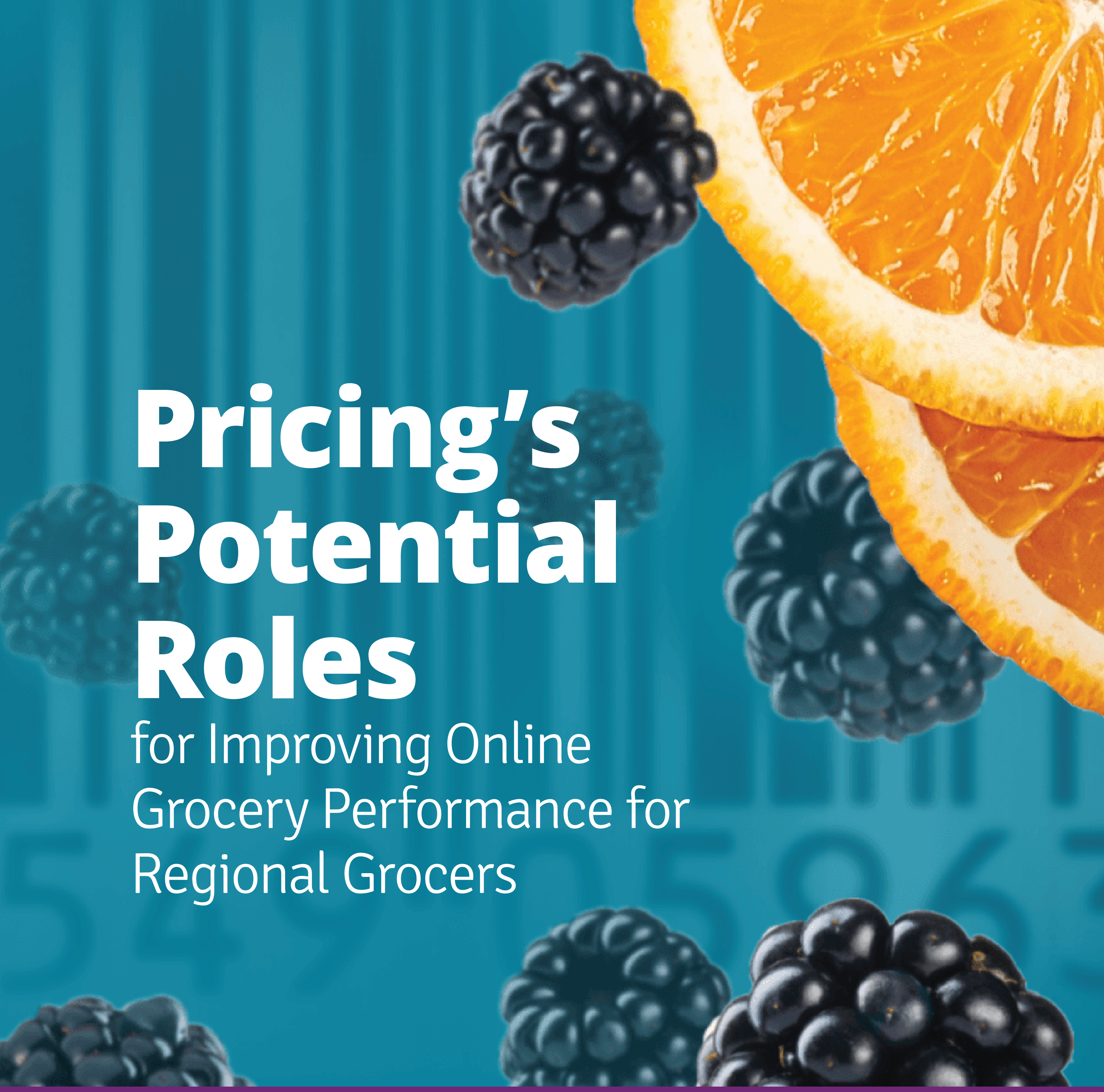

Pricing's Potential Roles

for Improving Online Grocery Performance for Regional Grocers

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Table of Contents

Mercatus, a leading provider of grocery eCommerce solutions, has commissioned a comprehensive research initiative in coordination with Brick Meets Click, a Grocery analytics and strategic insight firm, which highlights the challenging realities and critical choices ahead for regional grocers in the online market.

Introduction to the Research

The custom research report is based on a recent pricing study that analyzed how eight banners in one market implemented online pricing strategies versus in-store. The banners researched included Aldi, Costco, HEB, Kroger, Market Street, Target, Tom Thumb, and Walmart.

The following research and content is specially created for regional grocers that want to improve their profitability and customer experience of their eGrocery offering.

The report is broken down into four sections:

1. Realities and Reminders
2. Roadmap for Online Grocery Pricing Strategy
3. Recommendations for Pricing Strategy
4. Closing the Online Pricing Research Loop

The research reveals that regional grocers face a tougher fight online against low-price market leaders like Walmart, who enjoy significant advantages in terms of price, service fees, and retail media revenues. The research and report provide a landscape and roadmap for regional grocers who are looking to adapt their online pricing strategy.

The report proposes a Three C's Framework that focuses on owning the customer connection, offering greater control over choices made, and more effectively managing costs. The report suggests that grocers should consider reorienting their fee structure to help customers save more money and realigning activities to lower costs in smarter ways.

By employing a variable fee structure, protecting advertised items, and offering a "free" pickup option, regional grocers can create a more customer-centric online shopping experience, realize labor savings, and ultimately, achieve a more sustainable path to competing online.

Let's dive in!

Realities and Reminders

Grocers are at a crossroads, aiming to improve both the profitability and experience of eGrocery while also remaining competitive.

This report maps out a different path that regional grocers who operate a first-party site/app can pursue. It reframes how products and services are priced, reorients the fee structure to help customers save more money, and realigns activities to lower cost in smarter ways (Table 1).

About this report:

- Is intended for regional grocers although other formats can also adapt this approach to their business.
- Assumes that grocers offer Pickup and Delivery already to better serve the demand and preferences in the market.
- Focuses on Pickup as grocers typically have greater control and responsibility for key activities across the three stages.
- Emphasizes direct labor cost as grocers can manage these areas on an ongoing basis; however, grocers should consider other direct/variable costs too.
- Is based on a recent pricing study that analyzed how eight banners in one market executed online strategies versus in-store.

Table 1: Three C's Framework via Stages of Online Grocery Shopping

Three C's Framework	**Ordering** *Build, choose options, & pay*	**Assembling** *Pick, pack, & stage*	**Distributing** *Retrieve, transport, & transfer*
Own the customer **Connection** *Where it's most important*	•Profiles •Preferences •Purchase history	•Shopping updates •Out-of-stock alerts	•Arrival notifications
Offers greater **Control** *Over choices made*	•Search & display •Shoppable recipes	•Substitution practices •Suggestive selling	•Geolocation tools •Receiving windows
More effectively manage **Cost** *That make sense*	•Product markups •Ad monies •Cross- & up-selling	•Pick-&-pack practices •Fulfillment alternatives	•Fee structures •Special charges •Subscriptions

Stages of Online Shopping

Executive note: Some grocers have an entrenched belief that online prices need to be the same as in-store. However, there are grocers who are breaking from that tradition because they have seen others adapt, they better understand the online landscape, or they have a true sense of the realities they are facing with competition.

As we look ahead and plan for the future, it's crucial to understand the current landscape and the challenges that regional grocers face in the online market.

In Part 1: Realities and Reminders, we will delve into the tangible challenges that regional grocers confront when competing against low-price market leaders like Walmart. We'll also revisit some fundamental aspects of online grocery shopping that can serve as reminders for crafting effective strategies. Let's discuss these realities and reminders to set the stage for the strategic roadmap that follows.

Regional grocers face several stark realities related to competing online against national rivals.

1. Online orders introduce incremental costs.

Pickup, the lower cost-to-serve method than Delivery, can easily inject an incremental $13+ in direct labor costs associated with assembling (i.e., pick, pack, and stage) and distributing (i.e., retrieve, transport, and transfer) a single order. And this does not account for CapEx investments and/or other OpEx budget lines, which would only increase this figure.

2. Demand for eGrocery has softened and growth is decelerating.

As COVID-related concerns and financial supports diminish, a portion of online customers have returned to doing more grocery shopping in-store due to personal preferences or cost considerations . While the base business remains significantly elevated versus pre-COVID levels, slower growth will challenge the larger CapEx investments intended to reduce direct labor related costs.

3. National rivals have stronger opportunities to offset eGrocery's higher cost structure.

Although retail media networks (RMN) promise ancillary revenue, national grocers will be the big winners as they will leverage their scale and capabilities. National rivals also have the advantage with memberships or subscriptions as they can build a more compelling bundle, but these tactics have less impact on lowering costs as compared to RMNs.

Reality #1 – Online introduces incremental costs, which can add >$13 in direct labor costs associated with assembling and distributing an order.

Pickup is considered the lower cost-to-serve method than Delivery, and when analyzing the manual processes and basic practices related to assembling and distributing, a single order can add an estimated $13.70 simply in direct labor cost and that ignores all the sunk costs.

Assembling

$12.62

per order
to pick, pack, & stage

Based on:
- Single-order pick session,
- Selecting 37 SKUs,
- At a rate of 66 units per hour, and
- Paying an hourly rate of $16.30 per hour to part-time employee plus 30% in benefits for fully-loaded rate of $21.20 per hour.

Source: Brick Meets Click, Activity-Based Cost Modeling, April 2023

Distributing

$1.08

per order
to retrieve, transport, & transfer

Based on:
- Single-order transfer,
- Seven bags with 37 SKUs,
- One-way trip distance of 200 feet, and
- Paying an hourly rate of $16.30 per hour to part-time employee plus 30% in benefits for fully-loaded rate of $21.20 per hour.

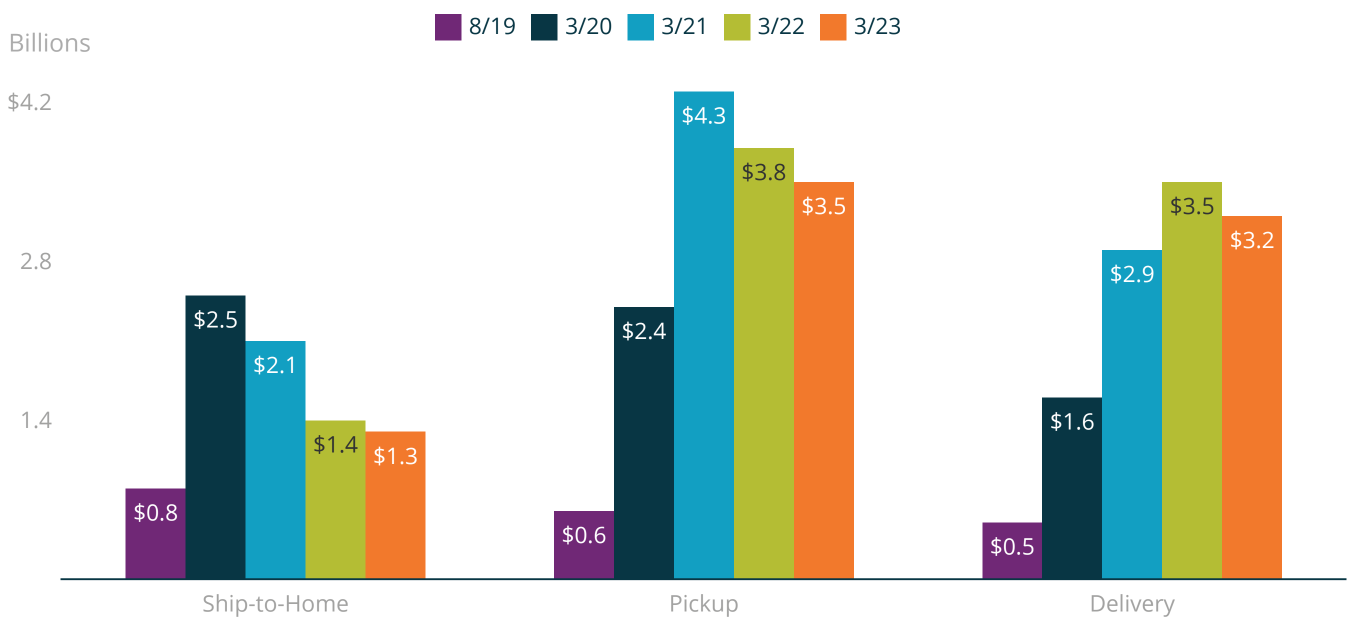
Source: Brick Meets Click, Activity-Based Cost Modeling, April 2023

Executive Note: In understanding your direct labor cost per order, here are some key variables: store size, pick path, employee factors, product mix, and wage rates can affect this measure. In addition, presence or absence of enhanced assembly methods can impact the costs.

