Can Traditional Grocery Get It Right?

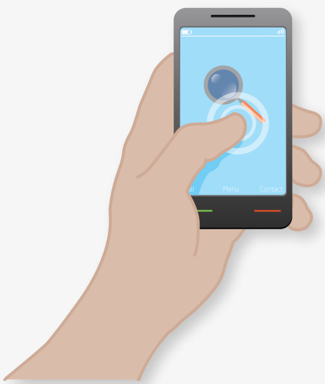
THE INDUSTRY'S LATEST CHALLENGE: DECIDING IF AND HOW TO BUILD AN OMNICHANNEL EXPERIENCE

It's been a tough 20 years for traditional grocers. Burdened with razor-thin margins and limited investment in consumer research and innovation, the industry's traditional stalwarts have seen themselves slowly fall victim to a variety of specialized players—from Walmart in the '90s, to Whole Foods, Trader Joe's, Aldi and dollar stores more recently.

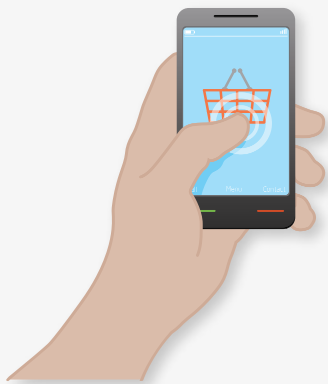
During this time, traditional grocers' share of grocery spending has dropped from 90% in the late 1980s to under 50% today. And this share decline has not yet bottomed out. Omnichannel is just the latest in a series of challenges for undifferentiated middle grocers. In fact, 96% of consumers said they planned to purchase groceries from a non-traditional food retailer in the next 12 months.

This industry pressure has led to a flurry of acquisition activity as a mechanism for traditional grocery chains to either drive growth or stay relevant. Take Safeway's recent sale to Cerberus Capital, following on the heels of Supervalu selling five of its chains to a consortium of private equity buyers, Kroger's acquisition of Harris Teeter, and Great Atlantic and Pacific Tea Company's continued hunt

EXHIBIT 1: Many Consumers Search for and Purchase Groceries Online



67%
of consumers search for grocery information online



But only **26%**
of consumers purchase groceries online

Source: Kurt Salmon Consumer Survey

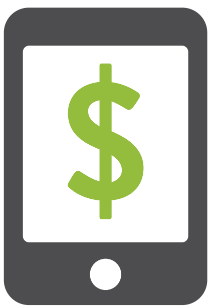
59% of consumers surveyed said they'd be likely to use online searchable store inventory, but only 8% of grocery stores currently offer this omnichannel service.

for potential buyers. Now, this undifferentiated middle group of grocers faces a new threat in the form of online retailers like AmazonFresh, eBay Now, Instacart, Peapod and even Walmart.com.

The way it looks now, traditional grocers are on the verge of losing the next major grocery battle: omnichannel. In fact, traditional grocers are currently staring down a huge chasm between the omnichannel services they're providing and what their consumers want and, increasingly, expect.

According to a 1,400-person consumer survey conducted by Kurt Salmon in 2014, 67% of consumers have searched for grocery product information online, while 26% of consumers have purchased a grocery-related product online. (See Exhibit 1.) And 48% and 33% of these online consumers are researching and purchasing, respectively, using a tablet or mobile device.

