Executive Insights

The Future of Ecommerce in Food and Beverage

Food and beverage (F&B) ecommerce activity has seen an unprecedented increase, especially during the COVID-19 pandemic, as lockdowns and other restrictions forced consumers to purchase more products online than ever before. The number of U.S. households that bought groceries online more than quadrupled between August 2019 and October 2021, from 16 million[1] to more than 64 million.[2]

Now, as vaccinations become more widespread and brick-and-mortar restrictions continue to ease, F&B manufacturers and investors need to devise comprehensive ecommerce strategies that will enable them to maximize the opportunity offered. That includes outlining the capabilities necessary to capture the organic and inorganic surge in demand, as well as evaluating any profit improvement levers to ensure growth.

Navigating the four ecommerce channels

Prior to the onset of COVID-19, ecommerce accounted for roughly 3% of all U.S. grocery retail sales. But that figure grew to 8% in 2020 as more consumers shifted spending online. And the trend is expected to continue. The Mercatus Center at George Mason University expects that some 20.5%, or $263 billion, of retail grocery sales will be through online channels by 2026 (see Figure 1).

There are four primary ecommerce channels for F&B: click and collect (led by Walmart+), retail grocery delivery (led by Amazon, including Whole Foods), concierge services (led by Instacart) and direct-to-consumer (DTC). Ecommerce is not captured by scan data and is an "unmeasured" channel; therefore, market share estimates vary widely. In 2021, the big players are Walmart, Amazon and Instacart, with each holding an approximately 30% share of the ecommerce market.

1. Click and collect (led by Walmart+)

This is where consumers purchase goods online through retailer apps/websites and then go to physical stores to pick them up. Curbside pickup was already gaining share before COVID-19 hit, but with the onset of pandemic-related restrictions, it gained even more traction among retailers and consumers alike due to its contactless nature. Walmart+, for example, had as many as 8 million subscribers[3] by February 2021, though it has lost some of that share more recently.

Click and collect is also likely to continue growing once the pandemic is behind us, as grocery retailers have an incentive to invest in this channel to keep their store footprint relevant while consumers pick up the tab on the last mile. Indeed, data from Brick Meets Click shows that from August 2020 to August 2021,[4] curbside rose from 36.6% of active users to 54.7%.

In the meantime, curbside's increased adoption has led retailers to develop micro-fulfillment centers[5] to efficiently manage ecommerce sales with automated systems (e.g., robotic picking) in existing store footprints. Moreover, U.S. consumers like to drive

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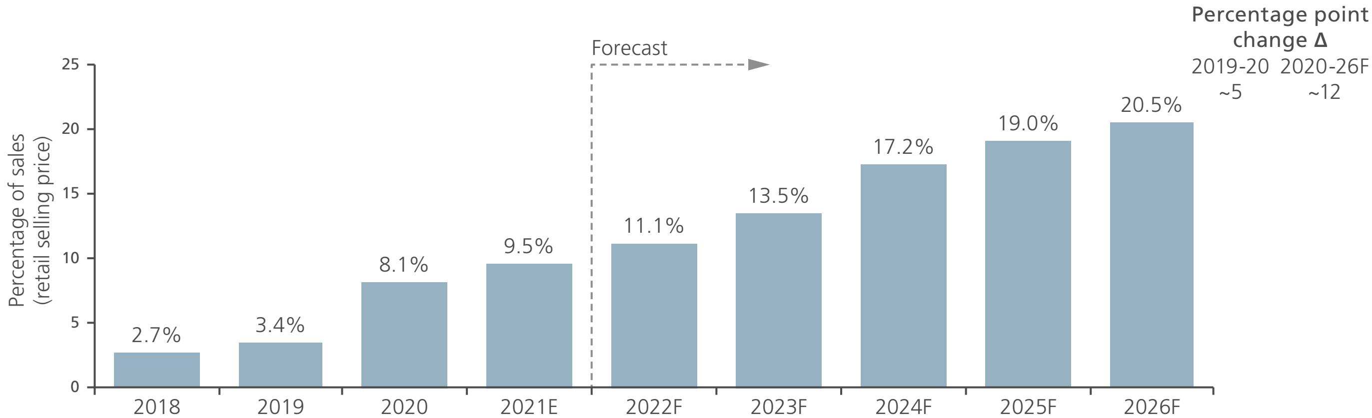
Figure 1

Ecommerce penetration of US grocery sales



	2018	2019	2020	2021E	2022F	2023F	2024F	2025F	2026F
Total grocery sales ($B)	$993	$1,016	$1,137	$1,097	$1,124	$1,158	$1,187	$1,225	$1,285
Ecommerce sales ($B)	~$27	~$35	~$92	~$104	~$125	~$156	~$204	~$233	~$263

Source: Mercatus; Supermarket News; L.E.K. research and analysis

their cars, so as restrictions ease and they return to work, it will be more convenient for many to schedule pickup at a time that works for them (e.g., on the way home from the office) as opposed to worrying about the exact timing of home-delivered groceries.

