retail Consumer Perception Survey is an annual survey of grocery shoppers across the United States to understand their shopping behavior. In 2018, the survey was rolled out to more than 2,000 grocery shoppers, who were selected to represent the U.S. population fairly in terms of age, household income, and location, among other demographic identifiers, and had shopped at multiple retailers. They were then asked questions to assess the relative performance of the retailers along with the emerging trends in the grocery industry.

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The profitability conundrum

Online grocery is not exactly new–it's been pervasive in Europe and Asia for a long time–but its rising popularity on US shores is a relatively recent phenomenon. Whether it's the Amazon-Whole Foods effect or the emergence of myriad niche and nimble digital newcomers, traditional grocers are facing increasing competition from their online rivals.

One of the reasons that the US market lagged in online grocery adoption is the impact to profitability. For any retailer, the cost to add dark stores or distribution centers, picking capabilities, logistics, and a digital supply chain are substantial. Add to that the complexity of last mile delivery in a catchment area that could be anywhere from three miles to twenty-five miles wide, and it is not a particularly attractive proposition.

At the same time, given the extremely thin margins of the average US grocery retailer, missing out on a market share shift could be a critical mistake.

As illustrated below, the profitability of a grocery retailer is highly dependent upon a stable and growing top-line and it does not take a substantial market share shift to wipe out a retailer's profit margins.

Do you know how much market share you are at risk of losing and what to do about it?

Traditional grocer economics

2%

EBIT

and

22%

Volume variable margin

Example: Hypothetical grocer analysis

Historical P&L summary		
Sales	$100B	100%
COGS	$78B	78%
EBIT	$2B	2%

Analysis	
Market share loss	0.4%
Sales loss	$7B
EBIT loss	$1.6B
New EBIT	$0.4B

Assumptions	
Volume variable margin	22%
Potential share loss	0.4%

So, if it's expensive to get into the game but also expensive to stay out of it, how does a grocery retailer with already thin margins cope?

Taking cost out of the business by driving operational efficiencies is a popular go-to strategy. But the current disruptive landscape requires a hard look at new strategies to drive top-line growth as well. Doing this in a profitable way will require greater precision than ever before in what strategies are executed where and for which consumers. While there are big shifts in consumer behavior happening at scale, not all consumers are behaving the same way, and there are very few strategies that will serve them all effectively. Using advanced data and analytics that offer an intricate understanding of consumers, along with the ability to anticipate buying behaviors and optimize future value propositions, will make a real difference for grocery retailers. Doing so will drive the most efficient growth strategy so that it can be sustained for today, and tomorrow.

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Know consumers better than ever before

In the last year alone, consumer interest and adoption in online shopping for groceries has made a sizable jump. In fact, according to KPMG's 2018 Grocery Retail Consumer Perception Survey, 48 percent of consumers currently do some or all of the grocery shopping online and 59 percent plan to do so in the future.

While the number of consumers who are planning to shift 40 percent of their shopping online is the fastest-growing group, the majority of consumers will do less than 20 percent of their shopping online. Thus, we anticipate a barbell effect where there is an increasing number of consumers shifting significant spend online while there is also a large group that will remain in store (see chart below).

Online shopping rises.

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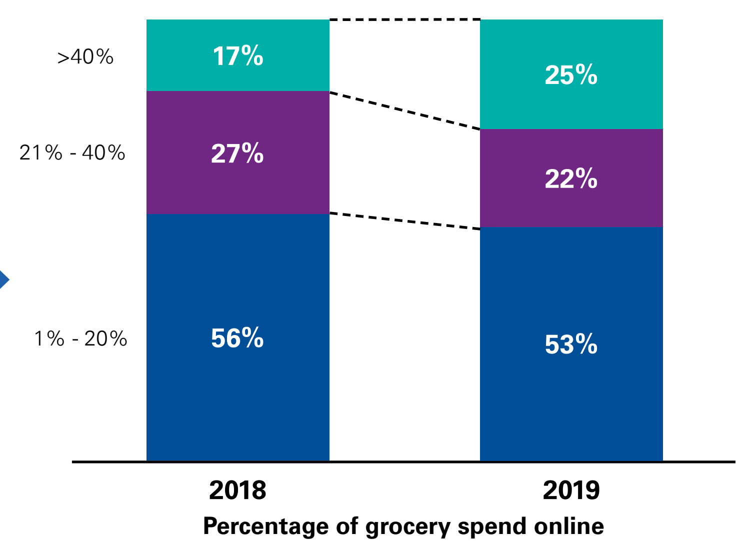
Source: KPMG 2018 Grocery Retail Consumer Perception Survey

The number of consumers shopping online for groceries is increasing, but a large group of shoppers also prefer to remain in store.



n=2019

May not equal 100% due to rounding

These consumer segments have very different preferences in both how they shop and what is important to them, so it is critical for grocery retailers to understand which consumers they serve. Knowing who their online consumers are takes on even greater importance as they may differ considerably from a retailer's brick-and-mortar consumers.

