E-commerce Challenges: The Story of Online Groceries

What could be easier than ordering all your groceries online and having them delivered to your doorstep at a time you choose? No more driving to the store, wasting gas and time, pushing carts down aisles, jostling with over-anxious shoppers, or waiting in the check-out lines. For those who don't mind giving up the "social experience" of shopping, as well as aspects like thumping melons to test for freshness, tearing off a shock of sweet corn to smell for mold, or sampling a cut of salami before ordering, online grocery shopping provides a compelling value proposition. In 2013 an estimated 12.5 million online shoppers will generate $5.9 billion in online grocery sales in the United States at over 1200 online grocers.

Online grocery sales have grown 75% since 2006, and are expected to growata around 9% annual through 2016 to an estimated $9 billion. The United Kingdom has the largest online grocery market at around $10 billion in sales. In fact, online grocery sales are growing at nearly three times the rate of traditional grocery sales offline. In a recession, driven by the high cost of restaurant food, as well as gas for cars, consumers are cooking at home more often, and looking for food deals and convenience online. Online recipe sites are seeing a doubling of traffic. Still, there's a lot of room for future growth: online groceries still account for less than 2% of all grocery sales in the United States.

There are three online grocery business models: start fresh, leverage out, and local build. The history of large-scale online grocery begins with the "start fresh" approach of Webvan, launched in 1999 with $400 million of venture funding, and another $600 million of stock sales to the public. Webvan's business plan was audacious: start a totally new nationwide, online, grocery distribution system serving 10 cities at first, and expanding to additional major cities in a few years. When Webvan flamed out in July 2001 after having spent almost $1 billion trying to build the Web's largest online grocery store based on huge distribution warehouses in seven U.S. cities, most pundits and investors thought the entire online grocery business model was either a failure or a fraud. Facing the costs of building an entirely new distribution system of warehouses and truck fleets to compete with existing grocery businesses, not to mention the expense of marketing, and a huge IT infrastructure, Webvan compounded its problems by offering below-market prices and free delivery of even small orders at just about any time of the day or night in urban areas often clogged with traffic. Webvan is generally considered to be the largest and most spectacular e-commerce failure in history. That said, it was also ahead of its time: very few customers felt

by BEA Systems' Weblogic platform, which can track customer preferences, such as the level of fruit ripeness desired, or the preferred weight of a cut of meat. FreshDirect also uses NetTracker, Web site traffic and online behavior analysis software, to help it better understand and market to its online customers. At peak times, the Web site has handled up to 18,000 simultaneous shopping sessions. The final piece in the formula for profit is a supply chain that includes dealing directly with manufacturers and growers, thus cutting out the costs of middle-level distributors and the huge chains themselves. FreshDirect does not accept slotting fees (payments made by manufacturers for shelf space). Instead, it asks suppliers to help it direct-market to consumers and to lower prices. To further encourage lower prices from suppliers, FreshDirect pays them in four business days after delivery, down from the industry pattern of 35 days.

FreshDirect was profitable for the first time in 2008. The key to profitability has been improving its execution of the initial concept, and a rededication to customer service, just plain listening to customers. In recent years, FreshDirect has introduced the following "customer centric" ideas:

- **Produce:** Employed experts to rate the freshness of all produce and set prices accordingly. This reduces customer concerns about not being able to feel the product.
- **Packaging:** Eliminated the use of foam, and reduced the number of cardboard boxes by 1.5 million in response to customer complaints.
- **Favorites: Developed a customer relati-onship management system that tracks each customers' past purchases, and presents them on-screen for re-ordering. Increased order size by 10%.**
- **Recommender system:** Added a YMAL (You-Might-Also-Like) cross-selling tool, which recommends products that other customers purchased. Added 5% to total revenue.
- **Rating systems:** Developed a rating system for its own produce and seafood that allows grocers to showcase their best goods and customers to decide what "looks" good online.
- **Order pattern analysis:** Instituted a system to reminds customers of their favorite products and e-mails them when the system thinks they might be running out.
- **Computer-driven truck packing:** Created to handle over 45,000 deliveries a week in the New York Metro area.
- **Web apps:** FreshDirect introduced an iPhone app that allows mobile shoppers full access to its complete Web offerings. More than 65% of FreshDirect's customers have smartphones, and 50% have iPhones.

With these features and direct mail campaigns, FreshDirect has increased customer loyalty and reduced its churn rate (the number of customers who leave the service). Currently, 65% of its total customer base of around 600,000 active customers are repeat, loyal customers, whose average order size is over $120, and who contribute 80% of FreshDirect revenues. Word among investors

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is that FreshDirect is planning an IPO in the near future, causing many to roll their eyes as they remember the history of Webvan in early part of the decade. Is this time different? The technology has changed drastically, there's more bandwidth to explore food products online, and the culture has shifted to using smartphones as mobile shopping devices. Best of all, FreshDirect is working from a financial perspective. Although a private company that does not issue financial information, analysts estimate that in 2013 FreshDirect will generate over $450 million in revenue, and expand its customer base to over 600,000 customers in the New York and Philadelphia metropolitan areas.

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