2. Retail grocery delivery (led by Amazon)

Although a single retailer, due to its size (largest store in the world) and uniqueness, Amazon is worthy of being managed as its own channel. In 2017, it bought one of the largest grocers in the U.S.: Whole Foods. Today, customers can buy groceries from Whole Foods through Amazon.com (for shelf-stable items, with Subscribe & Save for scheduled auto-deliveries), Amazon Fresh (typically for same-day delivery) and Prime Now (via local Whole Foods locations only, and free for Prime subscribers). Notably, Amazon announced in June that it would shut down its Prime Now platform by the end of 2021 and consolidate the grocery traffic to its Amazon website while maintaining the same two-hour delivery window.

In the meantime, while online grocery was already one of Amazon's fastest-growing businesses before the COVID-19 pandemic, those sales surged once lockdowns were put in place, tripling in the second quarter of 2020 alone. Since the start of the pandemic, Amazon Prime has added an estimated 50 million subscribers.[6] In response, it has increased grocery delivery capacity by more than 160% and tripled its number of grocery pickup locations.

3. Concierge services (led by Instacart)

These are third-party delivery operators that allow consumers to purchase groceries online from a range of banners. "Shoppers" then select the items from existing brick-and-mortar locations and package them for home delivery. Instacart, which claims an estimated 30% share[7] of the online grocery delivery and pickup market, partners with some 600 national, regional and local retailers, covering 85% of U.S. households.

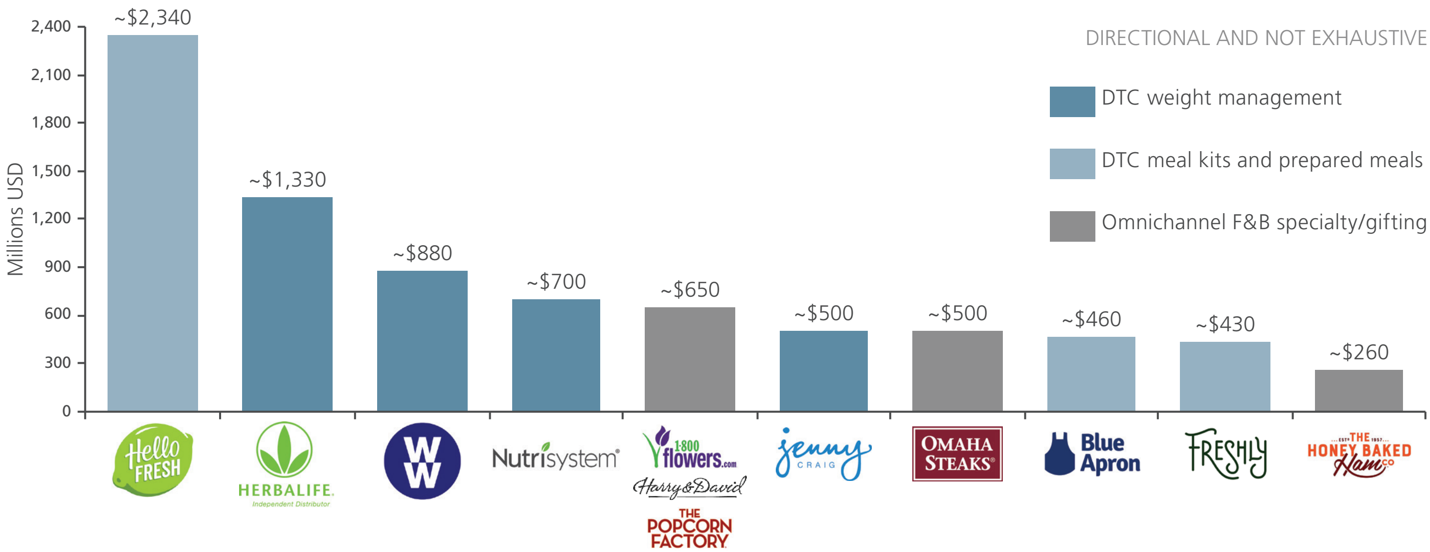
But other established delivery services have been expanding into grocery delivery as well. DoorDash has inked partnerships with the Meijer, Smart & Final and Fresh Thyme chains, while Uber is teaming up with Gopuff to offer delivery of convenience store and grocery items in 95 U.S. cities. Concierge services experienced explosive growth during the early days of the COVID-19 pandemic. Instacart, for example, said it saw five years of growth in just five weeks, and grew by more than 300% year over year.