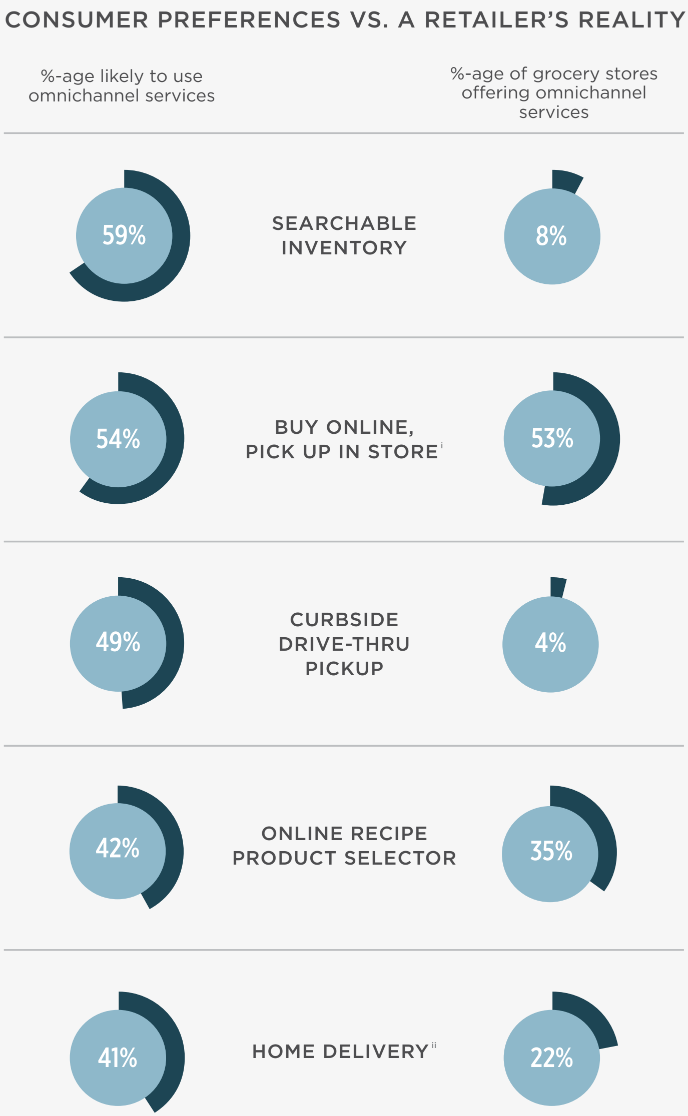
Beyond basic searching and purchasing online, consumer demand is growing for additional value-added services—and, if implemented, grocers would likely benefit from increased sales and loyalty. For example, 59% of consumers surveyed said they'd be likely to use online searchable store inventory, as illustrated in Exhibit 2, with 39% saying they'd purchase more from a grocer who offered that service. Plus, 54% of consumers would be likely to use buy online, pick up in store services, with 33% saying it would lead them to purchase more.



But despite this growing consumer demand, most traditional grocers are just beginning to implement these types of omnichannel offerings. In a Kurt Salmon study of nearly 50 large grocers, only 8% offered searchable online inventory, and just 53% offered buy online, pick up in store ability.

So how can traditional grocers fight back and gain both more alignment with their consumers' wants and some much-needed differentiation? First, they need to invest in developing a robust, unbiased understanding of their core consumers. Many grocers skimp on gathering consumer research, instead relying on their category captains to provide insights on a category-by-category level through a traditional category management relationship. Of

EXHIBIT 2: There Is a Large Gap Between Consumer Demand and Current Grocery Offerings



[i] Majority of these grocers are offering this service for just a limited product selection such as deli, bakery and floral orders.
[ii] Many of these grocers are piloting this service in select geographies or utilizing a third-party partner.
Source: Kurt Salmon Consumer Survey

Traditional grocers still have time to get it right and drive loyalty by directly responding to their consumers' unmet demands and building a compelling, customized omnichannel experience.

course, these supplier-based insights can not only be incomplete or biased, but, more importantly, they offer a disjointed view of a grocer's consumers across the entire consumer experience.

Next, armed with action-oriented consumer insights, grocers need to put them to use through a rapid innovation process, one that enables them to constantly identify and cheaply test promising ideas, rolling out the ones that work more broadly and moving on from the ones that don't enhance the consumer value proposition and the grocer's bottom line.

The gauntlet has been laid down whether grocers decide to act or not. But as the middle ground of grocery gets increasingly squeezed by discounters, specialty players and online innovators, traditional, undifferentiated grocers will soon have even less room to play. Enter omnichannel, which represents a significant opportunity. Traditional grocers still have time to get it right and drive loyalty by directly responding to their consumers' unmet demands and building a compelling, customized omnichannel experience. ❖

AUTHORS

Bruce Cohen, Senior Partner and Head of Private Equity and Strategy Practice
bruce.cohen@kurtsalmon.com

Dan Goldman, Senior Manager

Promising Investment Opportunities in the Grocery Space

HISPANIC GROCERS

These grocers will benefit from growth in the Hispanic population, which is expected to hit 30% of the U.S. population by 2050. In addition, Hispanic families spend more on packaged goods and food at home than non-Hispanics, driven by larger household size and active cooking habits.