Reality #2 – Demand has softened and growth is decelerating, challenging ways grocers can grow sales or improve the profitability of online orders.

Demand has softened as COVID-related concerns and financial support payments diminish, prompting some users to return to in-store shopping. Although the sales base remains much higher versus pre-COVID levels, sales are forecast to grow at a slower rate over the next five years.

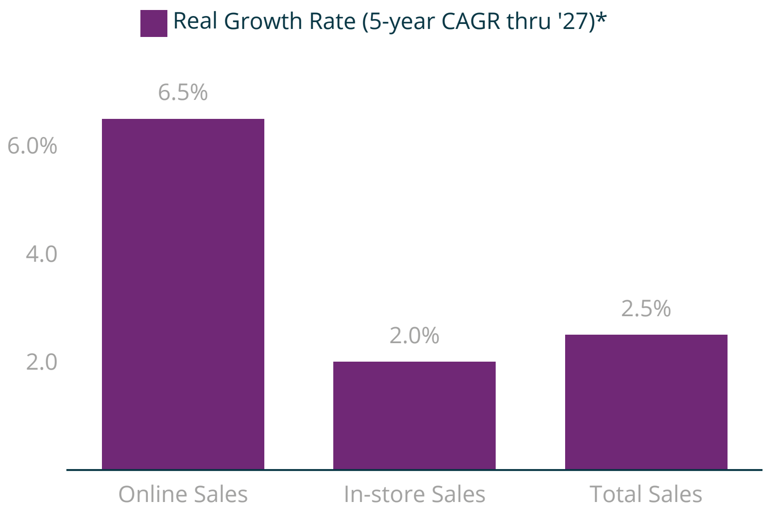
Chart 1: US Monthly eGrocery Sales by Receiving Method



Source: Brick Meets Click/Mercatus Grocery Shopping Survey, 2019-2023.

Executive note: Grocers should assess their sales forecast as well as their plan to reduce the cost to serve online demand over the next several years. The online market is much more competitive, making it more costly to attract new customers and vital to retain existing ones.

Chart 2: US Grocery Sales Forecast



** Real Growth Rate excludes the effects of price inflation. CAGR = Compound annual growth rate.*

Source: Brick Meets Click/Mercatus 5-Year Grocery Sales Forecast, January 2023.

Reality #3 - National rivals have stronger opportunities to offset this higher cost structure via ancillary revenue, like from retail media networks.

Retail media networks (RMN) promise ancillary revenue that can help offset a portion of the incremental cost of online orders; however, national grocers will be the big winners due to their scale, and emerging capabilities will help generate even larger revenue streams in coming years.

Walmart advertising - FY23

$2.90

Reduction in Cost per order

Estimate for US eGrocery business

Source: Brick Meets Click estimates*

20% CAGR

Walmart advertising - FY25

$4.20

Reduction in Cost per order

Estimate for US eGrocery business

Source: Brick Meets Click estimates*

Executive note: Retail monies can be leveraged as an offset against the cost-to-serve online orders for their customers. Grocers should estimate what revenue equates to on a per-order basis, and carve out a share of earnings to support online channels.

Implication - Regional grocers need to consider a different path forward since the one taken by national rivals isn't a sound choice for several reasons.

Following Mass or other national rivals is risky, because their strategies are based on their scale and price positions. The two waterfall charts illustrate how differently Regional Grocers and Mass will likely attempt to cover most of the direct labor cost.

Table 2: Example - How Retailers Likely Can Cover the Direct Labor Cost Only of a Pickup Order Today

Line Item	Regional Grocer	Walmart
Direct labor cost (universal basline)[1]	$13.70	$13.70
Assembly efficiencies[2]	$2.40	$5.16
Service Fee[3]	$0.99	$0.70
Retail media monies	$0.35	$2.90
Disctribution efficiencies[4]	$0.00	$0.05
Remaining direct labor cost	$9.96	$4.89

Note: The direct labor cost is simply a hypothetical baseline measure by which assumptions are made as to how a regional grocer would be able to offset.

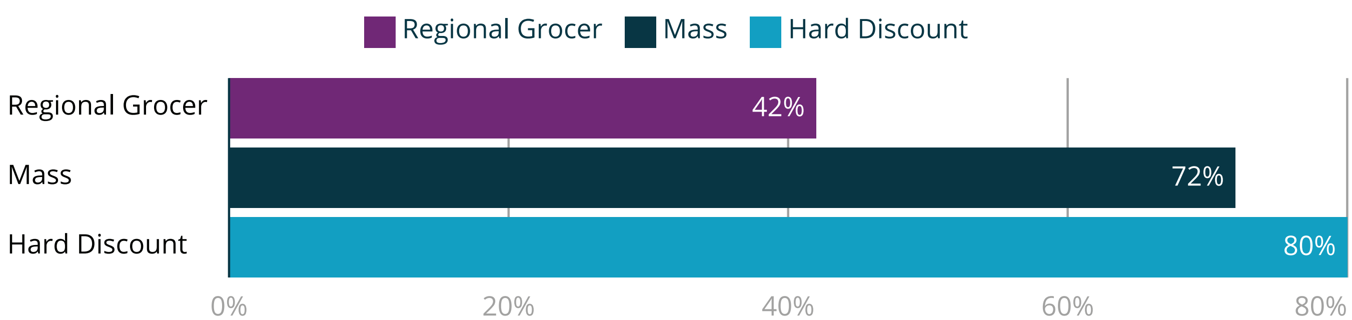
1 Hourly rate of $16.30 per hour to part-time employee plus 30% in benefits for fully-loaded rate of $21.20 per hour.
2 Encompasses the activities of picking, packing, and staging.
3 Weighted average based on 80% of regional grocer's customers exceeding the $35 purchases threshold to avoid $4.95 fee and 90% of mass' customers, i.e., Walmart, doing so to avoid $6.99 fee.
4 Relates to the activities of retrieving and transferring an order to the customer in the pickup point. In certain cases, like at Target, multiple orders are batched together to eliminate the need for separate to/from the transfer point.

Executive note: Grocers should aim to measure how each of these components contribute to improved order profitability, but also understand how fees can help drive greater efficiencies with both the assembly and distribution functions.

Reminder A - Customers are much less likely to shop at a regional grocer due to cost, i.e., low prices, as compared to their national, discount rivals (Chart 3).

A recent in-market pricing analysis found that discounts in Mass (i.e., Walmart) and Hard Discount (i.e., Aldi) enjoy significant price advantages over regional grocers when it comes to a customer buying a basket of commonly-purchased products (Chart 4a and 4b).

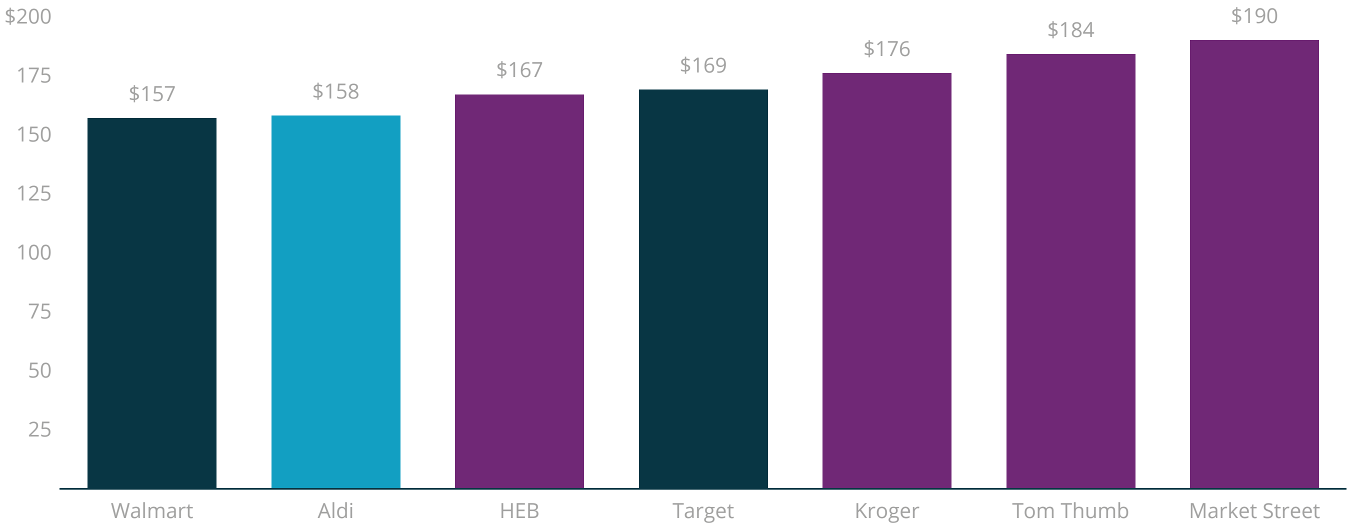
Chart 3: Shopped at Format Because of Low Prices



Regional grocer, e.g., Food Lion, HEB, Hy-Vee, Publix, Raley's, Weis, Wegmans; Mass, e.g., Target, Walmart; Hard discount, e.g., Aldi, Lidl, Save A Lot.

Source: Mercatus Omnichannel Shopper Behavior Report, Volume 1, 2022.