4. Direct-to-consumer

DTC, where consumers order products directly from brands, is a bolder channel choice for F&B manufacturers as it requires more investment and marketing to support its growth than do the other online channels. But it can also provide the most upside, retaining the value that is captured by intermediaries in other segments. As the pandemic was starting to make its way around the globe, annual sales of some of the most successful DTC and omnichannel players were already topping $500 million (see Figure 2).

Several large F&B manufacturers have launched DTC websites to sell their own products in addition to offering them through other channels, among them Pepsi and, in the U.K., Kraft Heinz. Even

Figure 2
US revenues of select DTC and omnichannel brands (2020)



Note: For private companies, revenue estimates are derived from secondary sources; 1-800-Flowers includes revenue from food gifting brands (i.e., Harry & David, Popcorn Factory) only
Source: Winsights Grocery; The Food Institute; Forbes; Inc.; Digital Commerce 360; Planet Lean; Biz Journals; L.E.K. interviews, research and analysis

foodservice distributors, such as Sysco, expanded into DTC during the pandemic to find additional revenue opportunities.

The potential of ecommerce has come into focus

Now, after more than a year of pandemic-related tailwinds, the potentially immense payoff that F&B manufacturers can realize by successfully expanding their ecommerce presence has never been clearer. Maximizing the potential of ecommerce requires that they take the following four key steps:

Step 1: Develop an ecommerce strategy

F&B manufacturers need a comprehensive ecommerce strategy that includes a strategic vision, a BHAG (big hairy audacious goal) and an outline of capabilities necessary to execute along with a thorough evaluation of any profit improvement levers they have to ensure profitable growth. The plan should clearly address how to navigate the four ecommerce channels and how to approach key capabilities (e.g., fulfillment) through building, partnering with or acquiring key enablers. And regardless of the strategic elements that they decide to incorporate, F&B manufacturers should develop a resourcing plan to fully support the broader ecommerce strategy and ensure its success.

Step 2: Organize for success

For business to expand in ecommerce, dedicated resources are essential. Many manufacturers establish stand-alone ecommerce capabilities (across people, processes and technology) that utilize specialized channel knowledge to create best-in-class solutions. Sam's Club and Walmart, for example, each have separate CEOs and supporting organizations for their respective ".com" businesses.

If ecommerce is new to the organization, this will also require a significant talent acquisition effort, but bringing in outside talent can often be the best option for success. The result of successfully organizing around ecommerce is that the speed at which decisions are made is much faster than it would be otherwise. For example, price changes can be made multiple times a day online versus over multiple months in a brick-and-mortar environment.

Manufacturers that sell through Amazon will also need to decide whether to manage the channel via a first-party (1P) or third-party (3P) relationship. If they choose to work with a 3P, they'll need to decide whether fulfillment should be handled in-house or through a partner. These decisions have tremendous implications for a business's cost structure and ability to scale online.

Having a 1P relationship allows larger brands (e.g., more than $100 million of Amazon sales) to benefit from traditional brand/retailer relationships and requires only moderate capabilities to manage Amazon's unique inventory flows. Having a 3P relationship with self-fulfillment requires the most investment to build out or leverage the brand's existing fulfillment capabilities. It also enables full control over operations (e.g., brand content, shipping, pricing, customer service) and the economic benefits of traditional retail DTC.

Finally, a 3P relationship with partner fulfillment is best suited for smaller brands because they can leverage outsourced fulfillment capabilities to provide cost-effective paths to meet demand and scale their online business.

If an F&B manufacturer has a DTC element in its ecommerce strategy, even more radical changes are required. Well-run DTC organizations operate quite differently than traditional F&B suppliers; they run at a much faster speed and require more nimble decision-making. Most important, DTC organizations need to find a way to get eyeballs to their websites in order to drive traffic and volume.

This is no easy task. The ability to drive traffic is the main barrier for many F&B suppliers looking to unlock their DTC potential. Creative content is required to give consumers a reason to frequent the site, which is often specific to the community of consumers it serves (e.g., gluten intolerant, veterans).

Omnichannel is another great way to drive traffic. For example, wineries and their tasting rooms can be used as the "hook" for club consumers, while meal kit providers can partner with retail brick-and-mortar grocery to drive mindshare through in-store merchandising and displays.

Step 3: Establish ecommerce price pack architecture

For many F&B manufacturers, the accelerating shift from in-store to online sales has serious profitability implications, as ecommerce runs the risk of being the lowest-margin channel, with high last-mile delivery costs and greater price transparency. All this can lead to a "race to the bottom" with more frequent price changes than occurs with brick and mortar.