As our survey results reveal, consumers who are heavy users of online grocery, and those who are willing to consider it, are two very different buying segments. Upon closer look, we found several distinct segments of consumer buying behaviors that can help drive a company's strategy.

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We’ve broken them down into four key shopper segments, which include:

Online pioneers

This group does the largest portion of its shopping online today and plans to shop online even more in the future. On average, over 40 percent of their grocery spend is done online, but it varies widely by individual retailer and market. Interestingly, these shoppers spend the most on food consumption—both groceries and dining out. While they place the highest importance on product quality and assortment in determining where to shop, they are also more interested in promotions than other segments.

— The majority are under age 35

Spend the most on food consumption:

— 80 percent spend more than $250/month on groceries

— 79 percent spend more than $100 dining out each month

— 60 percent have a club membership

— Focused on promotions and shopping experience

Next-in-line adopters

This is the fastest growing segment of consumers, who are dabbling in online shopping but not yet fully committed. This segment predominantly lives in the suburbs. They primarily shop a mix of traditional grocery and warehouse clubs or big-box retailers.

— Do less than 20 percent of their shopping online today and plan to increase

— 67 percent have a club membership

— Product assortment is the most important shopping criteria

— This segment is the least concerned on price and promotion of all segments

Online dabblers

This group shops online today and plans to shop a bit more online in the future, but they have no plans for it to be the majority of their shop.

— Do a limited amount of shopping online

Similar to those who do not shop online at all, except that they:

— Spend more per month on groceries

— Live in slightly more densely populated areas

— Shop around a lot more

— Are much more likely to have a club membership

In-store crowd

This segment prefers to shop in brick-and-mortar stores and does not show signs of shifting much of their spending online in the future. As you might expect, this is an older generation that is less tech savvy and tends to be more price sensitive.

— Do almost all their shopping in brick and mortar and plan to continue

— Older – almost 80 percent are over age 35

Spend the least on food consumption:

— 40 percent spend less than $250/month on groceries

— 47 percent spend less than $100 eating out each month

— Most concerned about price and quality

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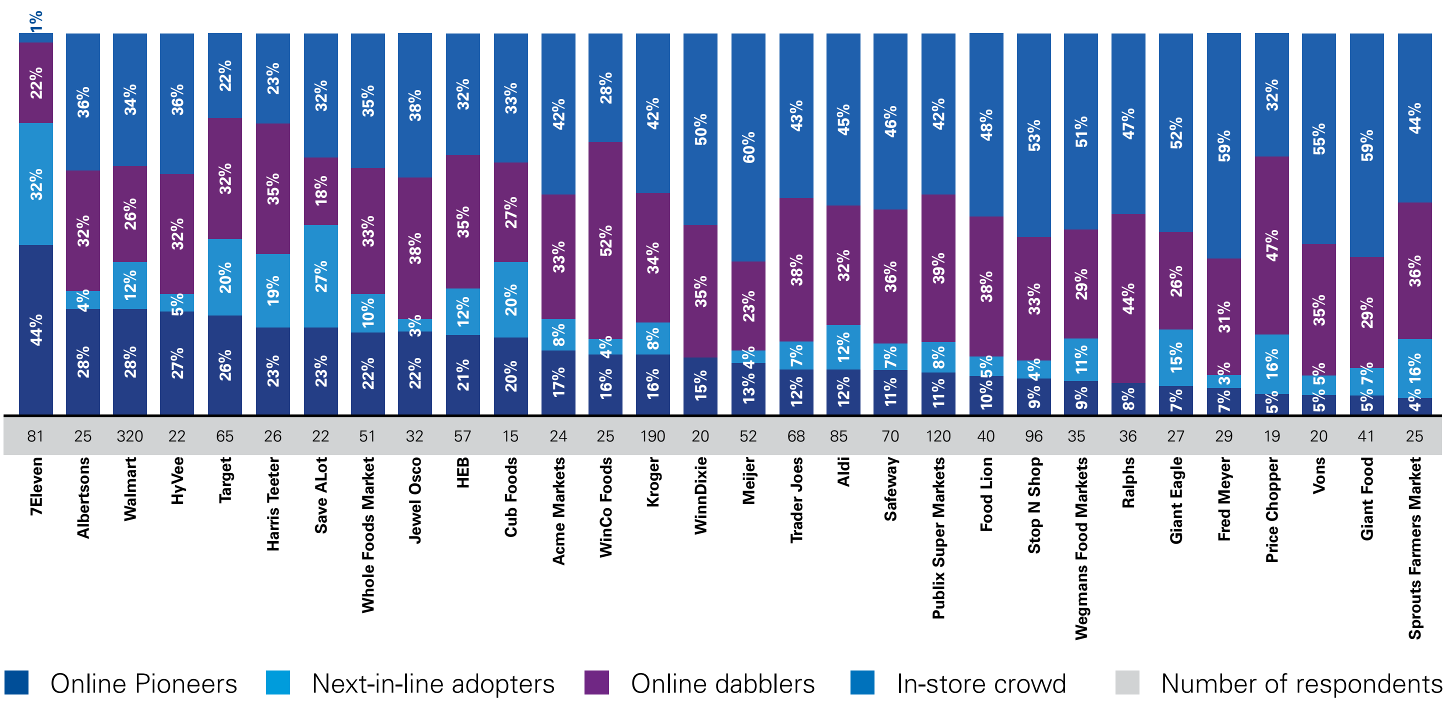
Understanding the percentage of each segment in the loyal and potential consumer base is critical to formulating the right strategy at the right time. As seen in the graph below, there is a wide range of consumer mix by retailer. Some retailers have a consumer base where 80 percent of their consumers who regularly shop with them primarily shop in store, for others this can be as little as 50 percent. What's more, in some cases, the difference between consumers who use the retailer for some shopping have a much bigger tendency to shop online than those who use the retailer for their primary shop. In the example below, only 20 percent of the retailer's primary shoppers are online pioneers, but this number increases to 30 percent when looking at all consumers who shop that store. This indicates a risk factor for losing more of the shop as consumers migrate online, and also a missed opportunity where they are missing significant share of wallet with some consumers today.