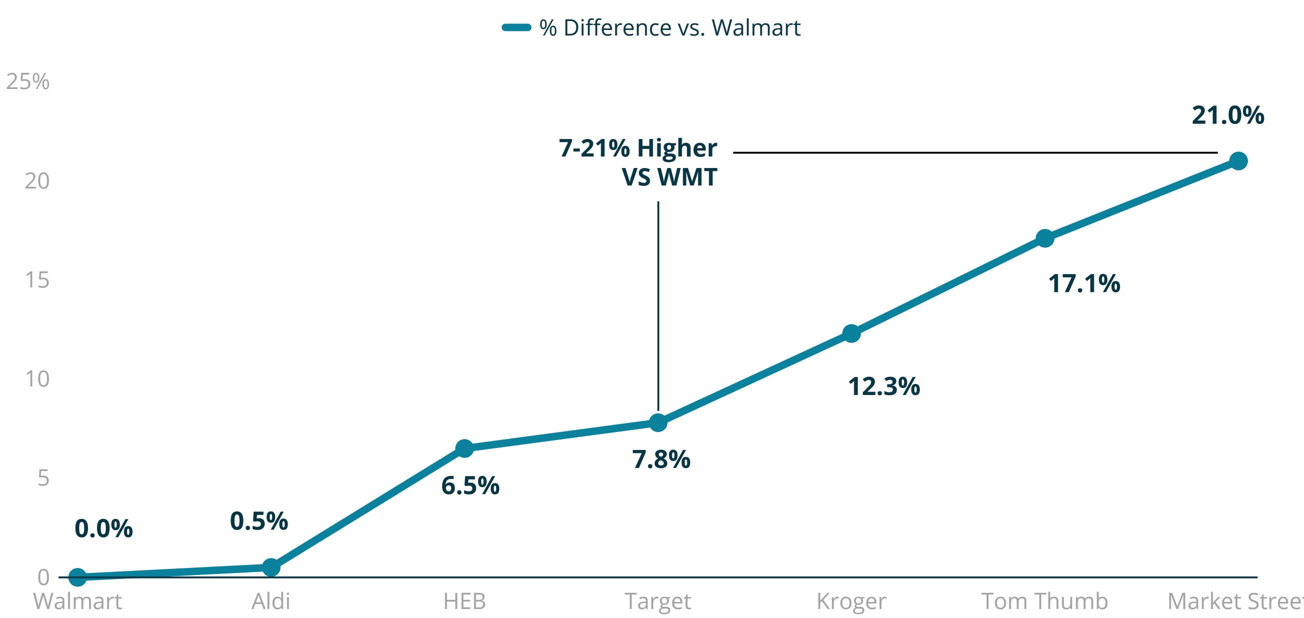
Chart 4a: Instore: Value of 40 Commonly Purchased Products



Note: Reflects net price paid for like items, including TPRs, instore coupons, or loyalty member discounts, but excludes sales tax. Equalized to the dominant pack size offered across banners if same sizes wasn't universally available. Product mix in basket correlates to the sales contribution of department to the total store.

Source: Brick Meets Click Market Basket Analysis, Plano, TX, March 15-16, 2023.

Chart 4b: Value of 40 Commonly Purchased Products



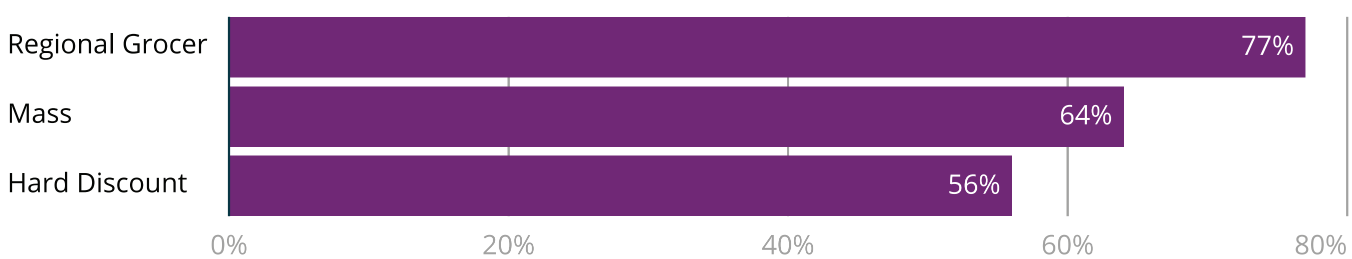
Reflects net price paid for like items, including TPRs, instore coupons, or loyalty member discounts, but excludes sales tax. Equalized to the dominant pack size offered across banners if same sizes wasn't universally available. Product mix in basket correlates to the sales contribution of department to the total store.

Executive note: Reframe any price comparison by emphasizing the benefits of shopping online with your regional grocery store. Highlight that shopping online saves customers time and offers a seamless, convenient experience, as compared to shopping in-store.

Reminder B - Customers are more likely to choose convenience when they shop with a regional grocer as opposed to a national, low-priced rival (Chart 5).

Although this selection criteria generally relates to in-store shopping, it is relevant for Pickup since both shopping modes require a visit to the store. And those that primarily bought groceries from Mass or Hard Discount tend to drive past more stores to shop at those banners (Chart 6).

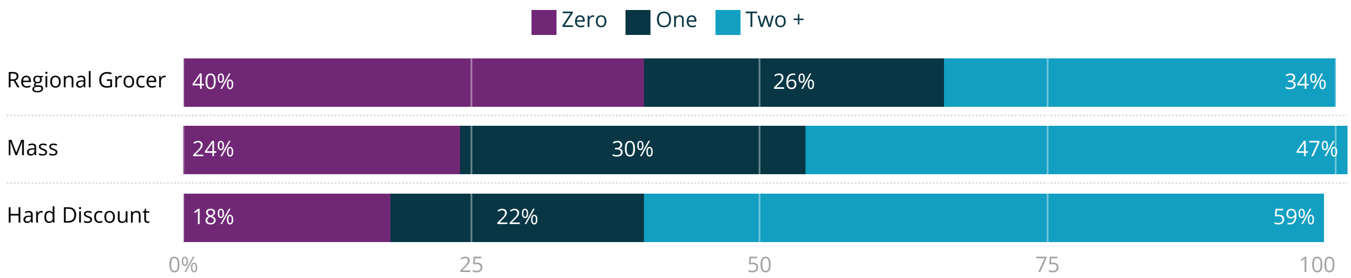
Chart 5: Shopped at Format Because of Convenience



Regional grocer, e.g., Food Lion, HEB, Hy-Vee, Publix, Raley's, Weis, Wegmans Mass, e.g., Target, Walmart; Hard discount, e.g., Aldi, Lidl, Save A Lot.

Source: Mercatus Omnichannel Shopper Behavior Report, Volume 1, 2022.

Chart 6: Number of Stores Passed on Way to Primary Grocer



Executive note: Focus consumer messaging about shopping online more around aspects of convenience and some of its perceived benefits, like saving time or spending time doing things they enjoy more than shopping in a store.

Reminder C - Regional grocers' customers typically expect to find different ways to save money than customers who shop at EDLP rivals (Chart 7).

While the net value remains much higher versus Walmart (see prior), customers at most regional grocers can still come away spending 7-10% less than the everyday price by taking advantage of member deals, temporary price reductions, and on-shelf/digital coupons (Chart 8a and 8a).

Chart 7: Shopped at Format Because of Ways to Save Money

Regional grocer, e.g., Food Lion, HEB, Hy-Vee, Publix, Raley's, Weis, Wegmans; Mass, e.g., Target, Walmart; Hard discount, e.g., Aldi, Lidl, Save A Lot.

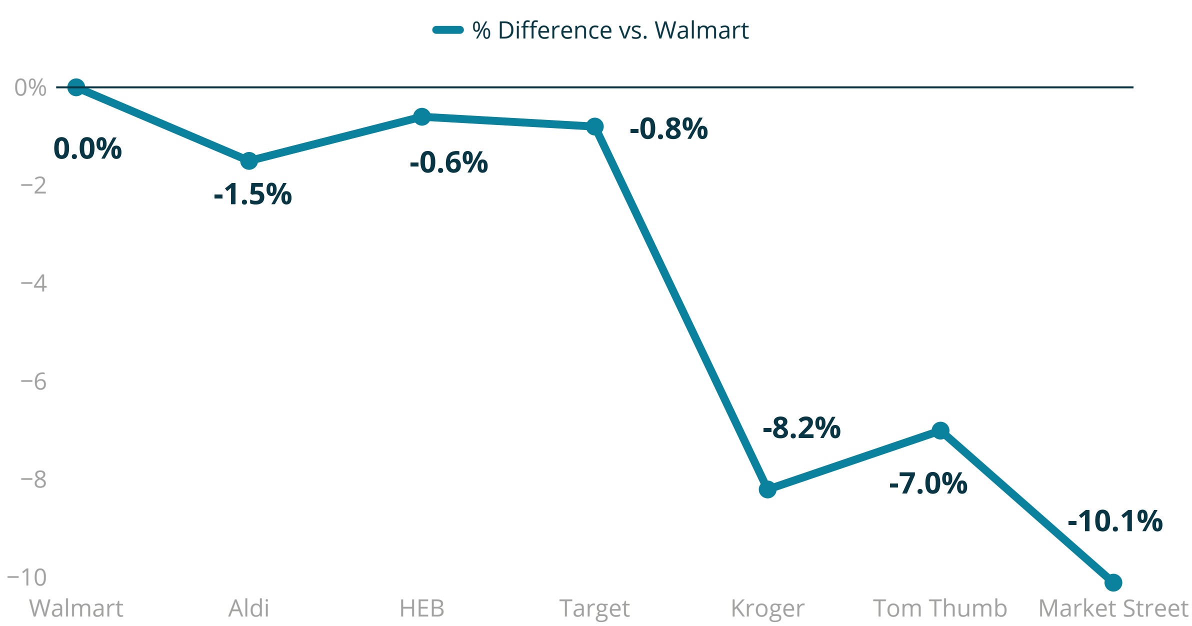
Source: Mercatus Omnichannel Shopper Behavior Report, Volume 1, 2022.

Chart 8a: In-store: Relative Saving vs. Everyday Value of Basket

Note: Doesn't not include cashback monies when using a retailer's store-branded credit card.

Source: Brick Meets Click Market Basket Analysis, Plano, TX, March 15-16, 2023.

Chart 8b: In-store: Relative Saving vs. Everyday Value of Basket



Note: Doesn't not include cashback monies when using a retailer's store-branded credit card.

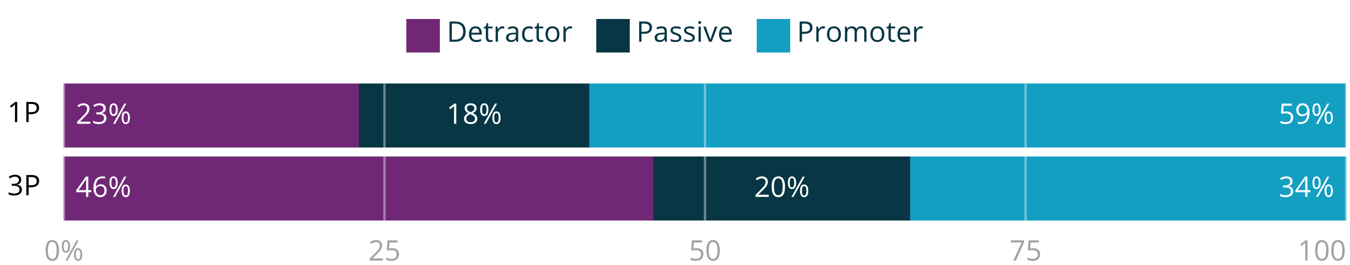
Source: Brick Meets Click Market Basket Analysis, Plano, TX, March 15-16, 2023.

Executive note: Highlight the various savings that customers accrue – especially during the checkout stage. This serves as an explicit reminder on how customers saved money when shopping at a regional grocer, whether that's in-store or online.

Reminder D - First-party (1P) has significantly stronger Net Promoter Score® (NPS®) ratings for repeat intent than third-party (3P) (Chart 9). Fees are the most pressing pricing issue (Chart 10).

A factor contributing to 1P's higher NPS is that households are significantly more likely to use the 1P site when buying from their primary grocer. When it came to reasons for lower NPS ratings, fees took the top spot when it came to elements of pricing for both provider types.