NORTHGATE GONZÁLEZ MARKET. This ~$800 million, 42-store chain is centered in Southern California, with a recent acquisition helping it expand into Arizona. The grocer is family owned.

LA MICHOACANA MEAT MARKET. The grocer has 117 Texas stores and sales of ~$118 million and is owned by its founder, Rafael Ortega.

FOOD CITY. Owned by Bashas', a family-owned Arizona grocery chain that filed for bankruptcy in 2009, Food City has 42 stores in the Grand Canyon State.

Private equity firms looking to invest in the grocery sector should seek to identify evolving consumer needs currently unmet by traditional grocery's approach of trying to be everything to everybody. A consumer needs-driven gap assessment can highlight a plethora of compelling investment opportunities. Here are a few of the more promising consumer niches and players.

ASIAN AND SOUTHEAST ASIAN GROCERS

One of the fastest-growing population groups in the United States, with 51% growth between 2000 and 2012, Asian Americans have an average household income that's 28% higher than the U.S. average. Plus, Asian groceries can have broader appeal among gourmet shoppers of all ethnicities as the popularity of many Asian cuisines expands.

99 RANCH MARKET 大華超級市場

99 RANCH MARKET. With over 30 stores, most in California and others in Nevada, Washington and Texas, this grocer targets premium suburban locations with large Asian populations.

PATEL BROTHERS "Celebrating Our Food.... Our Culture"

PATEL BROTHERS. This family-owned Indian grocer has 52 stores in 19 states across the East Coast and one store in California. It's uniquely positioned in the Indian grocery space, which has few major players and is dominated by local single-store operations.

H MART

H MART. A Korean American–focused supermarket with 43 locations across the United States, most of its locations are on either coast. It also opened its first European store in England in 2011.

GOURMET AND SPECIALTY GROCERY

Taking advantage of the growing foodie movement, specialty grocery sales have grown at a 14% combined annual growth rate from 2010 to 2012, to $88 billion. These stores are also well positioned to capitalize on growing movements toward local and artisanal gourmet options and can create a unique customer experience.

DEAN & DELUCA

DEAN & DELUCA. This upscale grocer has broad international name recognition—35 of its markets and cafés are international (Japan, South Korea, the Middle East)—meaning it has significant expansion potential in high-end neighborhoods and tourist locations alike. The grocer, which is owned by its founder, also acquired Northern California–based Oakville Grocery in 2007.

Bristol Farms
Your Extraordinary Food Store

BRISTOL FARMS. With only 15 stores, primarily in Southern California, this $200 million gourmet grocer has significant white space potential. It was acquired by Endeavour Capital from Supervalu in 2010.

Citarella
THE ULTIMATE GOURMET MARKET

CITARELLA. A grocer and a seafood importer, wholesaler, and restaurant, Citarella has five New York City–area doors and is family owned.

LOCAL AND SUSTAINABLE

U.S. sales of organic products are projected to reach $35 billion in 2014, up from $28 billion in 2012, according to the USDA. And the number of U.S. farmers' markets has shot up 364% from 1994 to 2013, further demonstrating consumer interest in this growing category.

NEW SEASONS MARKET. This ~$60 million natural grocer is based in the Pacific Northwest, where it has 13 stores. It also acquired California-based New Leaf Community Markets in 2013, giving it a compelling path to continued growth.

MRS. GREEN'S NATURAL MARKET. A 100% natural and organic market based in the Northeast, it has 20 stores and is projecting 18 additional openings this year—with a target of 100 stores. The chain is part of Natural Markets Food Group, which is owned by Catalyst Capital.

FRESH THYME FARMERS MARKET. This grocer opened its first store in the Chicago suburbs in April 2014, but it has already identified 22 additional locations and wants to hit 60 stores across 12 states in the next five years. Headed by Chris Sherrell, who launched and sold Sunflower to Sprouts, it is backed by investors from Meijer.