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At a typical suburban home in the year 2020, Cecilia receives a text message from her favorite grocery store. It's a reminder that the family-sized box of cereal she or her husband, Andrew, typically buys every two weeks might be running low. In fact, she poured the last bowl for her son this morning. She adds the item to the family's virtual shopping basket with a simple voice command. She then reviews and confirms the rest of the staples in the basket—coffee, bananas, chicken, bread, milk, and diapers—and texts Andrew to remind him to pick up the groceries on his way home.

Two days earlier, in anticipation of her family's typical weekly shopping trip, night-shift employees at the store had gathered the long-shelf-life items from Cecilia's virtual basket in the backroom. Now, triggered by Andrew's arrival in the parking lot, the pickup counter employee adds the perishable items. When Andrew enters the store with his reusable jars and containers, he is greeted by a professionally trained chef, who offers a dinner menu suggestion based on the chicken breast in his order and a few seasonal vegetables delivered to the store by a local farmer that morning. Andrew has her scan a prepackaged box of ingredients and place it in his cart. As he heads toward the pickup counter, he grabs a bottle of wine recommended by his frequent shopper store app. Just 15 minutes after he arrived, Andrew heads out of the store with the bulk of his family's grocery needs, plus a few special items.

For traditional grocers, this tailored and engaging customer experience harks back to the days before the self-service model came to dominate the industry. It's only in the last century that supermarkets have relied on customers entering their stores, wandering the aisles, and largely helping themselves. But reestablishing a customer-centric approach today is possible, and it won't require a technological breakthrough in hardware or software. All the pieces exist. It will, however, require a fundamental rethinking of the customer's grocery shopping experience, as well as the supply chain and store operations to support it.

At first glance, the prospects for supermarkets may not seem dire. Overall, groceries remain an exception to the impressive growth of Internet retailing over the past two decades. According to estimates by Brick Meets Click, online grocery sales in the U.S. currently hover just above 3 percent. In the United Kingdom, which has among the highest penetration rates, research by Kantar Worldpanel puts the share at only 5 percent. PwC's 2014 Achieving Total Retail survey of more than 15,000 online shoppers worldwide reported that only 13 percent of consumers shop online for groceries, compared with 32 percent of consumers in all category purchases. A 2014 Nielsen survey found that 74 percent of shoppers believe that shopping for groceries in the store is more convenient than shopping for them online. And the industry lag is

Illustration by Lars Leetaru

not driven just by deeply ingrained consumer habits and preferences. The grocery category itself presents challenges to an online model—for example, product perishability, temperature-controlled ("cold chain") distribution requirements, and items with a low value-to-weight ratio.

However, the competitive dynamics are changing, especially in the United States. Online competitors want to claim their share of grocery sales, which account for roughly half of U.S. retail spending. Our forecasts suggest that over the coming decade, growth will be flat or will decline across all grocery formats except online, which will have double-digit growth rates. Amazon established Prime Pantry as a national subscription program for dry goods and expanded AmazonFresh from Seattle to Los Angeles and San Francisco; expansions to Washington, DC/Baltimore and New York/New Jersey are rumored to be in the works. Not to be outdone, Google has announced a US$500 million "war chest" to support Google Shopping Express, which delivers products from retailer shelves—including groceries—to customer homes.

Because online players can provide more variety than a physical store, clinging to the self-service model is fruitless for traditional grocery stores. To survive and thrive in the coming decade, supermarkets need to return to the customer-centric mind-set of old—while leveraging the digital tools of today.

History Repeats Itself

Nearly a century ago, Piggly Wiggly and other regional chains began experimenting with the self-service format and ushered in the modern grocery industry paradigm: an ever-increasing selection, in ever-larger stores. Prior to this model, however, small general merchandise stores served customers dry goods and other nonperishable staples at a counter typically staffed by no more than two or three clerks. Located within neighborhoods and small communities, these stores also delivered goods to their customers (often on credit, because the store owners personally knew their clientele).