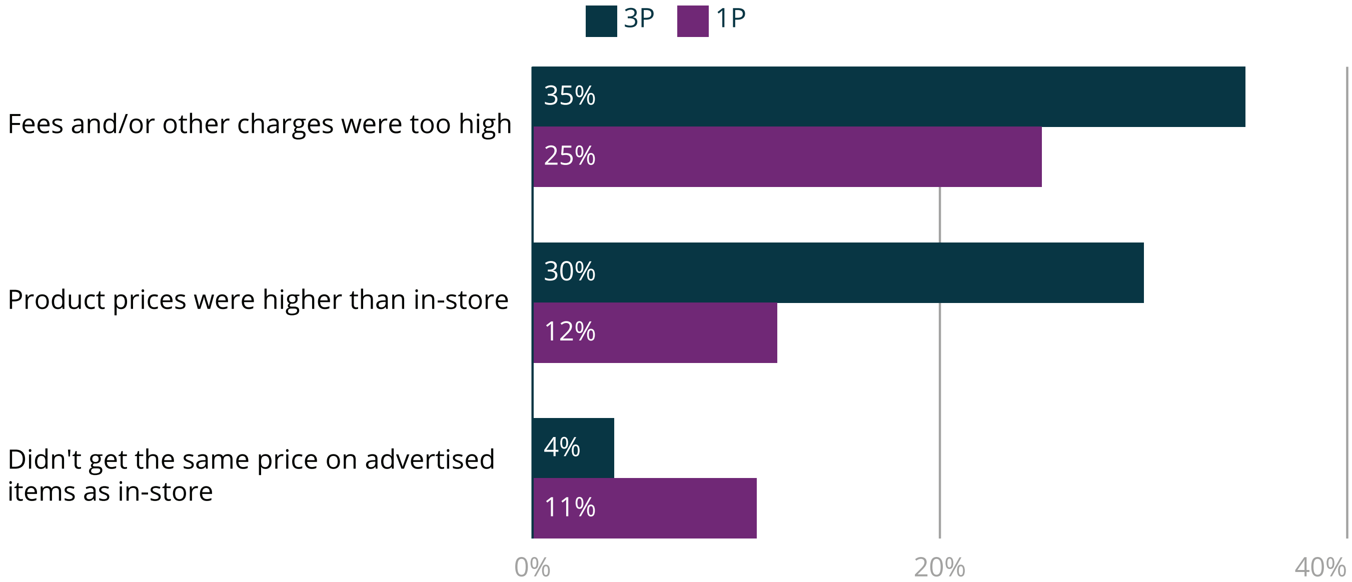
Chart 9: NPS Related to Likelihood to Use Service Again*



** NPS = Net Promoter Score® that uses an 11-point ratings scale, segmenting respondents as "detractors" (0-6), "passives" (7-8), and "promoters" (9-10). Note: Based on most recent online order within the past month. Intent to use again was defined as "within the next 30 days."*

Source: Mercatus, Online eGrocery Shopping Survey 2023

Chart 10: Pricing Factors Impacting Lower Repeat Intent Ratings^



^ Partial list of responses. Based on most recent online order within the past month. Includes only respondents that were considered a "detractor" or a "passive" according to the Net Promoter Score ® framework.

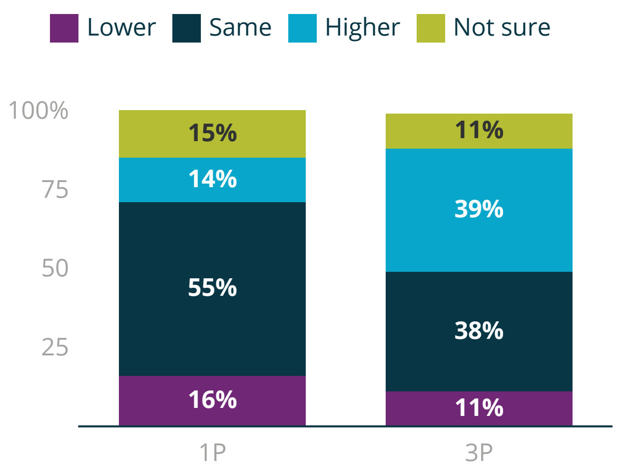
Source: Mercatus, Online eGrocery Shopping Survey 2023

Executive note: If true, highlight that customers find better deals, avoid added costs, and/or get the same deals online for advertised items when shopping on the 1P site/app in comparison to doing so on 3P sites/apps.

Reminder E - Customers' perceptions about online product pricing reveals there's lots of confusion. Although there's less confusion on 1P sites/apps

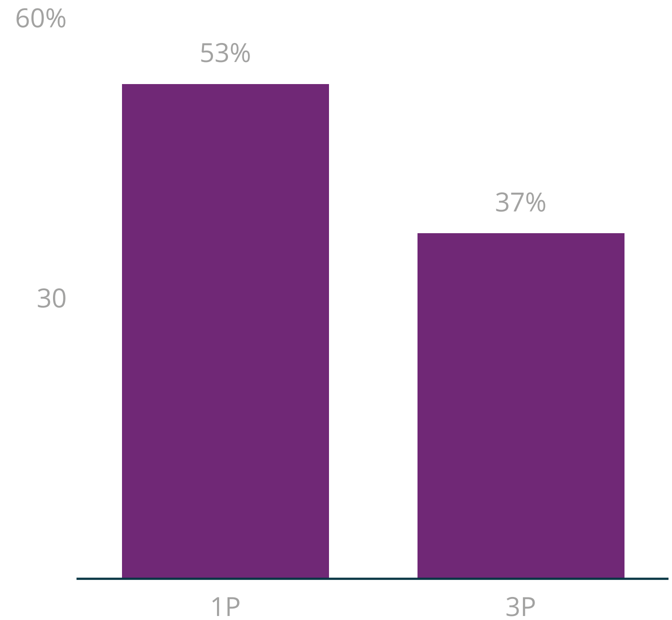
Since most grocers currently price products on their 1P website/app at parity with in-store, it's revealing that just 55% of the 1P customers sensed the same thing (Chart 11). And, when it comes to whether perception matched reality, basically 1 in 2 were on the same page (Chart 12).

Chart 11: Customer Perception about Prices Online vs. In-store*



Source: Mercatus, Online eGrocery Shopping Survey 2023

Chart 12: Correctly Perceiving Online Prices vs. In-Store^



Source: Mercatus, Online eGrocery Shopping Survey 2023.

Executive note: Analyze how your 1P platform compares to any 3P sites that are used. Measure variations in pricing elements, including promoted and non-promoted pricing, digital coupons, explicit costs (e.g., fees, charges, tips) and how savings are communicated to the customer.

Navigating the eGrocery landscape is akin to traversing a complex maze. Regional grocers are at a critical juncture where they need to balance profitability, customer experience, and competitiveness. The realities they face are palpable - online orders introduce incremental costs, demand for eGrocery has softened, and national rivals have stronger opportunities to offset eGrocery's higher cost structure. However, grocers can't afford to simply follow the strategies of national rivals, as their tactics are based on their scale and price positions.

In store customers tend to choose grocers for convenience. Even so, they expect to find different ways to save money and appreciate the benefits of shopping online. Further, grocers first-party platforms have significantly stronger NPS ratings for repeat intent, but there's an opportunity to do better by helping customers avoid paying more than necessary when it comes to fees. However, grocers elect to approach pricing products online, customers should be able to generally learn about the approach employed.

This next section provides a roadmap to help evolve the pricing strategy and better position pricing to win.

Roadmap for Online Grocery Pricing Strategy

The roadmap presented here is simply a guide for grocers looking to navigate the complex landscape of eGrocery pricing. It builds upon the challenges identified in the previous section and emphasizes the importance of organization-wide input and buy-in, acknowledging that each grocer's circumstances are unique and will require a tailored approach. The roadmap underscores the essence of strategic planning – making informed choices that align with the company's objectives and strategies.

Roadmap – Grocers should get input and buy-in across the organization as they chart a course to pursue based on their unique circumstances.

How retailers implement should vary depending on a range of factors and considerations that will likely lead grocers to make different choices. That is what strategy is essentially about – making choices that make sense given a company's objectives and strategies.

Action and Recommendation Roadmap

STAGE 1 Establish Baseline	**STAGE 2** Model Enhancements	**STAGE 3** Determine Details
• Quantify direct labor costs and consider other relevant costs*. • Capture current and forecasted sales levels. • Determine the role and impact that retail media moneis play.	• Estimate order distribution based on tiered fee structure. • Project how the fee structure will lower unit cost to assemble order. • Set the upper band of the fee structure and then the other tiers. • Establish product markup to cover all/part of remaining cost.	• Create messaging for site/app • Consider how to price protect advertised items. • Establish pricing philosophy between 1P and 3P site/apps.

* Other relevant costs could include but are not limited to retail value of special deals used to drive trial, service fee waived on first x orders, credit for product returns, indirect labor associated with supervisors, etc.

Stage 1: Establish Baseline

The first stage is about understanding the current situation and setting a foundation for the subsequent stages. It involves:

- Quantifying direct labor costs: Understand the cost of labor involved in the eGrocery process.
- Considering other relevant costs: This could include the retail value of special deals used to drive trial, service fee waived on first x orders, credit for product returns, indirect labor associated with supervisors, etc.
- Capturing current and forecasted sales levels: Understand the current sales performance and predict future sales trends.

- Determining the role and impact of retail media monies: Understand how retail media investments impact the overall business.

Stage 2: Model Enhancements

The second stage is about refining the pricing model to optimize costs and efficiency. It involves:

- Estimating order distribution based on a tiered fee structure: Develop a fee structure that reflects the cost and value of different order types.
- Projecting how the fee structure will lower unit cost to assemble orders: Understand how the new fee structure can improve efficiency and reduce costs.
- Setting the upper band of the fee structure and then the other tiers: Define the fee structure clearly, starting with the maximum fee and then setting the other tiers.
- Establishing a product markup to cover all or part of the remaining cost: Determine how much of the cost needs to be covered by product markups.

Stage 3: Determine Details

The third stage is about ensuring that the strategy is effectively communicated and implemented. It involves:

- Creating messaging for site/app related to changes: Communicate the changes effectively to customers through the site/app.
- Considering how to price protect advertised items: Develop a strategy to ensure that advertised items are priced appropriately.

- Establishing a pricing philosophy between 1P and 3P sites/apps: Define a clear pricing strategy that differentiates between 1P (first-party) and 3P (third-party) platforms.

It’s important to note that the journey doesn’t end at Stage 3. Grocers should consider Stage 4 as “Implement Plan,” where the strategies and actions are put into action. Following implementation, Stage 5, “Assess Impact,” becomes crucial. This stage involves a thorough review of the implemented plan by comparing actual results to expected outcomes 3 to 6 months after completing implementation. This iterative approach ensures continuous improvement and adaptation to changing circumstances, allowing grocers to stay competitive and profitable in the dynamic market.