Catering to consumer segments



May not equal 100% due to rounding

Source: KPMG 2018 Grocery Retail Consumer Perception Survey

Consumer segmentation enables retailers to understand the preferences of their consumer mix and serve them better. This chart shows the online spend for consumer segments that selected the retailer as their primary store.

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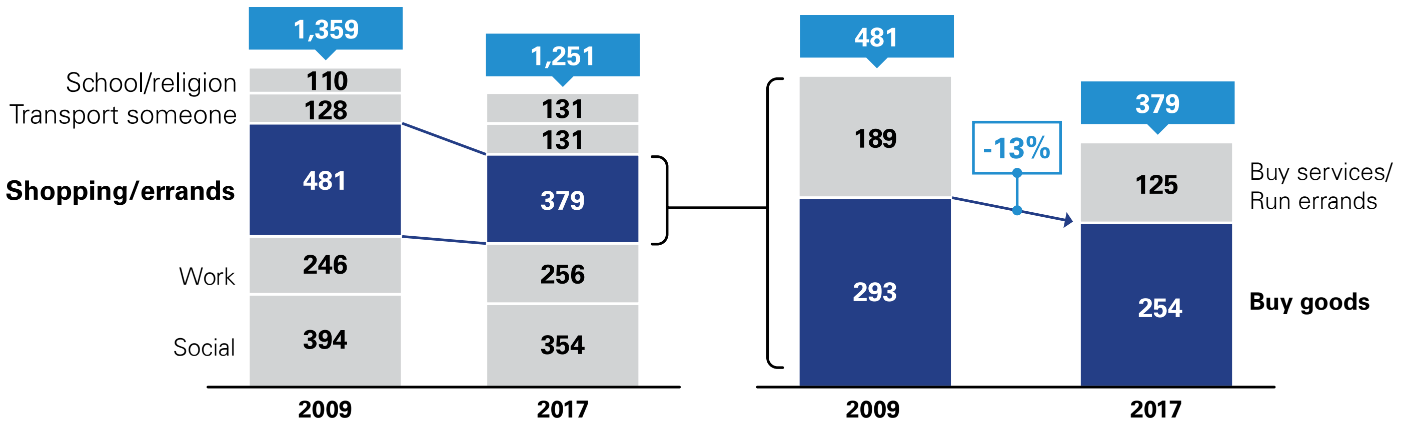
Regardless of the proportion of online pioneers a retailer has, one commonality among retailers is that they all still have consumers who shop in stores. But how often and when will they go to stores? As pointed out in KPMG's "Autonomy Delivers" research, consumers are not only shifting their shopping patterns, they are also shifting their driving patterns. As a result, we believe that many consumers will consolidate their shopping experiences. For example, what once was a stop in a store on the way to an errand, may no longer be a matter of convenience because the errand may not be necessary anymore. So the key to succeeding in this area may not always be about leading the digital race, but may be a confluence of factors dependent on the consumer segment the retailer serves.

