Internet Grocery Stores
What does the future look like?
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In the past several years, there has been an explosion of Internet companies on the retail market. Internet grocery stores exist, but thus far, they have not had the type of impact that other Internet stores have had. The supermarket industry is a $450 billion dollar industry, and online supermarkets have the potential of gaining a portion of that amount. While several grocery stores have started up in this country, no online grocery store has emerged as an Internet powerhouse, like an Amazon.com, priceline.com, or Wal-Mart.com. This paper will examine the viability of Internet grocery stores, and their possible future. The paper is organized into several sections. First, we will examine why anyone would want to buy their groceries over the Internet. Then, the current Internet grocery stores and their operations will be examined. Next a look at how the some of the major retail Internet companies operate, and how they serve their customers. The fourth section will examine how the overall internet retail industry can be applied to internet grocery stores. Fifth and finally, the possibility of Internet grocery stores surviving and thriving will be examined.

Section I. – Why Buy Groceries over the Internet?

With the rapid of the explosion of the Internet, people have been discovering new ways to make life a little easier. There are Internet auctions, the ability to get news at anytime, amazing research possibilities, and Internet stores to save time and money. The Internet stores have really taken off in this country, with several retail Internet companies worth well over one billion dollars. Despite the success in the retail market for Internet
companies, the success has not been as noticeable for online grocery stores. This leads to the question; why would anyone want to buy his or her groceries over the Internet?

There are a number of reasons why people might want to buy groceries over the Internet. Some of the reasons are price, selection, quality, and convenience. Not all of the reasons that would lure people to Internet grocery stores have been realized yet. If there were significant price savings to buying groceries over the Internet, that would probably entice a number of people into buying their groceries online. Low prices are a big reason for the successes of many of the leading (non-grocery store) Internet retailers. If there was a bigger selection at online grocery stores, people may shop online when they need particular goods. If the online grocery stores had higher quality, that could be a reason for people shopping online. Finally if online stores were more convenient, by avoiding the hassles of the supermarket, many people would consider shopping at online grocery stores. If all of these reasons were present, the online grocery business would be booming right now. Unfortunately, the main attribute that seems to be working in favor of the online grocery stores in convenience. Some online grocery stores boast that their goods are of a higher quality than conventional grocery stores, but higher quality goods have not led a very large number of people to switch to online grocery stores.

When a customer goes to an online grocery store, they select all of the groceries they want, and then they plane an order to buy them. To pay for the goods, the customer gives the company their credit (or debit) card information or sometimes companies will accept other methods of payment if arranged in advance. Right now, costs for online grocery shopping are about the same as conventional grocery stores, but shipping makes them cost a little bit more. Then the customer awaits the delivery (if they chose to have
the goods delivered), or sets up a time to go pick up the groceries which will be waiting for them. This saves the hassle of having to go through the grocery store to pick out goods and then waiting in line to pay for them. But there is a further advantage to shopping for groceries online. With most online grocers, once a customer has placed an order, they can create their own list. This list can then be brought up the next time they shop. This will save a lot of time because the customer would only need to modify the list of groceries that they prefer. So there are plenty of reasons why customers would want to shop online for groceries, either now, or in the future after more advantages appear.

Section II. – How do the Current Internet Grocery Stores Operate?

Internet grocery stores are here, but have yet to make the impact that many other online stores have made. In general, the online grocery stores discussed will be in one of two categories, national online grocery stores and online grocers that only serve certain area (regional online grocery stores). Netgrocer and Grocer Online are a couple of national online grocery stores. Those stores can serve people anywhere in the country. There are many more regional online grocers, such as Peapod.com, Albertsons, and Webvan. These regional stores serve many different metropolitan areas, such as Manhattan, Seattle, Boston and San Francisco. The approaches taken by the national stores is very different from the approach the regional stores have.

The national online grocery stores are similar to the other online consumer stores in many ways. A consumer selects the goods they would like to buy, they pay for the goods online, and their order is shipped to them within a few days. There is a delivery fee involved, and the amount of the fee usually depends on the amount of the order, and
the distance the order needs to go. This is very similar to how the some of the major
Internet stores operate.

The local stores operate differently. The local online grocery stores have their
customers select the goods they want and then arrange a time to pick up the goods. With
most local online grocers, deliveries can be made for an additional fee. This allows a
customer to shop for groceries without ever having to leave their house. With both
national and regional grocery stores operating, it is worthwhile to examine the advantages
and disadvantages each type of online grocer has compared to each other.