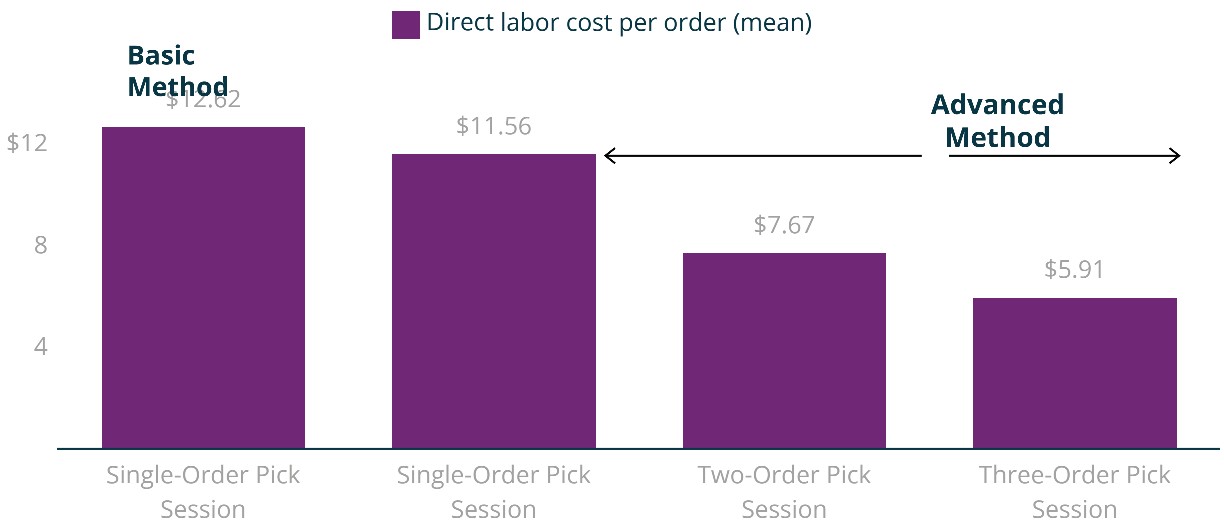
Recommendations for Pricing Strategy

This section provides the roadmap recommendations for grocers looking to implement changes in their strategy. The recommendations includes establishing a baseline, modeling enhancements, and determining details. This is important as it provides a structured approach to implementing changes.

Recommendation #1 – Leverage advanced assembly practices and methods to lower costs per order by batching out more orders together.

Using advanced practices is a proven way to lower direct-labor cost per order that generates greater efficiencies as order density grows (Chart 13). One key to realizing more of the potential savings is being able to increase the number of orders assembled per pick session (Chart 14).

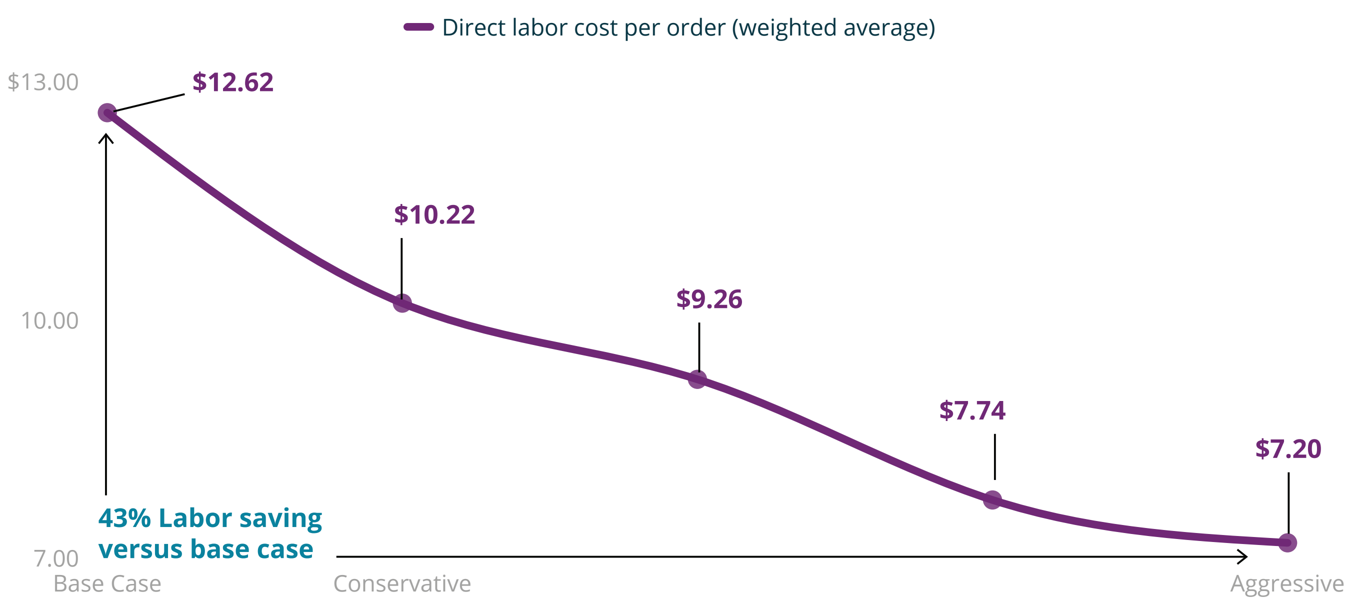
Chart 13: Cost to Manually Assemble an Online Order



Note: For illustration purposes, the maximum number of orders assembled during same pick session was set at three (3) although some retailers may batch out more than three at certain times. Quantity and type of products held constant for comparison purposes. Cost per order represents the average for orders containing between 36 and 40 items. Payrate represents a part-time employee receiving a $16.30 hourly wage rate plus 30% in benefits for fully-loaded rate of $21.20 per hour.

Source: Brick Meets Click, Activity-Based Cost Modeling, April 2023

Chart 14: Weighted Average Assembly Cost per Order Based on Order Mix



Executive note: Consider a service fee structure that can help build order density during the assembling and distribution activities as well as offset some of the cost to fulfill an online order.

By increasing the number of orders assembled per pick session, grocers can significantly lower the direct-labor cost per order.

Recommendation #2A - The fee structure should financially reward customers for behaviors that enable the retailer to reduce costs and should pass a reality check.

For fees to provide the desired win-win outcome, grocers need to better understand that the explicit fee is a cost that some customers may either want to avoid entirely or want to pay no more than necessary, depending on their respective trip mission, need state, etc.

Table 4: Comparative view of grocery Pickup fees in Dallas Trade Area

Strategic Fit Regional Grocers

Pricing Structure	Core Rationale	Reality Check	Banners	Details
Variable fee based on cycle time	Allows the customer to make the trade off between fees and speed	Customers who want to receive orders sooner are willing to pay a premium versus those with less-immediate needs.	HEB	>1 hr. and <2 hrs. = $7.95 >2 hrs. and <4 hrs. = $4.95 >4 hrs. = $0
Fixed fee	Reinforces that this is a value-added service and helps cover some of the incremental costs to provide the service	While it does more effectively cover incremental costs than a variable fee, it doesn't help increase orders per pick session.	n/a	$4.99
Variable fee based on spend	Increases the AOV as customers will spend more to avoid paying the fee	Setting the threshold for a discounted fee too low doesn't have the desired effect on AOV, e.g., 86% of orders exceeded the $35 threshold for a lower/no fee.*	Walmart Kroger Tom Thumb Aldi	<$35 = $6.99, AOV ≥ $35 = $0 <$35 = $4.95, AOV ≥ $35 = $0 <$30 = $3.95, AOV ≥ $30 = $0 <$35 = $3.99, AOV ≥ $35 = $1.99
No fee:	Attracts new customers to the service	Lower product prices are more likely to attract cost-conscious customers. However,this position is owned by national discount chains.	Target Market Street	Free

**Brick Meets Click eGrocery Performance Benchmarking, 2022.*

Source: Brick Meets Click Market Basket Analysis, Plano, TX, March 15-16, 2023.

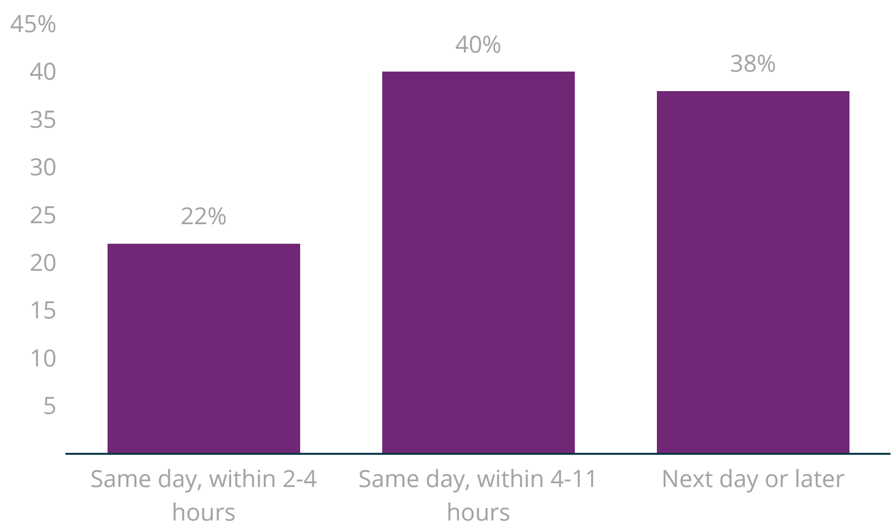
Executive note: Estimate the potential impact that implementing a variable fee based on cycle time will have on reshaping order demand in order to gauge the second-order-effect related to improving assembling productivities.

By understanding customer perspectives on fees, grocers can design a fee structure that not only covers costs but also incentivizes customer behaviors that contribute to cost efficiency.

Recommendation #2B - Design a variable fee structure based on order cycle times. This can help reshape demand in ways that create a win-win outcome.

Given the choice, many customers would select a later time slot versus paying a premium for receiving their order sooner (Chart 15a and 15b). As a result, the customer saves, and the retailer also benefits due to an improved ability to batch more orders during the same pick session (Table 5).

Chart 15a: Variable Fee: When Customers Choose to Receive Order



Source: Mercatus, Online eGrocery Shopping Survey 2023. Brick Meets Click estimates. Example refers to two scenarios given to the same consumers related to a delivery service.

Chart 15b: Variable Fee: When Customers Choose to Receive Order

Source: Mercatus, Online eGrocery Shopping Survey 2023. Brick Meets Click estimates. Example refers to two scenarios given to the same consumers related to a delivery service.

Table 5: Example: Impact of Shifting When a Single Pickup Order

Online Stage: Activity	Customer	Retailer
Ordering: n/a		
Assembling: Shifts to two-order pick session, using advanced practices, from basic, single-order pick	n/a	Saves $4.95
Distributing: Customer shifts to 4-8 hrs., same day from within 2-4 hrs., same day	Saves $3.00	Forgoes $3.00
Net Impact	+$3.00 win	+$1.95 Win

Source: Mercatus, Online eGrocery Shopping Survey 2023. Brick Meets Click estimates. Example refers to two scenarios given to the same consumers related to a delivery service

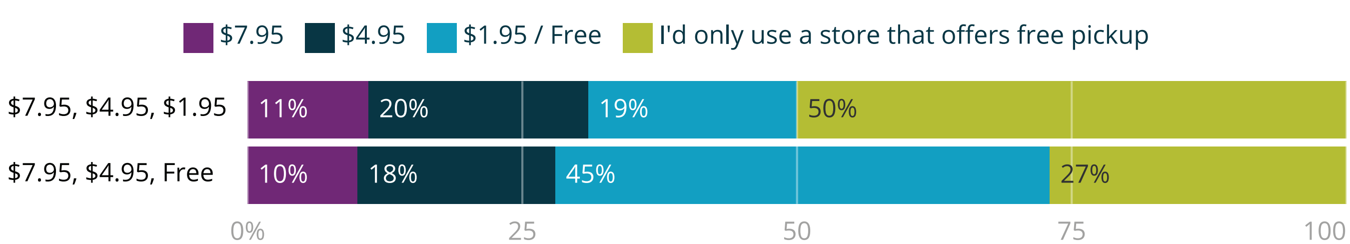
Executive note: In addition to leveraging a variable fee structure, assess if it makes sense to add a "free" option as a way to attract more customers and/or remain competitive versus key rivals.