U.S. annual trips per person by mission, 2009–2017[1]

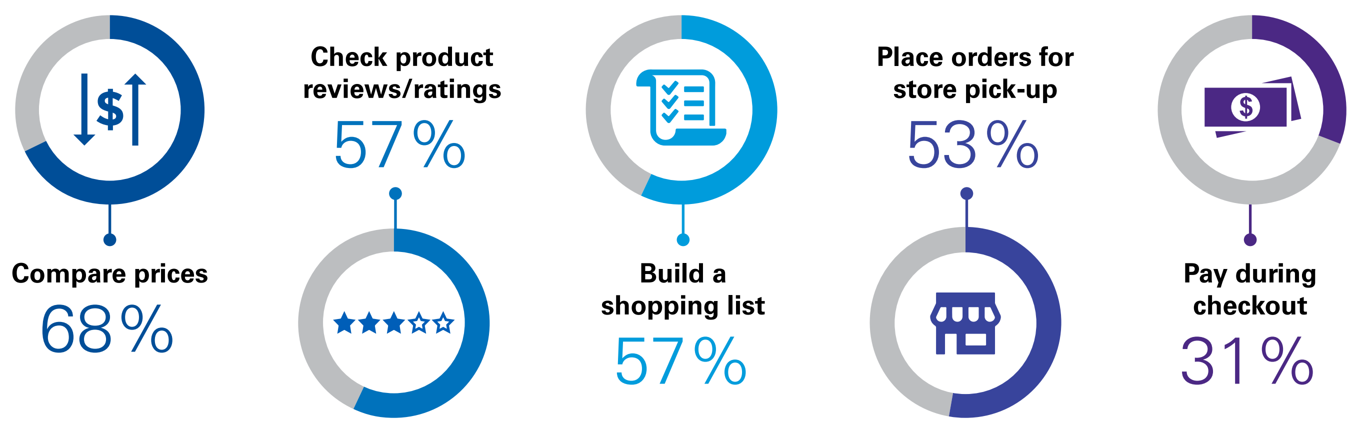


As e-commerce penetration grows, US consumers are making fewer shopping trips.

Source: [1]U.S. National Household Transportation Survey, US Department of Transportation, Federal Highway Administration

For many, the key will be to retain the in-store shop when consumers begin consolidating the brick-and-mortar stores that they visit. We believe that there are a few key ways to do this including focusing on a convenience offer appropriate for the retailer's consumer base and staying strong in categories that will stay in store.

Browsing for information



Source: KPMG 2018 Grocery Retail Consumer Perception Survey

Although the majority of shopping is still in store, consumers are turning online to research what is most important to them.

Even if your brand, or certain store locations, are heavily skewed to "in-store crowd" shoppers, you cannot ignore certain digital capabilities. Determining the optimal offering for your stores requires a combination of understanding your consumer's needs, mapping their current journey and identifying frustrations with the shopping experience.

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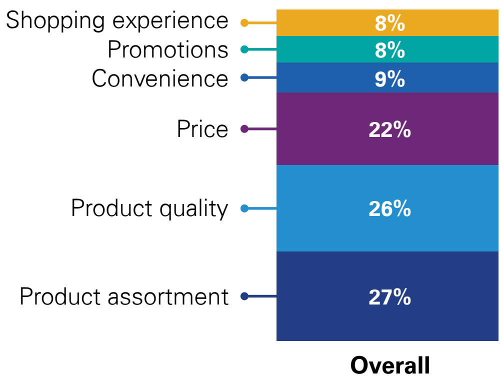
Innovating in-store approaches

Product assortment and product quality are of primary importance to heavy online shoppers, outpacing price as a critical factor, according to our survey results.

What matters most



n= 2019

Source: KPMG 2018 Grocery Retail Consumer Perception Survey

Consumers who shop online frequently cite product assortment and product quality as the factors most important to them.

Brick-and-mortar grocery retailers have a natural local convenience advantage, which they can leverage to their benefit. The "how" will depend on the consumer segments the grocer serves. Using information on consumer shopping patterns, buyer behaviors, brand preferences, and more will enable a retailer to target consumers with personalized offers and innovative in-store experiences designed to enhance convenience.

Many grocers have already opted to add click and collect, which allows you to order online and pick up in store. The popularity of this option stems from the relative ease of both consumer adoption and retail execution. But even with click and collect, it's important to understand the consumer the retailer serves. For instance, if the targeted consumer no longer drives to the store, the click and collect option is useless, garnering no return even though it was initially a less expensive investment to make.

Therefore, it's critical for a retailer to gain a deep understanding of who their consumers are, when and how frequently they are visiting physical stores, and how likely they are to migrate online. Such information helps

Insights in action

Why am I losing visits?

A discount grocery retailer was losing transactions but unable to figure out why. They did not have new competitors opening near their stores. Their price position was already very low. They knew consumers were shopping online more often, but did not think it impacted their consumer base. Although they only had limited information on their consumers, an IT systems conversion was underway so they did not want to complicate it.

KPMG used external data sources and advanced analytics to pinpoint the problem. Within a few days, we identified that while there was not a significant increase in competitor locations within three miles of their stores, there was a significant increase in hard discount and dollar stores in their overall trade area. Utilizing market consumer visit data, we identified that 65 percent of their consumers shop at a large national retailer weekly. While our client was not closely located to the new hard discount and dollar stores, these large national retailer stores were having an impact. What's more, we identified that the large national retailer was lowering prices on key items. We could also see that the consumers who were no longer shopping with our client were increasing their visits to the large national retailer.