The self-service innovation marked the first step in the transition away from service-based to price-based competition. The second step was the nationwide expansion of grocery chains, designed to capture the scale benefits in purchasing. During the 1920s, these chains began stocking perishable meats and produce, but the first modern supermarket didn't come into existence until 1930. That year, Michael Kullen opened a massive store, King Kullen, on the fringes of New York City that was scaled to sell 100 times the volume of a typical chain store of Kroger or A&P, his former employers. The no-frills store housed within a former warehouse offered wider variety and rock-bottom prices.

Over the next 20 years, the national chains converted their small-footprint stores into the new supermarket format, generally reducing their overall store counts but expanding the average size of each store. In the 1950s and '60s, what today's shopper would recognize as a modern grocery store, with a mix of packaged goods and perishables, dominated grocery sales in the newly developed suburbs. Unfortunately, some of the behemoths of the industry failed to make a smooth transition. For example, A&P, a company dating back to 1859 and once the world's largest retailer, with nearly 16,000 stores, began a long decline in the early 1960s, ultimately declaring bankruptcy in 2010.

In the late 1980s, even the most successful grocery stores started to feel squeezed by the entrance of a new player. It was then that Walmart entered the grocery business with its first "supercenter." This Wall Street darling had achieved $1 billion in sales a mere 10 years after its 1970 IPO—faster growth than any company, in any industry, had previously achieved. Kmart, one of the former kings of discount retail (along with Sears), followed suit, but struggled to keep up as Walmart's growing scale advantages fueled further price reductions and a greater variety of offerings.

Other retail formats—most notably convenience stores and club stores—also emerged during the latter part of the last century, but as of the mid-1990s, supermarkets still controlled more than two-thirds of the grocery channel. Over the last 20 years, however, supermarket revenue growth in the U.S. has been flat in real dollar terms. Meanwhile, supercenter sales have grown nearly 7 percent annually—the lion's share going to Walmart. At

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48 percent, traditional supermarkets still account for the largest share of the grocery market in the U.S., but supercenters now have a 23 percent share and club stores 11 percent. Convenience stores retain the 14 percent of the market they had 20 years ago, but drugstores now capture 5 percent as they seek to own a larger share of wallet of their pharmacy customers.

That brings us to the present, with online behemoths such as Amazon entering the mix. And although the extra cost of delivery to the home adds expense in comparison with the self-service model, customer perception has shifted as Amazon and other online retailers tout "free shipping." (Amazon spends $6 billion on shipping while collecting only $3 billion in shipping fees—but it still makes a profit, albeit a small one.) Traditional supermarkets are feeling more pressure than ever, and from all directions.

Start with the Customer

The grocery industry recognizes that the same consumer will choose among the various channels available at different times for different needs. Thus, rather than segmenting by customer demographics, the industry focuses on trip types: the "stock up," the "fill in," and the "quick trip." Historically, supermarket chains sought all three trip types by building stores close to a critical mass of customers, with convenient parking. And although they understood that the same customer makes different types of trips, they inevitably hoped shoppers would impulsively buy more as they wandered the aisles regardless of their original intent. (Did you ever wonder why high-volume staples such as bananas, bread, and milk are typically in opposite corners of a grocery store?) Supermarket chains have thus been reluctant to aggressively pursue the online model, including curbside pickup. And for good reason: Academic studies such as the 2008 Harvard Business School working paper "I'll Have the Ice Cream Soon and the Vegetables Later: A Study of Online Grocery Purchases and Order Lead Time" have shown that the delays typical of ordering online reduce shoppers' impulse to purchase hedonistic goods.

But the emerging online subscription models—such as diapers from Diapers.com or Amazon Mom—turn the old approach on its head. They apply a customer-centric alternative by targeting the needs of a specific customer segment rather than seeking to be all things to all people. Having found a valuable segment, these online players focus on recurring "stock up" purchases and offer exceptional service to build a loyal customer base. Over time, they hope to offer a wider range of products through partner sites, whether personal hygiene products from Soap.com or grocery dry goods from Amazon Prime Pantry. A focus on such staples offers a successful entry point for emerging online grocery models as they seek to retrain supermarket shoppers. But these staples could also offer the foundation for traditional grocers to rethink the in-store shopping experience.

