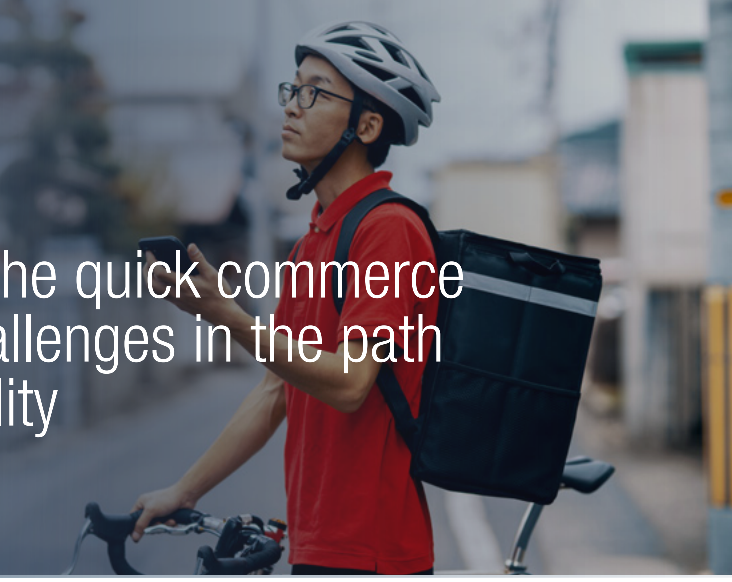


A&M INSIGHTS

Capitalizing on the quick commerce opportunity: Challenges in the path toward profitability

Background

The rise of work from home, social distancing concerns and customers' growing focus on convenience created the perfect conditions for quick commerce to flourish in the past two years. The new, faster form of e-commerce where companies deliver groceries in less than 20 minutes has attracted $14 billion in funding just in the first year of the pandemic1 as Covid-19 catapulted a once-niche retail channel into a business in its own right.

Today, more than 30 companies[2], from start-ups such as Gorillas and Getir to existing online delivery players like Deliveroo are competing for a slice of the market. Big chains are also joining the race by launching their own instant delivery solutions or entering partnerships with rapid grocery apps. U.K.'s Sainsbury is one example, having partnered with both Uber Eats and Deliveroo[3] while also offering its own Chop Chop rapid delivery service[4].

Quick commerce offers significant growth potential given the continuation of post-pandemic consumer trends and other drivers such as Europe's high disposable income and high levels of urbanisation. In fact, market penetration is very low, with only 1.5 percent of French population and 11.5 percent of Parisian residents using instant grocery delivery services.

Dark-store

2,000 to 2.500 SKUs

200 to 400 m²
(non premium location)

Picking: 3 min max

Delivery ride

Delivery by employed riders using electric bicycle

Delivery radius of 1.5 to 2km
Catchment area with 70k to 150k inhabitants

Delivery reception

Order within 15 min max

[1] Catch them if you can: the $14bn rise of rapid grocery delivery services
[2] Quick Commerce in Western Europe: Trends, Operational Models and Prospects
[3] Sainsbury's partners with Uber Eats and Deliveroo
[4] Vigie Grande Conso

The availability of funding has fuelled the sector's growth so far, but the economics of its operating model are yet to be proven. Most businesses remain loss-making despite soaring sales due to heavy spending on client acquisition and labour costs. Other operating costs such as picking and delivery mean companies are averaging a loss of €2 to €5 per order, according to A&M's analysis. Further, grocery retail is notorious for low margins, adding complexity to the challenge.

The route to profitability requires new and legacy players to adapt rapidly to the fast-changing competitive landscape and invest in value creation levers including quality of the products, a more balanced assortment size and order picking productivity. The industry's ability to grow beyond convenience shopping and find sustainable market demand also needs to be proven.

Finally, competitors should be prepared to face consolidation, with many likely to be swept up in the inevitable wave of mergers and acquisitions. The recent acquisition of U.K.-based Dija by Softbank-backed Gopuff shows this trend is already underway.