Given the margin profile of the business, wholesale price investments were not possible. Instead, we needed to isolate the consumers most likely to shop at the large national retailer and evaluate their shopping patterns to develop targeted strategies to respond. It was also critical to look at store-level performance metrics and feedback such as employment data, consumer feedback on locations via Yelp or other social media sources to create store-level action plans. This approach allowed the retailer to make targeted investments to win back consumers.

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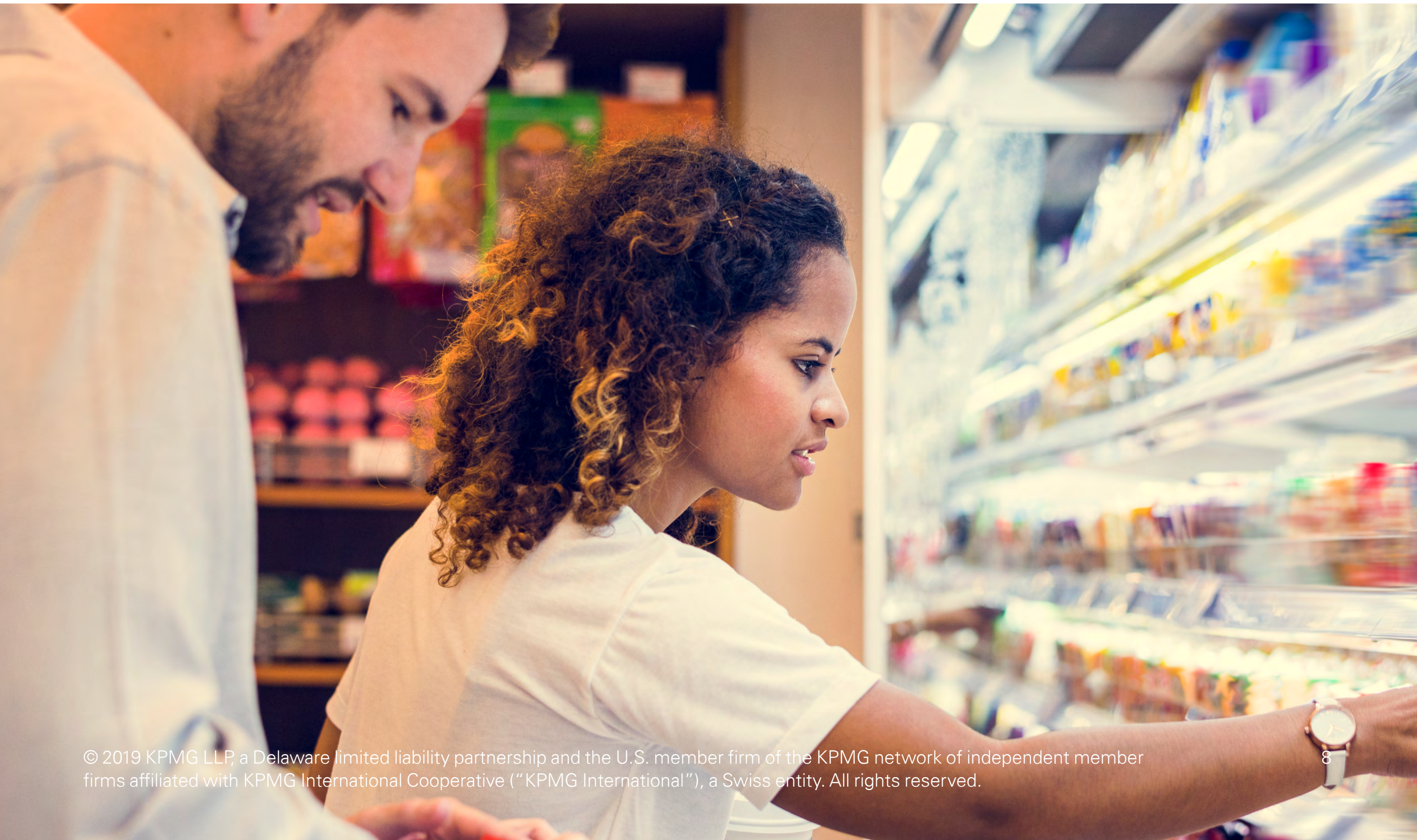
determine the economics of supporting that consumer and explores various options to retain them. Armed with new insights, a retailer may decide to invest more in-store, shift what products the store carries, or provide unique service offerings within their catchment area.