Whereas in-store sales in channels like convenience stores tend to skew toward more lucrative single-serve products (e.g., $1.79 twenty-ounce soft drink), online sales tend to skew more toward lower-margin multipacks. Single-serve products can generate huge margins for manufacturers, as a desire for immediate consumption means consumers tend to forgo making price comparisons with other products. Moreover, last-mile shipping for F&B products — especially beverages — is expensive, and pricing transparency helps create that race to the bottom as retailers and manufacturers fight for share.

With that in mind, F&B manufacturers need to develop an ecommerce price pack architecture (PPA) strategy and a granular view of where profits are generated across their categories, products and SKUs. Such granular profitability analysis will enable them to have a deep understanding of which parts of their business should be strategically prioritized when they're investing to support ecommerce. Without this understanding, manufacturers may find themselves rushing to increase top line sales as their margins quickly erode underneath.

Developing a PPA strategy is critical to establishing channel "swim lanes" in order to reduce price comping by retail partners. A PPA strategy involves balancing consumer, retailer and supplier needs so as to strive for a win-win-win situation. This requires understanding the consumer's willingness to pay (through advanced discrete choice conjoint science) versus the cost to produce at the attribute level (e.g., size, count, claims, price). A well-established PPA strategy will enable tweaks to the offering (e.g., size, count, claims, price) by channel to reduce the profit erosion threat from price comparisons across channels.

To help stave off the race to the bottom, some brands should also establish a minimum advertised price (MAP) to protect against deflationary price pressures. But it should be done with surgical precision. Not all brands lend themselves well to a MAP policy; enforcement of MAP can be tricky and must be a commitment, with trade-offs to be weighed.

Finally, to optimize trade spend and drive sales toward strategically important categories, the management of trade promotions is essential. Trade spend is typically the second-largest cost item for beverage manufacturers after cost of goods sold, so the costs associated with not effectively deploying that capital are significant. Many manufacturers employ robust trade management tools that can optimize trade spend based on pricing elasticity and advanced analytics.

Several platforms utilize visualization techniques to model consumer behaviors and generate strategic insights. For example, Eversight's Offer Innovation solution allows retailers and manufacturers to micro-test thousands of different promotions with real shoppers on digital platforms so they can use those results to build best-in-class promotion strategies. Indeed, manufacturers need to utilize the latest platforms to ensure their trade spend aligns with high-margin and value-accretive products, and that it's properly driving purchasing in those categories.

Step 4: Optimize the digital shelf

The digital shelf presents a double-edged sword to F&B suppliers. On the one hand, there are no limitations to what can be displayed on the shelf. On the other hand, it can be hard to get noticed in the digital sea of product proliferation. Attracting attention on the digital shelf requires a different set of resources and capabilities that manufacturers need to embrace. Getting the "blocking and tackling" right is critical to success.

Key elements of optimizing the digital shelf include ensuring:

- Product titles include keywords but are still clear and readable
- All images are clear and high quality, conveying both product count and notable benefits
- Product descriptions include key facts, nutritional information and relevant keywords

Additionally, there should be a minimum of 25 product reviews four-star or higher (out of five) to leverage search rankings; reviews also impact offline sales. And although brands do not have control over pricing, they should monitor prices as retailer algorithms can price-match incorrect SKUs, resulting in prices that are either too high or too low.

Blocking and tackling resources are also needed to manage product images and related content online. Multiple images, in-depth descriptions and videos can help drive consumer engagement, while managing online reviews is equally critical. So is the ability to manage trade and promotions online.

For example, digital coupons have become critical to online success. In April 2021, digital coupons overtook print circulars in redemption for the first time in history. Digital load-to-card coupons comprised just 4% of distributed coupons, but redemptions increased to 29% in 2020, despite overall coupon redemption falling by 21%. Total coupons distributed decreased 15%, with free-standing inserts comprising 90% of distribution and just 28% of redemption in 2020.

This means the conversion rate from distribution to redemption in digital coupons is much higher than in paper. Surveys indicate the uptick was driven across all age groups, with the strongest growth coming from baby boomers. Clearly F&B manufacturers need to embrace digital coupons and other digitally savvy promotion techniques to drive ecommerce growth for today's consumer.

Post-pandemic ecommerce will not look like pre-pandemic ecommerce

The disruption to retail that the COVID-19 pandemic set in motion — and, by extension, to consumer behaviors more broadly — is unlikely to be matched again in our lifetime. Few consumers are likely to return entirely to their pre-pandemic F&B shopping habits as they continue to take advantage of the convenience that ecommerce affords. With that in mind, F&B manufacturers and investors alike need to devise comprehensive ecommerce strategies to maximize this opportunity by outlining the capabilities required for growth and comprehensively evaluating profit improvement levers to ensure the growth is value accretive.

Endnotes

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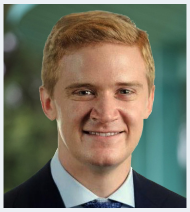

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