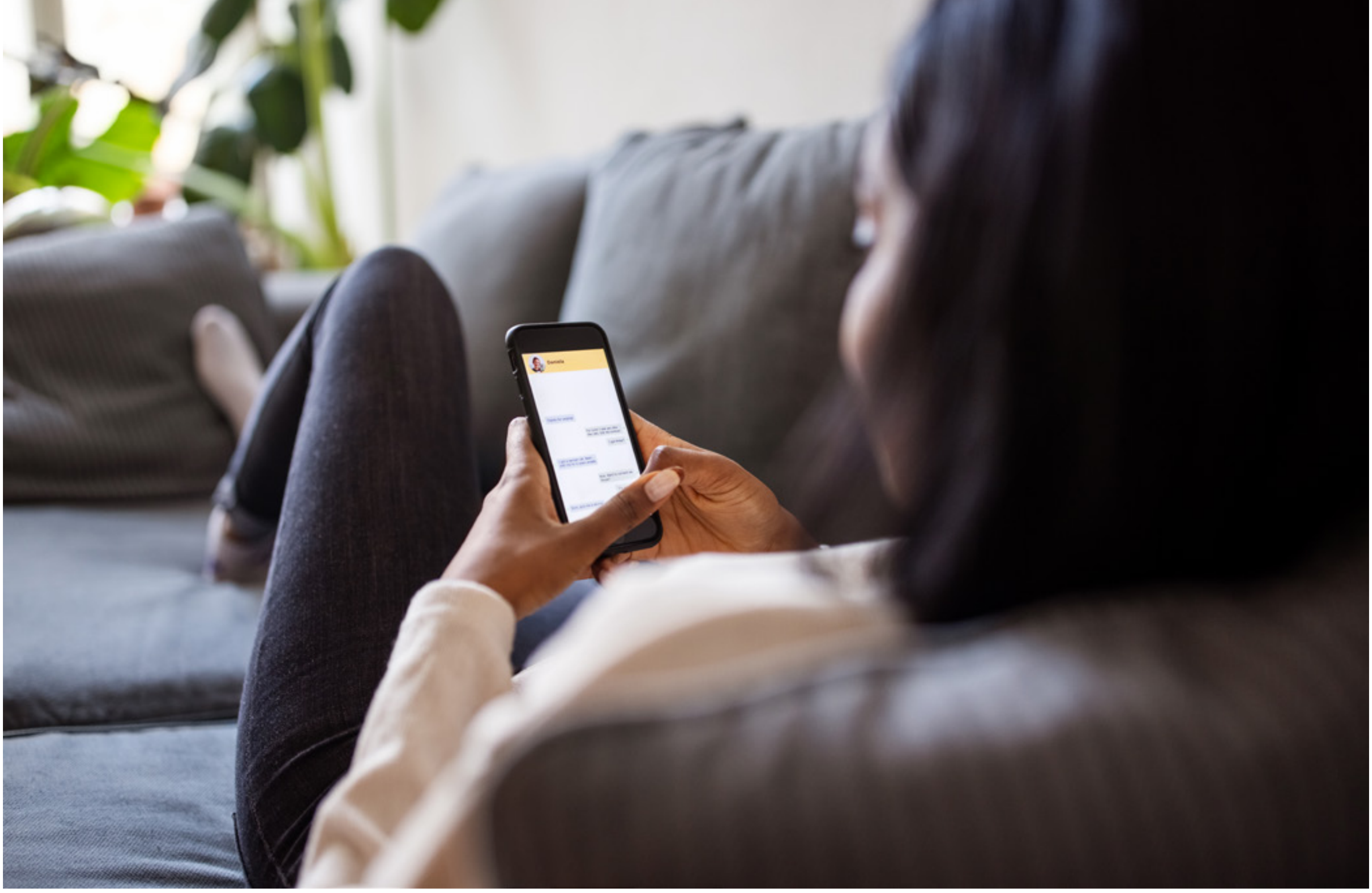
Examples of Operator/Partnerships

gopuff
GORILLAS
Zapp
cajoo
ocado zoom
Flink
getir
Sainsbury's CHOP CHOP

ASDA, Carrefour } Uber Eats

Carrefour, Waitrose, Morrisons, ALDI } deliveroo

Kroger } instacart



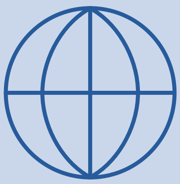
Ultra-fast, hyper-local: the quick commerce business model

Quick commerce blends traditional e-commerce with innovations in last-mile logistics, with a focus on narrow assortment and hyper-local fulfilment centers. Its proposition is simple: To deliver groceries and other convenience items at customers' doorsteps in as little as 15 minutes. Dark stores – small warehouses located at non-premium addresses but close to customers – and riders on two wheels are a key part of instant grocers' value proposition.

Berlin-based Gorillas, one of the start-ups achieving multi-billion valuation in funding rounds recently, is by far the market leader in the space, operating in 55 cities across nine countries. Other competitors in Europe include Gopuff, Flink, Cajoo, Getir and Zapp.

While most of these players operate in a vertically integrated model, providing an end-to-end service with their own app, dark stores, pickers and delivery riders, the market has evolved to include partnerships with incumbent grocers. These typically involve hosting the retailer's offering on the third-party app, with picking in-store by retailer staff and delivery by gig riders, but other variants exist.

Such link-ups are critical for quick commerce players as they give them access to more competitive purchasing terms, to an efficient logistics to replenish dark stores and to real estate locations. For legacy grocery retailers, it is a way to tiptoe into the new marketplace without big investment requirements, and strengthen customer loyalty through greater client stickiness.