Consider a retailer with research that shows that their consumers are buying more of their packaged goods items online but continue to purchase fresh foods in-store. As they plan for the future, the retailer may start testing smaller formats with more fresh food offerings and enhanced in-store experiences. This provides consumers with new fresh food options or activities, such as being able to marinate fresh meat in store and allow it to soak up the marinade in a bag while you shop and drive home. Taking it one step further, if the retailer has insight into the consumer's shopping preferences at other stores, they could consider repurposing existing, inefficient physical space for other stores preferred by that consumer, further increasing convenience and appeal to encourage frequent visits. This could yield both increased profit margins and footfall to the store, all while making the experience more attractive for your best consumers. Remember, along the way, even little innovations can add up. Even if it's as simple as adding the convenience of offering prepared (peeled and/or sliced) fruits and vegetables at the same price point as whole ones.

Or think about the retailer catering primarily to "online pioneers." The store offers meal kits, which has achieved moderate success. However, they decided to innovate further by replacing the center of the store with a kitchen, where consumers not only pick up their meal kit but can also do all of their prep and cooking there. It now becomes a fun and entertaining experience where a consumer can prep, cook, take home a freshly prepared meal and leave the mess behind. And it attracts new members of their targeted demographic and keeps them coming back for more.

Such examples point to the need for grocery retailers to go beyond traditional boundaries and start experimenting and testing ideas that benefit the consumer segment they serve.

By digging deeper, retailers can build new, valuable relationships with consumers by focusing on the segments they serve. "Online pioneers" are going to require comprehensive and compelling offers to get them through the doors. If servicing the "in-store crowd," practice longer range planning to adopt new digital strategies. Or when catering to "next-in-line adopters" and "online dabblers", consider focusing on category-specific retention. So, as consumers migrate online for those categories, the retailer can focus on ways to retain that piece of the in-store shop, determine if it makes sense to do so, or focus elsewhere.



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Reframe your game

The key to retaining the in-store shop will be unique to each grocer and require different analytics than before. In addition to understanding an individual's preferences for product, promotions, and pricing, we see that it is also critical to understand where consumers drive from to reach stores, what their other options are along the way, and how they cross-shop other locations to get the offer right.

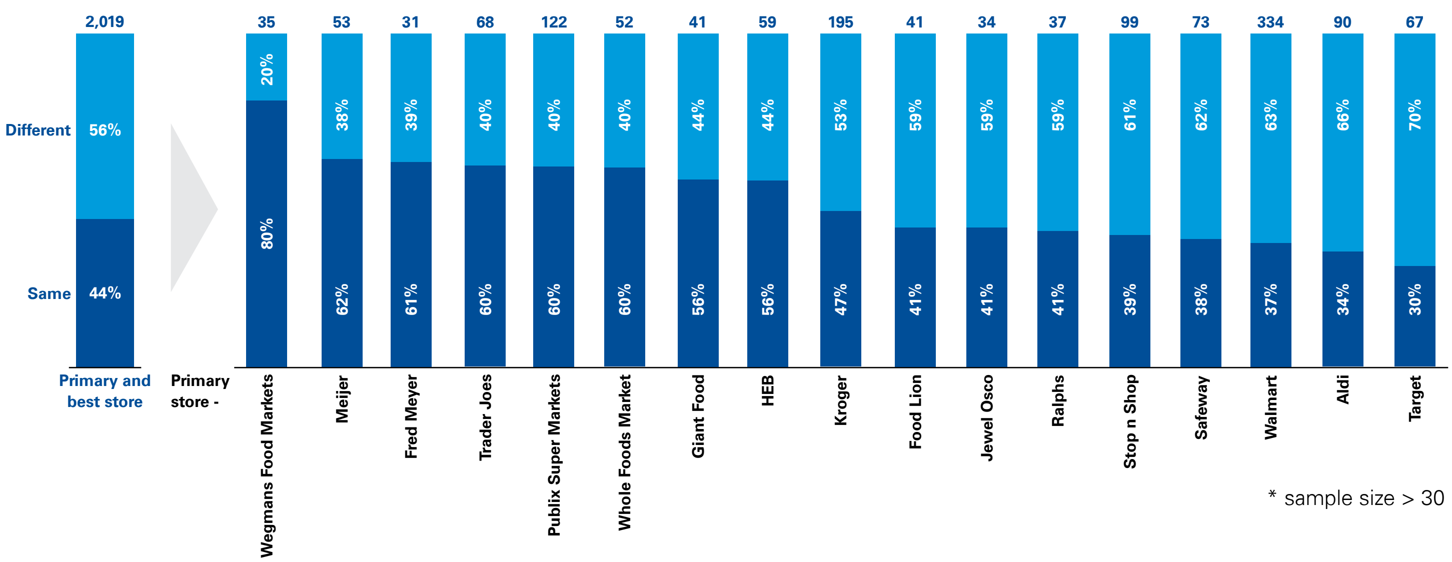
At KPMG, we call this a consumer-based value proposition, where we use advanced analytics and machine learning to identify an optimal offer in the marketplace along with when and how the consumer chooses a store to inform the most engaging mix for a consumer, store, region and category.