However, supermarkets can't do it alone. They will need to partner with the large brand manufacturers, which desperately want to move from the brute-force tools of mass advertising and trade promotion dollars to more precise techniques for consumer engagement. Although social media advertising has made steady progress in eroding investment in mass media, the real challenge for packaged-goods manufacturers is to wean their retail partners away from trade promotion, which exceeds $100 billion annually and represents the largest category of marketing spending. This is still the case despite the fact that a large percentage of trade promotions fail to deliver a positive return on investment.

These dollars could be reallocated to more targeted and profitable investments if the combined data of the retailers and manufacturers were leveraged. For example, global brands—including Coca-Cola, Kraft, Nestlé, and Procter & Gamble—have partnered with inMarket, a mobile platform, to provide in-store marketing via consumers' smartphones for nearly five years. And, using Apple's iBeacon feature, which was released in 2013, inMarket partnered with the Giant Eagle supermarket chain to beam ads in grocery stores in Cleveland, Seattle, and San Francisco. The ads generate tailored offers based on the customer's specific location in the grocery aisle.

Such spatial precision, combined with the wealth of data minable from retailer loyalty programs, producer websites, and social media, could enable an unheard-of degree of micro-segmentation. Our experience has shown that placing a product offer through collaboration with a retailer site increases the click-through rate by an order of magnitude over independent online placement. Imagine the potential of further collaboration to improve in-store digital engagement. And, as illustrated by the experience of Andrew above, digital tools can also enhance personal interactions in the store. The idea is to restore the lost art of service and personal engagement that the small-town general merchants offered before the era of the self-service grocery store.

A Tailored Supply Chain

Digital tools can personalize the grocery shopping experience, but the key challenge for traditional grocery stores is to cost-effectively transition away from the self-service model. The grocery supply chain has been designed to ship full truckloads containing pallets of cases for shelf display in a store—where customers do their own "picking." In online retailing, individual items are processed in fulfillment centers and aggregated for delivery to the consumer's home. Although the "last mile" of home delivery adds significant cost, bypassing the stocking of store shelves can create offsetting savings—at least in theory. That was the investment thesis of Webvan a dozen years ago, and it remains the dream of online grocers today (see "The Last Mile to Nowhere: Flaws & Fallacies in Internet Home-Delivery Schemes," by Tim Laseter, *s+b*, Third Quarter 2000).

Traditional supermarkets face the worst of both worlds if they don't rethink the supply chain. Delivery from the store or even curbside pickup of a grocery order placed online currently requires the incremental cost of an employee serving as a "personal shopper" to collect items from the shelves just as the customer would have done. That said, with some fresh thinking, grocers can cut needless costs. For example, why put high-volume staples such as toilet paper on the shelves for customers to sort through when they can be more efficiently packaged with other staples for customer pickup? What other products could be cost-effectively processed in the backroom of the store and picked up at a service counter, in the tradition of the local general merchant establishment in the days before the self-service supermarket?

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The packaging itself offers another potential opportunity. Amazon has already demonstrated the ability to rethink packaging in the purely online environment. Focusing on the customer experience, Amazon introduced its "frustration-free packaging" initiative in 2008. A key target was the heat-sealed plastic shells and wire twist ties common in consumer electronics. Traditional packaging simultaneously provides visibility of the product on the shelf and hampers shoplifting—neither of which is of concern to Amazon. In partnership with its suppliers, Amazon now lists 200,000 items as "frustration free." Suppliers have reported reduced costs, as the new packaging eliminates much of the dunnage and double handling previously used to secure the product for visual display.