The national online grocery stores have both advantages and disadvantages
compared to the local online grocery stores. The national stores reach everyone across
the country, so there is a potential for more sales revenue. Netgrocer claims over 200,000
people have ordered through them. These online stores also have the advantage of
having only one (or a few) warehouses to keep goods at. Having fewer buildings
(compared to sales) will keep costs down and result in higher profits for the national
online grocery stores.

There are two main disadvantages the national stores have compared to the local
online stores. The first is that because the food needs to be shipped, frozen and
refrigerated foods are difficult to ship. Some national stores cannot ship them, others will
ship them, but the goods need to be specially packaged. The second disadvantage is that
there are considerable shipping costs involved when shipping a large order of groceries.
To give an example of the shipping costs, lets look at Netgrocer. To ship $100.00 worth
of groceries to Iowa, there would be $20 in shipping charges. Part of the reason these
costs are so high, is the distance the goods need to be shipped. Because Netgrocer is
located on the East Coast, it costs more to ship goods far away from the company. To ship $100.00 worth of groceries to Maine, there would still be $9 in shipping charges. That is still high, but over fifty percent lower than the shipping costs to Iowa. The local online grocers generally charge a nominal fee (normally less than five dollars) to gather the groceries together for the customer’s pickup.

Neither national nor regional online grocery stores are offering big discounts to shop at their stores. The main attraction for shopping online is the convenience. The customer can save the hassle of going to the grocery store by shopping online. Also, after the first order, many of the online grocers let you save a “favorite” shopping list, so that you would only need to add and subtract from your basic list before you order. This will save customers even more time. With no online grocery stores making a big breakthrough to the American market, the next part of this paper will examine how the Internet has worked for sales of other consumer goods.

Section III. – How do the Major Retail Internet Companies Operate?

In the next part of this paper, the methods used by the major online consumer stores will be examined. The methods used by the major retail Internet companies, and their successes and failures can provide key insights into the future for online grocery stores. There are now hundreds of online stores that sell goods to consumers. Sales of goods over the Internet have risen dramatically in recent years, from zero just a few years ago to over seven billion dollars last year. Half of the American population is not even connected to the Internet yet, and many that are connected have not yet purchase goods online. With these facts and the growing popularity of the Internet, experts say the
amount of “e-commerce” (retail Internet sales) is supposed to keep going up, with no end to this growth in sight.

While there are many different stores that sell goods to consumers. This paper will look specifically at how two different companies, Amazon.com and Wal-Mart.com, are selling directly to consumers. These two companies were picked for a couple of reasons. First, both companies are considered “leaders” in the retail online industry, and their methods are similar to most other internet companies. Second, they have structures that are somewhat similar to how online grocery stores would operate. Amazon.com has been opening warehouses, or they are working on opening warehouses, across the country to better serve customers, and Wal-Mart.com is the online version of the national chain store Wal-Mart. They do a considerable amount of online business.

These online stores take orders directly on their websites, and people use credit cards to pay for their order (in some cases customers can use debit cards). When these stores get an order, the customer knows immediately whether or not the item they want is in stock. If all of the customer’s order is in stock, the order is shipped immediately. If part or all of a customer’s order is not in stock, the company tries to get that item as soon as possible. Once all of the materials to fill the order are in stock, the items are gathered together and shipped to the customer.

These stores have built such a following because they offer tremendous savings over conventional store shopping, a very large selection, and convenience. The savings are possible because of the elimination of stores, which saves the company money. Amazon.com offers discounts that are usually in the range of twenty to thirty percent, although sometimes higher. Wal-Mart.com has discounts on there goods also, but the
amount the good is discounted is not listed. The discounts offered both by Amazon.com and Wal-Mart.com give their Internet companies a competitive advantage. They have a fundament cost difference that allows them to sell to the public at a cheaper cost.

One interesting fact about the leading retail Internet companies is that up until now, most have no profits. Wal-Mart.com and Amazon.com are no exception. Amazon.com has lost money every fiscal quarter of its existence, and they do not project any profits for at least another year or two. Wal-Mart.com has the power of it’s chain stores behind their internet sites, so Wal-Mart is making an overall profit, but their internet site has not yet been making profits for them. The initial strategy for these online companies is to build their customer base now, and then once they have customers, worry about profits later.