Why is this important? It's clear the competitive landscape is more crowded and less differentiated than it was before. Interestingly, our research shows that consumers perceive fairly marginal differences in the highest and lowest performers.

Adapt to consumer behavior, not preference

We also found that less than half the time, a consumer's primary store is not their favorite store. So, while the differences are marginal today, they are just enough to hold consumers captive for their primary shop. This also means that small improvements in a retailers' value proposition could have a big impact. Some retailers have as much as 80 percent of their primary shoppers claiming to prefer a different store (the average is 55 percent). Therefore, there is a lot of room for attrition if the value proposition is not strengthened, as well as a lot of opportunity for growth with the right improvements.

Headroom with existing consumers



Q - Which store do you consider your primary shop?

Q - Which store do you like best?

Source: KPMG 2018 Grocery Retail Consumer Perception Survey

For the average grocery retailer, more than half of their primary shoppers say they prefer a different store. If retailers strengthen their consumer-based value proposition and make the right improvements, they can position themselves for growth and opportunity.

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Pinpointing opportunity

Consumer-based value proposition

Using our unique datasets and tools, we can quickly identify the gaps in consumer value proposition at a store level, and how much it could be worth to close the gap. In this case, our client's store had tough competition. Taking that and the type of consumer into account, we were able to identify a significant opportunity in the fresh foods and big basket shops by using advanced analytics and geo-spacial analysis. Price turned out to be the main issue.

Invest in the value proposition

In many cases, it may be too expensive to make direct investments in price or convenience to manage these risks and capture the opportunity. In such instances, our consumer-based value proposition focuses on the consumer level to identify where companies can generate the most success. This method does not rely on the traditional view of market price indices and ad comparisons, but develops the optimal offer for the consumer. When data is aggregated at a store, region, or chain level, this can reveal more efficient ways for a retailer to invest in their value proposition and seek to identify new offerings that create distinction while building margin. The key is to understand, for every consumer, what level of business is affordable to keep a consumer, and then how do they go about retaining them.

Look at cost in a different way

Traditionally, cost reduction strategies have focused on product unit-level costs, but we suggest looking closer at the consumer unit-level. By doing so, a grocery retailer can determine the costs behind servicing a particular consumer segment to provide them with relevant offers they value. For example, if a retailer's primary consumer base is mature and part of the "in-store crowd", it's less important to have an amazing online offer because our research shows that this consumer segment is not migrating online right away. Conversely, if a grocer serves "online pioneers" a young demographic that is growing, it's wise to focus more on providing compelling online offers customized specifically to this group.

Contemplate consumer cost

This requires a combination of financial analytics that translates unit costs into consumer-level costs with other metrics. In addition to understanding consumers historical buying behavior, a grocery retailer can gain other insights by looking at where the consumer lives, their travel distance to the store, how long it takes to get to other stores, how competitive the offer is, how much return shop that consumers do relative to others, how can that be improved, etc.

Manage cost to serve

Breaking down the current costs to serve the consumer as well as their lifetime revenue value will shed light on where to put more of your investment dollars. Instead of trying to tackle disruption by moving all of your business online, or having a click-and-collect option in every store, consumer segmentation enables a much more targeted and refined solution. One that matches up more expensive investments with the consumers that want and need to have them.

Mix it up to drive growth

In the current environment, it may take a mix of actions and strategic plans to drive revenue growth. It's no longer affordable to invest blindly in all areas at once. Determining which moves to make, with data-driven precision, enables taking action without breaking the bank.

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Price I pay

Consumer-led price architecture that goes beyond KVI matching

Automate, consumer-driven promotions plans to drive maximum traffic and efficiency

Establish the right mix of EDLP, mid-low items and personalized offers

Feeling good about shopping

Reinvent loyalty to drive greater efficiency and results

Reinvent the shopping experience to create more excitement and monetize your real estate differently

Create surprise and delight

The right product variety, quality, and availability

Identify the assortment for each geography and localize where efficient

Make bolder decisions on space allocation based on the consumer and competition in each store

Determine the adjacencies that are less obvious but impactful

Fix critical inventory and transparency issues

Ease of shopping

Work out the process kinks in consumer experience in both click and collect and delivery

Determine the new labor model - both costs and processes

Insights in action

Delivering promotional performance

A leading regional grocery store chain with over 100 stores faced increasing competition and shrinking margins. Their same-stores sales had been decreasing and they were looking for ways to lower prices but their promotional program was ineffective.

Collaborating closely with the grocer, KPMG established a sales baseline for 50,000 products to gain a true understanding of promotional performance on individual and aggregate levels. The team created reporting for both store executives and merchants to inform better decision making and tracking, which revealed a potential $15 million in value capture.