By offering customers the choice to select a later time slot at a lower cost, grocers can incentivize behaviors that align with their operational efficiency goals.

Recommendation #2C - Add a "free" tier to the fee structure to attract more customers (Chart 16) and enable marketing to leverage the power of "free".

Many people want to avoid paying service fees, so offering a free option helps a retailer to position and market its services as an attractive alternative compared to operators who always offer free pickup (or effectively do so based on their fee structure), like several national grocers.

Chart 16: Pickup Customer Responses to Varied Fee Structures*



** Includes only respondents who use online grocery Pickup services. Both fee structures utilized the same temporal parameters, which included same-day within 2-4 hours, same day within 4-11 hours, and next day during the selected time slot.*

Source: Mercatus, Online eGrocery Shopping Survey 2023

Example Online Pricing Promotion - Free Curbside Pickup

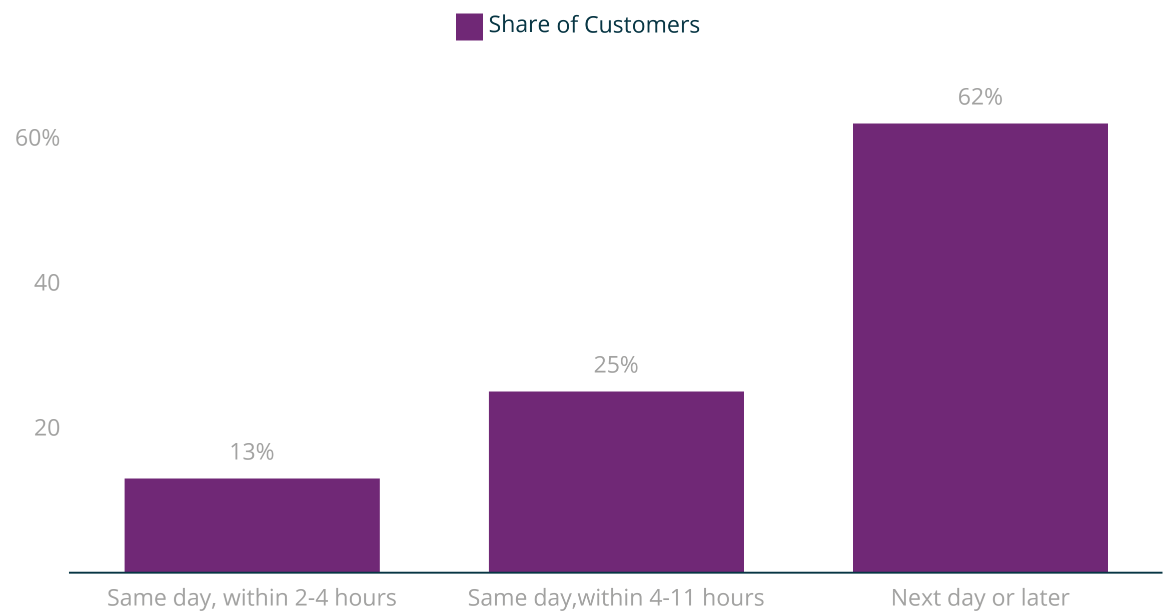
Executive note: Conduct a cost-benefit analysis on how adding a “free” tier impacts revenue projections from service fees as well as the sales lift associated with acquiring and retaining customers.

This approach not only has the potential to attract new customers but also to retain existing ones, thereby enhancing customer loyalty and market share.

Recommendation #2D - Estimate how adding a “free” tier to the fee structure impacts the assembly stage and the ability to cover direct labor cost.

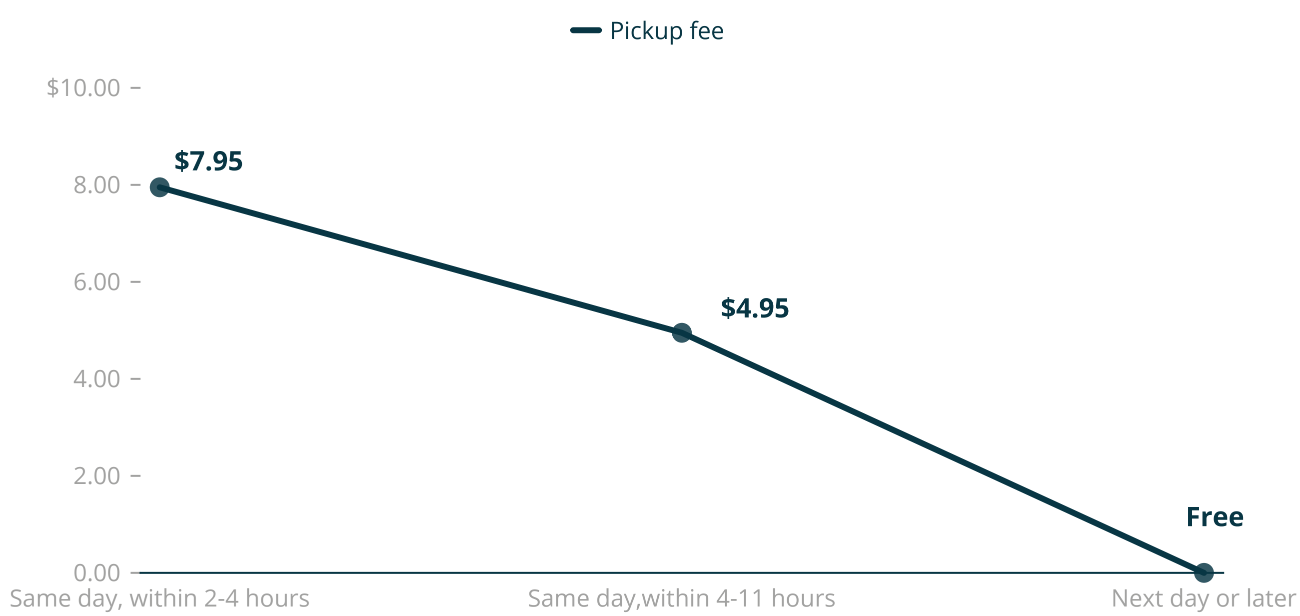
Most customers appear willing to place a Pickup order for next day if that enables them to completely avoid paying any service fee (Chart 17a and 17b). However, a retailer should identify other ways to offset the labor cost beyond improving assembly productivities (Table 6).

Chart 17a: Variable Fee: When Customers Elected to Receive



Source: Mercatus, Online eGrocery Shopping Survey 2023. Brick Meets Click estimates. Example refers to two scenarios given to the same consumers related to a delivery service.

Chart 17b: Variable Fee: When Customers Elected to Receive



Source: Mercatus, Online eGrocery Shopping Survey 2023. Brick Meets Click estimates. Example refers to two scenarios given to the same consumers related to a delivery service.

Table 6: Example: Impact of Shifting a Single Pickup Order

Online Stage: Activity	Customer	Retailer
Ordering: n/a		
Assembling: Shifts to two-order pick session, using advanced practices, from basic, single-order pick	n/a	Saves $6.71
Distributing: Customer shifts to 4-8 hrs., same day from within 2-4 hrs., same day	Saves $4.95	Forgoes $4.95
Net Impact	+$3.00 win	+$1.76 Win

Source: Mercatus, Online eGrocery Shopping Survey 2023. Brick Meets Click estimates. Example refers to two scenarios given to the same consumers related to a delivery service

Executive note: Grocers can start by establishing an estimate for the upper range or band for the fee structure that applies to confidently fulfilling an expedited or express order based on internal lead time standards.

This approach not only caters to customer preferences but also ensures that the operational costs are covered, thereby maintaining profitability.

Recommendation #2E - Determine the upper fee band by assuming no assembly or distribution efficiency associated with expediting a single Pickup order.

It could cost almost $13 to fulfill an expedited order given it will likely be assembled by itself (#1). However, most grocers would be reluctant to charge that high of a fee. So, as with credit cards, retailers can consider factoring in a portion of the fee into product pricing (Table 7).

Table 7: Example: Estimating Fee Based on Direct Labor Cost

Line item	Measure		Value
Assembling, i.e., pick, pack, & stage	Min./Order		31
Distributing, i.e., retrieve, transport, & transfer	Min./Order	+	3
Direct-labor	Min./Order	=	34
Wage rates (part-time)*	$/Hr.	x	$21.20
Direct labor cost	$/Order	=	$12.64
Pickup fee (upper band) rounded to nearest $.95	$/Order	=	$12.95

Note: Based on advanced pick-and-pack practices and related to assembling and distributing a single order.

Source: Brick Meets Click estimates. *Hourly rate of $16.30 per hour to part-time employee plus 30% in benefits for fully-loaded rate of $21.20 per hour

Executive note: Consider ways to subsidize some portion of the fee while still making it high enough to serve as an explicit reminder to the customer that online shopping is a value-added service provided by the grocer.

This approach not only ensures that the costs of expedited orders are covered but also maintains a reasonable fee structure for customers.

Recommendation #2F - Factor in a markup on product prices to help lower the explicit fee that customers pay and reduce some of the friction for customers (Table 8).

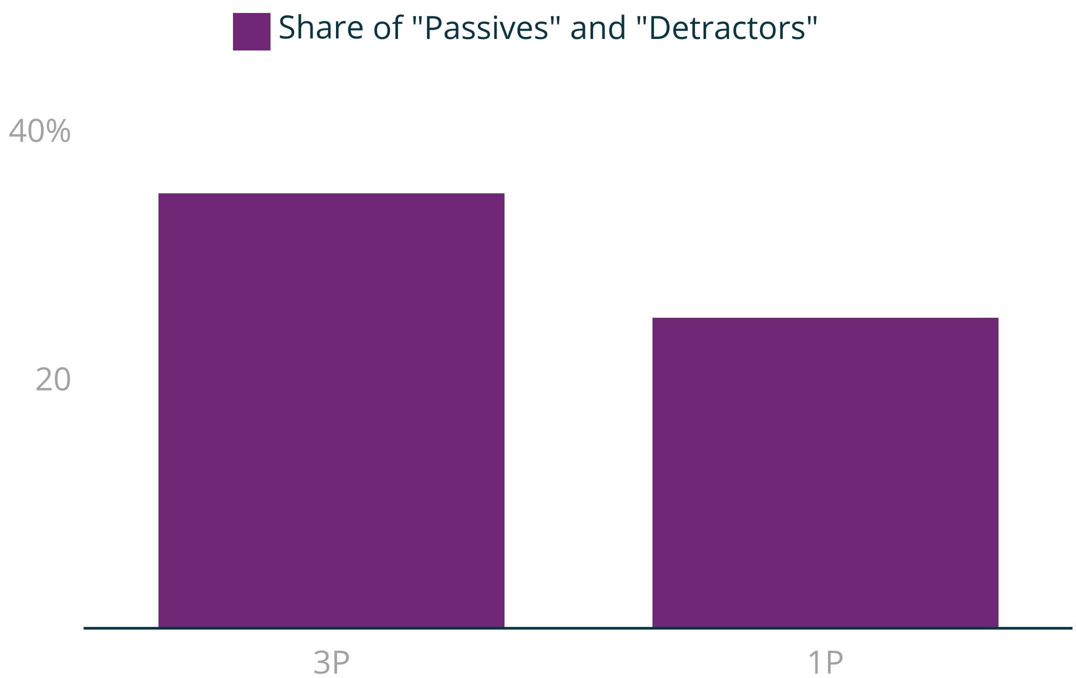
Table 8: Example: Estimating Fee Based on Direct Labor Cost

Line item	Measure		Value		Ext.
Direct labor cost	$/Order				$12.64
Average order value	$/Order		$150		
Online vs. in-store pricing	%	X	3%		
	$/Order	=	$4.50	-	$4.50
Pickup fee (upper band)	$/Order			=	$8.14
Pickup fee (upper band) rounded to nearest $.95	$/Order			=	$7.95

Source: Brick Meets Click estimates

By accounting for a portion of the labor costs in product pricing, as is done with credit card fees, grocers can reduce fees, which is a key reason why customers stop using a specific service whether they're ordering via a 3P or 1P site/app. (Chart 18).