One of the biggest problems facing online retailers is the lack of any barriers to entry. It is inexpensive to start a website, and if customers get angry with a company for any reason, there are no switching costs. This could cause major problems for the leading Internet companies, because they will not have the luxury to control prices at any time in the future. Further, an electronic glitch could alienate their current customers. A major online auction company, EBAY, experienced an electronic glitch this past summer, costing the company millions. If either Amazon.com or Wal-Mart.com is adversely affect by a technological glitch, there are many other online companies that customers could turn to, like Shopnow.com and BarnesandNoble.com. Next we will look at how Internet grocery stores can learn from the mainstream retail Internet industries.

**Section IV. How does the overall retail Internet industry apply to Internet grocery stores?**

The structure of the overall retail Internet market will give some insights into how the online groceries may fare. Some of the reasons for success in many online industries
are not present in the online grocery industry. But, there are other advantages that online groceries have that are not present in other industries. It is worthwhile to apply what is known about the national retail Internet stores to online grocery stores.

Currently, the online grocery stores are not making sales because of discounts, they get customers because of convenience. In some areas, Internet grocery stores cost the same as conventional grocery stores, and in other areas Internet grocery stores cost more than conventional grocery stores. Yet, there are still many people shop on online grocery stores. Netgrocer has served over 200,000 customers and Peapod.com delivers to over 2,000 customers every week. While no online grocery store has offered significant savings yet, in the future, prices at online grocers should decrease, but not by much.

The reason that prices will probably not decrease by much is that most of the bigger grocery stores have low profit margins. Most goods are only sold at a maximum of 2-3% over cost, which does not leave a lot of room for online grocers to lower the cost of items. While there is not much room for costs to decrease, costs should decrease for a number of reasons.

There is a possibility of online grocers lowering costs somewhat by eliminating the need for the stores where customers would need to enter and search for groceries. Many Internet grocery stores are building automated warehouses, which should decrease costs and result in lower prices for consumers. Both of these reasons should decrease costs. The approach that many online stores are using by opening up warehouses in different locations is perfect for online grocery stores. Stores in big cities could have a warehouse where they store the food, but do not have to have all of the expenses
conventional grocery stores have. This approach would only work in bigger towns and cities, but it could be huge.

Another way that there may be some savings for customers who shop for groceries online is if online grocers do a better job bargaining with suppliers. Wal-Mart is famous for getting good deals from suppliers, and then passing the savings along to customers. Wal-Mart is able to do this because companies do not want to risk losing Wal-Mart as a customer. If one or two online grocery stores became so big that they have tremendous bargaining power with suppliers, they could offer savings to customers because of their bargaining power. With this, there could be an explosion in the use of online grocers, even with costs that are the only slightly lower, because of how convenient it is to shop for groceries online.

One advantage online groceries will have as far as profitability is concerned is some barriers to entry. These barriers will be regional. Because there may only be enough space in a city for one major online grocer, it would take a lot of money and a big risk for another online grocer to move into an area that is already being served by an existing online grocer. These barriers to entry are not present in most retail Internet stores, so it gives online grocery stores a slight advantage with respect to the competition they may face.

Another advantage that online grocery stores have compared to other retail Internet industries is that groceries are almost always in stock. It is rare to go to a grocery store and not find the exact brand that one is looking for. This should lead to happier customers, because they will not have to wait until items come in stock (customers may have to wait on rare occasion).
As mentioned before, many of the leading Internet companies that sell directly to consumers have not made any profits yet. They are trying to build customers now, anticipating that customers will be much harder to get once a lot of online companies in the same industry get popular. This approach may be more important in the online grocery industry than in other sectors. If a major online grocer can go into a metropolitan area and set up a warehouse, and attract a large number of customers, there will be less incentives for competitors to locate in that market. Because of this, one should expect many leading online grocers to lose money for the next several years, as they try to position themselves as the online leader in grocery sales.

Section V. Conclusion: The Future or Online Grocery Stores

Online groceries face a bright future. The supermarket industry takes in $450 billion in revenues per year, and the Internet groceries should grow to take a large portion of that amount. Consumers should benefit from these online grocery stores mostly because of how convenient they are, but price benefits may also evolve. The next few years should see an explosion of Internet grocery stores, especially as some of them try to build up market share.

A few years ago, not many could have imagined bidding in online auctions, or buying books at huge discounts over the Internet. The changes that will happen in the online grocery industry also are unknown. The one thing that is known is that online groceries are around, and they are here to stay.