Working with KPMG to leverage analytics that determine the margin impact of each individual promotion and the drivers of that margin (specifically the cannibalization pull forward and halo driven by each) the grocer generated a 5 percent improvement in EBITDA in incremental margin within the first year. By creating a reporting suite, the grocer and its merchants were able to track actual savings relative to targets, make analytics-based decisions, and continue to drive savings after the project. Additionally, the KPMG team integrated analytics into the grocer's IT environment and provided training to sustain a new and more effective promotions process.

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How to execute

Find efficiencies in today's successes

Understanding consumers at a granular level and taking action on that understanding through personalization or localization will almost certainly require some investment. When it comes to funding this investment, we recommend that grocery retailers start by finding efficiencies in what they are doing today. For instance, many retailers pride themselves on their promotional plan, and yet we routinely identify savings of anywhere from 5 to 15 percent in margin improvement to be captured in less than a year by improving the promotions that are being run to be more consumer-centric and better at driving margin. All too often, the plan for consumers starts with what the retailer can afford instead of determining what is required to win the consumer and then figuring out how to afford it.

In summary, we have good evidence that the consumer is changing their behavior and this will continue into the future. And yet, adapting the shopping experience and value proposition to attract consumers is not easy and can get expensive. We see many grocery retailers currently have some sort of online offering, but the right execution and level of investment they put into it, what type of offer, and when and how they phase it in, depends on the consumer segments they serve. However, what is almost certain is that the earlier a retailer takes action and gets started in crafting this new formula, the better.

It's important to take action. Consider these next steps on how to move forward:

Create a consumer data-driven culture

Knowing your consumers better is not exactly a groundbreaking revelation. But it is a simple truth that works well, and it is often overlooked. And by gaining a deeper and more detailed understanding of consumers, retailers can service them better and compete in new ways.

Match investments with consumer needs

Understanding consumer needs is key to providing personalized relevant service in an affordable way. It is fairly easy to create a generic playbook of actions to drive growth, but to do so affordably in this environment requires knowing exactly where to deploy offerings, and how much to invest in each program, consumer, and store. This enables retailers to create a data-driven strategic approach for the future.

Innovate in store and out

Apply new thinking and experiment with your in-store strategy. Shopping in-store should be as easy and perhaps more fun, as shopping online, but this takes some effort to get the experience right. Coordinate it with your online offerings to create superior experiences that keep targeted consumers coming back.

Seize the advantages of advanced technologies

Explore the potential of new technologies such as AI and machine learning by making wise investments (small or substantial) that meet the wants and needs of the consumers being served.

Personalize perspectives

Targeting consumer segments with enhanced personalization can be an expensive investment, which is why investments should be made in conjunction with unit economic analyses. Realize new strategies may require taking a longer-term view on profits so be willing to let go of the traditional focus on week-to-week sales spikes.

Deploy a custom strategy

Avoid delegating business or jumping on the bandwagon of what others may be doing. Following a "me too" investment strategy does not focus on the preferences of consumer segments and may not be worth the investments.

Move forward now

Disruption waits for no one. Doing nothing or taking a wait-and-see approach is risky and may leave a retailer too far behind to catch up.

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Anticipate tomorrow. Deliver today.

KPMG Strategy combines rapid analytical capabilities, leading edge tools, and deep industry knowledge to produce value-based insights for our clients. Many of our strategy leaders have served as both consultants and operators within retail organizations so we know we can turn complex analytics into practical strategies for the store.

We are uniquely positioned to help you:

1. Understand what type of consumer base you are serving and how it varies by region and store group so that you know how quickly to adopt new technology and business models.
2. Identify where you have stores that are underperforming given the consumers they serve and the competitors in that market. We also know how to help you design solutions so that there is no longer underperformance.
3. Applying consumer-level insights to create actionable pricing, promotion, assortment, and store service plans.
4. Identify inorganic growth strategies — whether new uses for your store real estate, data monetization, or mergers and acquisitions. We have experts in each area who can guide you through the process.
5. Implementing the new processes and technologies that you need to succeed in this ever-changing environment.

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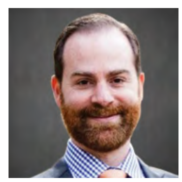
Katherine is a principal in KPMG Strategy with over 20 years of experience in consumer analytics as both a consultant and practitioner, focused in the retail and consumer sectors. She specializes in using insights to drive transformational growth strategies across a range of topics such as consumer strategy, pricing and promotions, localized assortment and differentiation, personalized communications, and loyalty strategies. She has led major engagements with grocery retail clients of all sizes in North America, the UK, and Ireland.



Adam Goodliss

Adam is a director in KPMG Strategy with over 10 years of professional services and consulting experience focused on the retail and consumer sectors. Adam has worked across a broad range of issues in grocery retail and specializes in all aspects of merchandising strategy and analytics, including optimizing promotional programs and trade spend strategies, COGS improvement, vendor negotiation strategy and analytics, space allocation, supply chain, and consumer analytics.

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