Packaging for groceries on the store shelf needs to grab the consumer's attention in less than two seconds in order to trigger a purchase decision. It also must be designed for efficient handling in case quantities in the distribution network and for individual use in the home environment. For items ordered for in-store pickup through a subscription model, however, package design could focus on different parameters. If the item is packed in the backroom for pickup at a store service counter, it doesn't have to "pop" on the shelves, but it needs to be most easily "picked" at the item level.

The iQ Shelf Maximizer introduced by Campbell's offers a hint of what might be possible. Campbell's red-and-white soup can represents one of the most iconic brands in grocery, but it was stagnating a decade ago. Among other innovations, Campbell's developed a gravity-fed dispenser that reduced shelf clutter and allowed shoppers to find and grab the desired individual can. Such shelving could also simplify a store-based picking operation, but it doesn't go far enough in streamlining the full supply chain, since stock clerks still feed the dispenser by hand from traditional cardboard shipping boxes. Following the example of the automotive industry's lean supply chain practices, the soup cans could be shipped with returnable containers machine-loaded at the Campbell's factory. A just-in-time flow of dispensers for soup and other canned goods into backroom picking operations could reduce handling costs and help move grocery toward the high inventory turns achieved in automotive. Other products in cylindrical containers, such as Morton Salt and Gerber baby food, would be obvious candidates for similar gravity-fed dispensers.

Or, to save packaging and provide greater customization, perhaps some products could be shipped in bulk and packaged in a store pickup zone. Just as many consumers now carry reusable shopping bags, they might also embrace the reusable containers of the past, such as milk bottles, or new special-purpose containers such as plastic cereal or coffee storage containers designed to be refilled through a subscription model with their favorite grocer. Such a sustainability focus could lead some customers (environmentally and digitally conscious millennials, in particular) to forgo the expedited home delivery of AmazonFresh and embrace next-day pickup points as a better trade-off.

The space savings from moving high-velocity items off the shelves and into the backroom could free up space dedicated to key suppliers to create an engaging customer experience. Imagine knowledgeable sales clerks trained by General Mills or PepsiCo to educate consumers on the benefits of a new product with in-store trials, and perhaps even signing them up for a new subscription service. The state-of-the-art "live chat" feature of a purely online retailer pales in comparison with what a physical grocery store could provide. Would a permanently staffed counter offer more value than an ephemeral end-cap display funded by traditional trade promotion dollars?

Grocers, Take Heart

Some traditional grocers have responded to online pressures by partnering with services such as Instacart. This startup connects people online with crowd-sourced personal shoppers who receive a cut of the fee for picking up the customers' requested items in the store and delivering them within two hours. Venture capitalists are responding—having finally recovered from the haunting memories of Webvan—bidding up Instacart to an eye-popping valuation of $400 million. Although the service is still prohibitively costly for most consumers, the venture's funding portends further disruption of the status quo. But traditional grocers can't stop there.

Sheltered for the first 20 years of the Internet retailing era, supermarkets and their vendors can now learn from other retail categories that weathered earlier attacks. For example, Best Buy has teamed with key vendors such as Apple, Microsoft, and Samsung to enhance the customer experience and avoid simple price-based competition with Amazon. Supermarkets would be wise to learn from this formerly high-flying retailer as it battles the online onslaught. Providing a better customer experience that leverages both digital and physical assets will be the key to success.

Both traditional supermarkets and grocery manufacturers need to develop capabilities aligned to the emerging digital world, and to break the single-minded pursuit of low cost and wide variety that has driven the industry for a century. The specific capabilities will vary by company, product, and region, but will in all cases require intercompany collaboration between grocers and their suppliers, and intracompany collaboration across functions including marketing, merchandising, distribution, and operations.

Few things are certain about the future of the traditional grocers in the digital world, except that decline awaits those who sit back and do nothing. But supermarkets should take heart—recent research from Cardlytics shows that loyalty to grocery store chains is higher than loyalty in any other retail category. The shoppers are supermarkets' to lose. It's time for grocers to stop thinking about the coming threat, and start planning for the opportunity. ✚

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