Chart 18: Fees and/or Other Charges were too High



Detractors (0-6), Passives (7-8), and Promoters (9-10) are segments based on the Net Promoter Score® related to questions regarding likelihood to use the same service again within the next 30 days. Note: Based on most recent online order within the past month..

Source: Mercatus, Online eGrocery Shopping Survey 2023

Executive note: Consider how to apply demand-shaping tactics like this to reward the customer choices that help reduce their cost to service online orders.

This approach not only reduces friction for customers but also manages the costs-to-serve online orders.

Recommendation #2G - Leverage a three-tier fee structure to pass along increased savings to customers who are motivated by paying lower or no service fees.

Pickup is about saving customers time as the potential time savings equates to nearly one hour if compared to in-store shopping. And, because customers value their own time differently and have different need states, this structure lets the customer make the choice (Table 9).

48 Minutes

Average Time Spent When Grocery Shopping During 2021 (Exclude travel time to and from store)

Source: Brick Meets Click estimates; Bureau of Labor Statistics, American Time Use Survey, 2021, 18 years and over, average time spent grocery shopping

Table 9: Example: Potential Pickup 3-Tier Fee Configurations

Receiving Windows	Option 1	Option 2
Same day, within 2-4 hours (30- or 60-minute time slot)	$7.95	$7.95
Same day, within 4-11 hours (30- or 60-minute time slot)	$4.95	$4.95
Next day or later (30- or 60-minute time slot)	$1.95	Free

Note: regarding time slot duration: Although most grocers provide a 60-minute time slot when picking up an order, shifting to a 30-minute time frame helps improve aspects of the distribution stage, i.e., when orders are transferred to the customer at the pickup point, as it helps to smooth inbound traffic.

Source: Brick Meets Click estimates; Bureau of Labor Statistics, American Time Use Survey, 2021, 18 years and over, average time spent grocery shopping

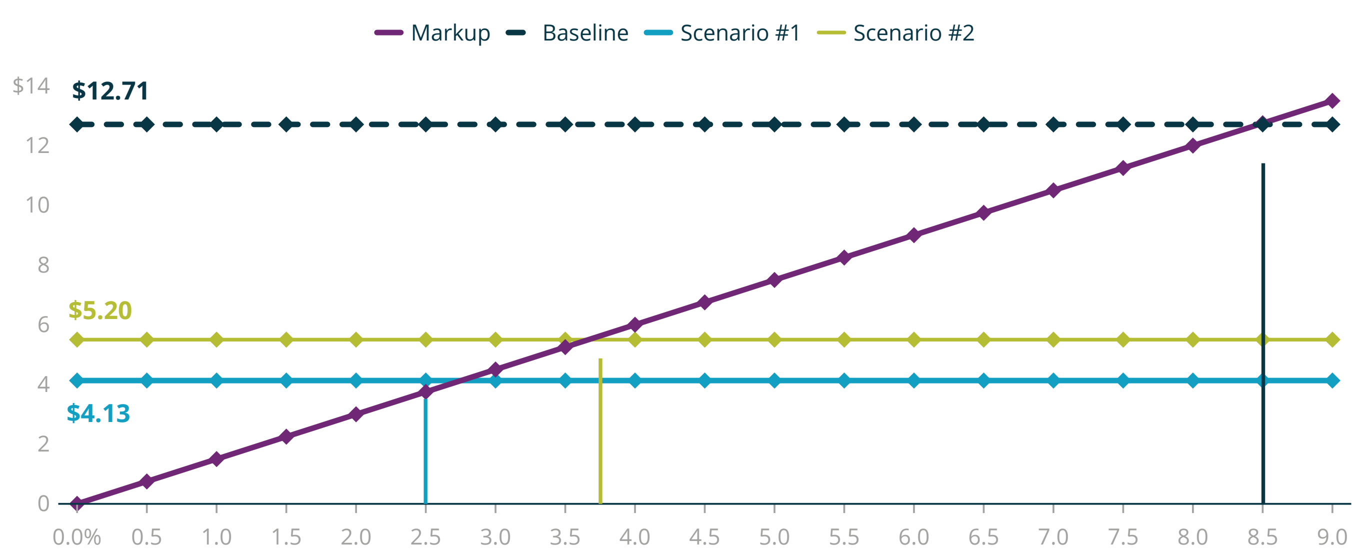
Executive note: Identify the range of fees in a 3-tier approach that are most appropriate for shaping demand with their customers, like $7.95, $4.95 and $1.95, or something else. Then assess the benefit of a free option to grow the customer base.

This approach not only caters to different customer preferences but also incentivizes behaviors that align with the grocer's operational efficiency goals.

Recommendation #3 - Assess the markup necessary to cover the direct labor costs after accounting for labor efficiencies, media monies, and service fees.

Grocers who leverage the fee structure to more effectively drive labor efficiencies, while still generating meaningful monies, can apply a lower markup (Chart 19 Markup) compared to a grocer that hasn't improved its pick and pack practice and is forfeiting fees without realizing increased AOVs (Chart 19 Baseline).

Chart 19: Online Markup Required to Cover Direct Labor Cost for a Pickup Order



AOV = Average order value or dollars spent per order

Source: Brick Meets Click estimates. Monies associated with online's markup is based on an average order value of $150, derived from Brick Meets Click's 2021 eGrocery Performance Benchmarking initiative and adjusted for grocery inflation through 2022.

Assumptions

Basic practices

- Pick session: 100% single-order, manual pick session (basic method)
- Weighted average fee: $0.99 based on 80% > $35 purchase threshold to avoid fee and 20% paying a $4.95 fee.

Enhanced practices

- Pick session: 15% single-, 25% two-, and 60% three-order pick session (advanced method)
- Weighted average fee: $2.43 based on same order mix as pick session paying $7.95, $4.95, and $0.00/free respectively.

Enhanced practices

- Pick session: 20% single-, 40% two-, and 40% three-order pick session (advanced method)
- Weighted average fee: $4.35 based on same order mix as pick session paying $7.95, $4.95, and $1.95 respectively.

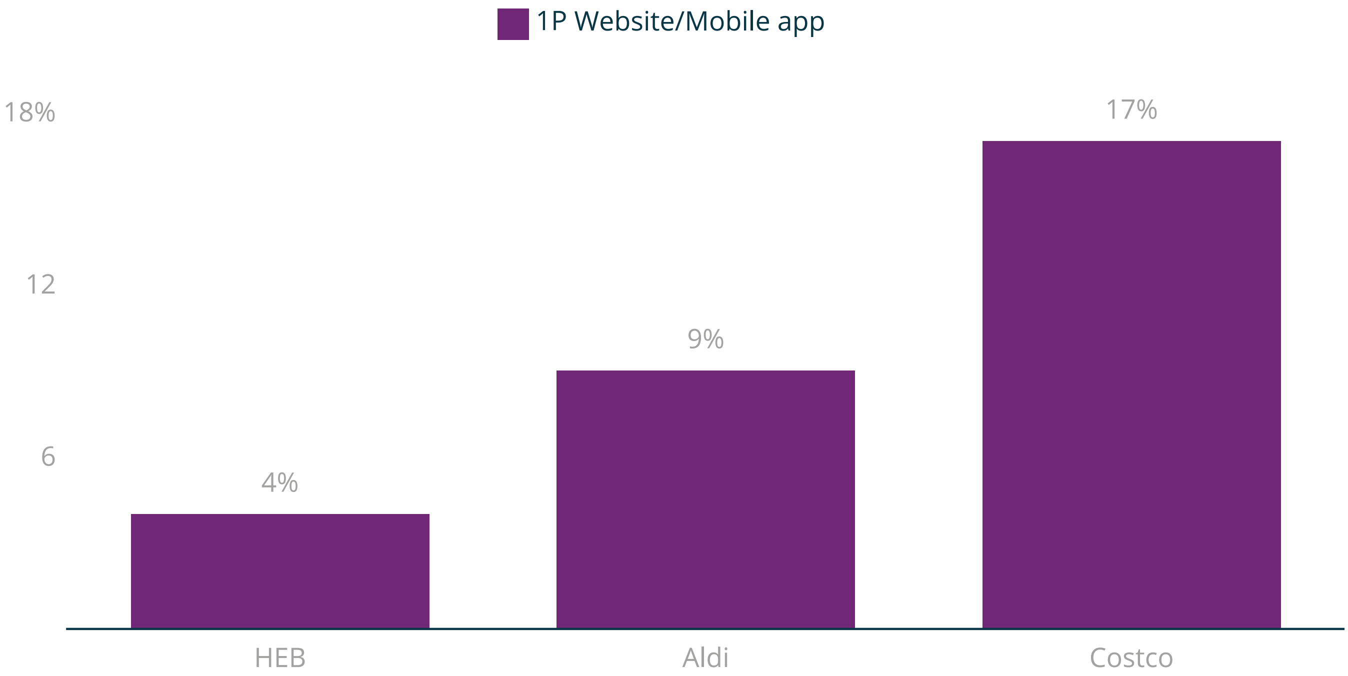
Executive note: Determine whether to include other related costs into the calculation (beyond direct labor cost) when considering the online markup. And, if Delivery is available via the retailer's 1P site, then adjust to account for its direct costs to fulfill.

This approach not only manages the cost-to-serve online orders, but also incentivizes operational efficiency.

Recommendation #4 - Communicate that online prices may be higher/vary versus shopping in-store and/or even possibly the weekly ad.

A Regional Grocer, a Hard Discounter, and a Wholesale Club banner each marked up the prices on its 1P site/app by varying degrees, likely driven by different decisions related to their respective businesses.

Chart 20: Online Markups vs. In-store Pricing



Reflects net pricing, i.e., less member deals, temporary price reductions, and coupons

Source: Brick Meets Click Market Basket Analysis, Plano, TX, March 15-16, 2023.

Executive note: Determine where to locate this information so that customers who are interested can find it. Also, be sure to clearly communicate to team members why prices may be different online so that they are informed and can answer questions.

By clearly communicating these differences to customers, grocers can manage customer expectations and maintain trust.

Recommendation #5 - Consider protecting advertised items and other promoted products to avoid customer confusion and/or frustration when ordering online.

Doing this helps to make the online ordering stage more seamless as it could be a source of friction for customers who review the circular before and/or while building their online basket (Chart 21).

Example Product Pricing Discount

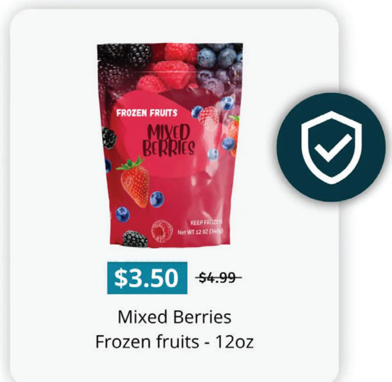
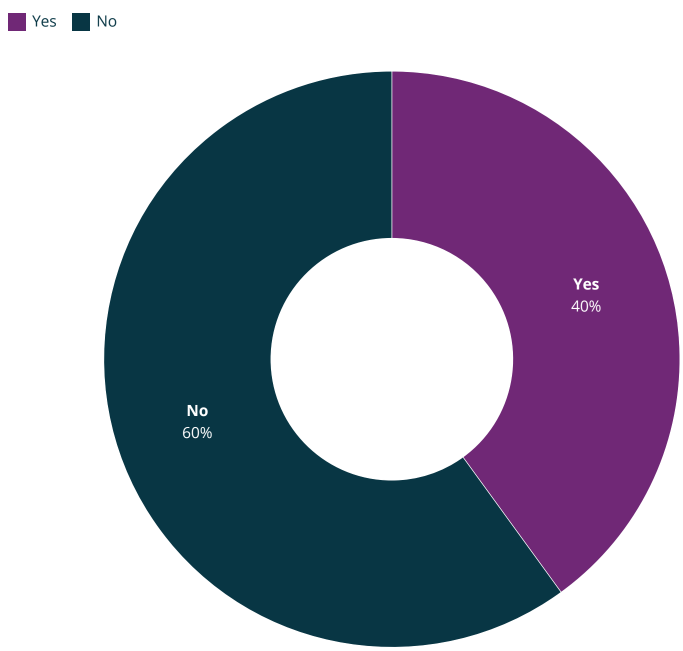


Chart 21: Reviewed Weekly Ad Circular Before Placing Most Recent Online Grocery Order



Note: Based on most recent online order within the past month.

Source: Mercatus, Online eGrocery Shopping Survey 2023.

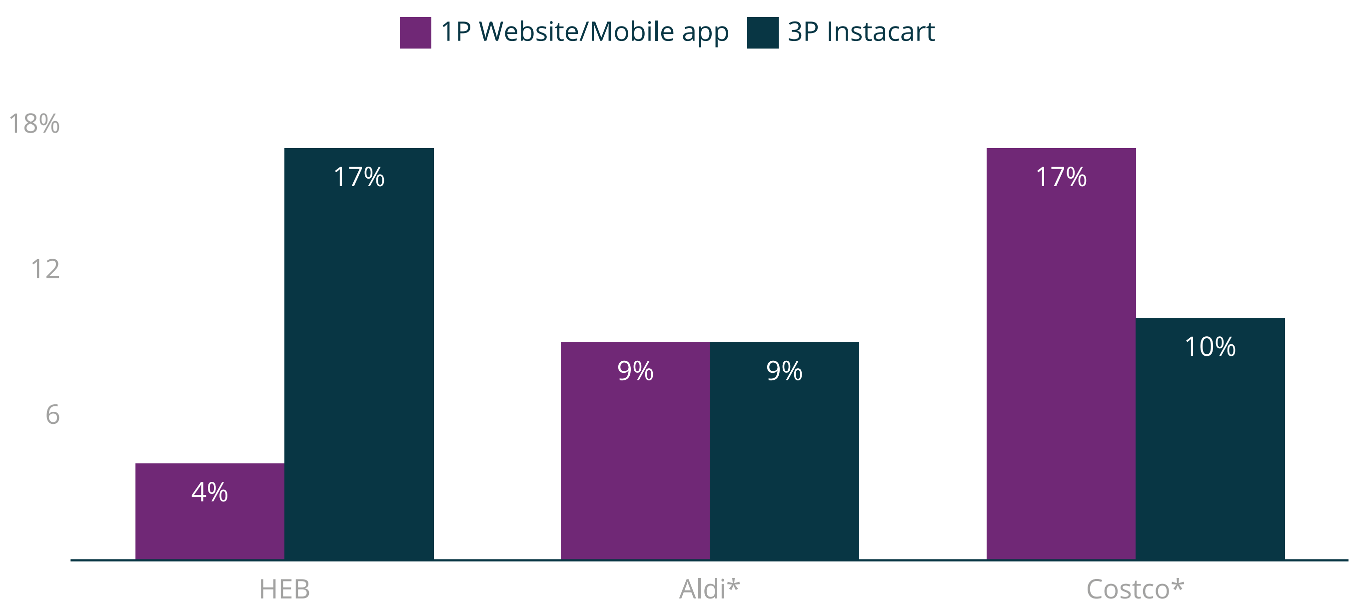
Executive note: Reweigh the markup target, factoring out the sales related to protected items. Also determine if and/or how you want to protect known value items (KVIs), by either handling like an ad item or applying a lower markup rate.

This approach not only reduces friction for customers but also ensures that the value proposition of advertised and promoted products is maintained.

Recommendation #6 - Establish the 1P site ideally as the lowest place to shop online, or at minimum, be sure that it's at parity with 3P sites (Chart 22).

Although 3P marketplaces may expand the market reach of the banner or attract net new customers, managing the pricing among 1P and 3P sites helps a regional grocer capture a larger share of demand online.

Chart 22: Online Markups vs. In-store Pricing of Products



** Banner's 1P site/app include varying degrees of integration with Instacart, which may affect their respective pricing decisions. Note: Costco offers grocery pickup on a very limited basis.*

Source: Brick Meets Click Market Basket Analysis, Plano, TX, March 15-16, 2023. Reflects net pricing, i.e., less

Why Costco looks this way

One the 1P site, Costco members could in effect pay the same amount for products as on the 3P if they became a member of Instacart+ for an additional fee.

If the Service that the 3P had, but 1P didn't, was factored into product pricing, this would effectively raise the 3P markup rate to 15%.

Executive note: Grocers should better understand what role retail media plays in its overall eCommerce and omnichannel strategies as this pricing philosophy is more essential for those looking to leverage retail media on its site.

This approach not only enhances the value proposition of the 1P site but also ensures competitiveness in the eGrocery market.

Section Closing

In this section, we have explored comprehensive recommendations to reevaluate your pricing strategy, enhance customer experiences, and optimize operational efficiency. Below we will provide a summary of the key suggestions:

1. Harness Advanced Assembly Practices - Implement advanced assembly methods to significantly lower costs per order. By increasing the number of orders assembled per pick session, direct-labor costs can be curtailed, leading to better operational efficiency. Simultaneously, consider instituting a service fee structure that balances the costs incurred during assembly and distribution phases, providing a fair pricing model to consumers.

2. Strategize Fee Structure - Design an innovative fee structure that creates a win-win situation. This should reward customers for their behaviors that contribute to cost efficiency. Implement a variable fee structure rooted in order cycle times. This helps in demand management and creates a conducive environment for cost savings for both the customer and the retailer.

3. Evaluating Impact of Free Tier - Conduct a rigorous analysis to understand the impact of introducing a “free” tier on your assembly operations and your ability to cover direct labor costs. Consider incorporating a markup on product prices to effectively lower the explicit fee that customers pay, making the service more attractive.

4. Implement Three-Tier Fee Structure - Deploy a three-tier fee structure to cater to a wider customer base, including those motivated by lower or no service fees. This strategy not only addresses customer preferences but also nudges them towards behaviors that align with the retailer’s operational efficiency objectives.

5. Markup Assessment - Thoroughly assess the necessary markup to cover direct labor costs after factoring in labor efficiencies, media income, and service fees. Determine whether to include other related costs into the calculation for a comprehensive understanding of online markup.

6. Transparent Price Communication - Maintain customer trust by clearly communicating the potential variations in online and in-store prices. Transparency is key to managing customer expectations and ensuring their continued patronage.

7. Protection for Promoted Products - Consider safeguarding advertised items and other promoted products to eliminate potential confusion and frustration when customers order online. This tactic ensures a seamless online shopping experience.

8. Maintain Pricing Parity - Strategize to establish your 1P site as a competitive shopping destination - ideally, the most affordable place to shop online. At minimum, ensure parity with 3P sites to capture a larger share of online demand.

Our next section 'Closing the Online Pricing Loop' will help you bring these recommendations into a cohesive, effective pricing strategy for your online grocery business.

Closing the Online Pricing Research Loop

In closing, we find ourselves in a dynamic eGrocery landscape that is constantly evolving. Grocers are standing at a critical junction, with the daunting task of enhancing profitability and customer experience while keeping up with the competition. The report hints at a softening demand for eGrocery and a slowdown in growth in the post-COVID era. National rivals, like Walmart, with their robust resources, are better positioned to absorb the higher cost structure of eGrocery. So, what does this mean for regional grocers? It's time to roll up those sleeves and rethink strategies to stay in the game.

This report serves as a compass for regional grocers navigating in the intricate maze of eGrocery pricing and strategy. It introduces the Three C's Framework, a beacon that guides you to own the customer, control choices, and manage costs effectively. The report further lays out a roadmap, divided into three stages: Establish Baseline, Model Enhancements, and Determine Details. Think of it as building a house, each stage laying the foundation for the next, resulting in a robust and comprehensive guide when considering pricing strategies.

So, what are the action items for regional retailers?

1. Embrace the Three C's Framework – Own the customer, control choices, and manage costs effectively. It's not just a suggestion; it's a mantra for success.

2. Leverage the Roadmap – Establish a baseline, model enhancements, and determine details. Let's add a Stage 4 as "Implement Plan" and Stage 5 as "Assess Impact". Measure your success by comparing actual to expected results 3 to 6 months post-implementation.

3. Revamp Pricing Strategies – How about adding a "free" tier to the fee structure? Evaluate the markup necessary to cover direct labor costs, and let's not forget to protect advertised items.

Table 3: Action and Recommendation Roadmap

STAGE 1 Establish Baseline	**STAGE 2** Model Enhancements	**STAGE 3** Determine Details
• Quantify direct labor costs and consider other relevant costs*. • Capture current and forecasted sales levels. • Determine the role and impact that retail media moneis play.	• Estimate order distribution based on tiered fee structure. • Project how the fee structure will lower unit cost to assemble order. • Set the upper band of the fee structure and then the other tiers. • Establish product markup to cover all/part of remaining cost.	• Create messaging for site/app • Consider how to price protect advertised items. • Establish pricing philosophy between 1P and 3P site/apps.

* Other relevant costs could include but are not limited to retail value of special deals used to drive trial, service fee waived on first x orders, credit for product returns, indirect labor associated with supervisors, etc.

Considering the Three C's Framework and leveraging the roadmap, grocers can make strategic choices that resonate with their objectives and strategies. The clock is ticking, and it's high time for grocers to adapt to stay competitive in today's market. Remember, it's not just about surviving; it's about thriving in this ever-evolving landscape.

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About Mercatus

Mercatus helps leading grocers get back in charge of their eCommerce experience, empowering them to deliver exceptional retailer-branded, end-to-end online shopping, from store to door. Our expansive network of more than 60 integration partners allows grocers to work with their partners of choice, on their terms. Together, we enable clients to create authentic digital shopping experiences with solutions to drive shopper engagement, grow share of wallet and achieve profitability, while quickly adapting to changes in consumer behavior.

The Mercatus Digital Commerce platform is used by leading North American retailers, including Weis Markets, Save Mart brands, Brookshire's Grocery Company, Kowalski's Markets, WinCo Foods, Smart & Final, Stater Bros. Markets, Buehler's Fine Foods, Southeastern Grocers' Fresco y Más, Harveys Supermarket and Winn-Dixie grocery stores among others.

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