Gorillas operates in 55 cities across nine countries

"Winner takes all" strategy: challenges and prerequisites to succeed

Quick commerce companies are pursuing an aggressive expansion strategy aimed at rapidly capturing most of the market and becoming profitable at scale – the so-called first-mover advantage. This includes opening dark stores in smaller cities such as Southampton in the U.K. and Utrecht in the Netherlands and increasing density in already established cities. The geographical expansion is critical to achieve the greatest number of orders in each area and saturate dark stores' capacity.

Companies are also investing heavily in client acquisition via advertising, coupons and promotions. In fact, the high level of incentives and the proliferation of new players are encouraging customers to switch from one platform to another, resulting in a high churn rate between operators.

While these strategies have so far supported top line growth, they face challenges in the long run. The current model of client acquisition and dark store deployment demands significant capital requirements, something that so far has been supported by generous inflows of cash being poured into the sector via venture capital and other sources. However, this is unlikely to be sustained because the route to self-generating cash and profit-making operating model remains uncertain.

A successful "winner takes all" approach will require competitors to tackle strategic challenges that go beyond cash funding, implementing actions and unique selling propositions such as:

01. Increase basket size with higher-margin items

In Europe, quick commerce is still mostly limited to grocery items and, within those, essential products which are typically low margin such as fruits and vegetables. Expanding product range to include alcohol, snacks as well as hygiene and beauty products is therefore crucial not only to increase basket size and drive margins, but also to target a wider range of consumer needs and grow beyond convenience shopping.

Broadening to other higher-margin, small-pack size categories such as pharmacy should be considered. Players must also maintain the ability to deliver qualitative products in their basic offering, especially in perishable fruits, vegetables, fish and meat.

However, companies need to prepare to manage picking complexity as assortment expands, with its impacts in delivery times and customer satisfaction. Analytics on steroid is one of the tools that could be used to optimize assortment structure, aligning SKU availability to customers needs and behaviours to minimize missed sales and maximize margins. Digitally-powered, efficient operations and seamless customer experience is what will make competitors stand out from the pack.

02. Delivery charges as revenue stream

There is an opportunity to generate upside revenue through yield management on delivery fees. Premium delivery charges could be deployed at primetimes such as Saturday evenings or other periods of heightened demand, such as bad weather.

Surge pricing is a commonplace strategy in ride-hailing apps like Uber but has been scarcely used by quick commerce players globally so far, Spanish start-up Glovo[5] being the exception. Because delivery fee sensitivity is high in the sector given the relative value perception (eg. fee vs grocery basket price), any initiative in that area should be considered and managed carefully.

03. Saturate dark stores picking capacity

Typically, dark stores process a minimum of 500 orders every day due to its reliance on manual picking. This means order picking is one of the most expensive processes in the operations of an instant commerce business, having a significant impact on its bottom line. A&M estimates that dark stores costs – including rent, replenishment, picking, management and IT – currently represent 20 to 25 percent of an average basket order, more than offsetting the gross margin of the sale.

Increasing order picking rates to fully saturate dark stores capacity is therefore key. Investment in technology and data-driven solutions for warehouses and inventory management will allow increased picking productivity and ensuing economies of scale.

04. Create loyalty with customer experience

In their race to gain market share, instant commerce players have created an environment of uncertain client loyalty. Customers easily change from one platform to another to take advantage of generous offers being deployed in the marketplace via coupons and other discounts.

Companies need to differentiate themselves and offer a positive end-to-end experience to customers to fight this market reality and ensure they create a loyal client base.

This means consistently delivering on the business promise of ultra-convenience through a seamless app navigation, a complete assortment range and fast delivery. A good understanding of app ergonomics is a key step to ensure that, as is the adoption of personalized and gamified promotions to make the customer journey not only smooth but enjoyable.

05. Achieve competitive purchasing and efficient logistic via partnerships

One approach to improve efficiency at dark stores is to seek competitive purchasing terms and enhance logistics. While this is typically achieved with scale and therefore is not yet a viable option for many players, partnerships can allow smaller operators to benefit from established grocers' negotiating power. Companies could also leverage the logistics network of large grocers to replenish their dark stores, further enhancing efficiency.

[5] Glovo introduces dynamic charges for food deliveries

How can A&M help?

Our professionals have both operational and advisory experience together with a proven track record in leading businesses through tough, complex situations:

- Operating model transformation and cost reduction to ensure the resources and skills of an organisation are organised to deliver the strategy and ensure future success.
- Supply chain and operations across sales and operations planning, global logistics, warehouse strategies, advanced methods for e-fulfilment, network planning, distribution, performance improvement.
- Margin management to ensure the customer value proposition leads to EBITDA improvement via improved sourcing and clear pricing and promotions strategy.
- Cash forecasting and working capital optimisation to create a cash-focused culture with accurate forecasting as well as strategic drivers to conserve cash and drive sustainable change.
- E-Commerce and digital optimisation to align operating model, skills, and CapEx and OpEx budgets to deliver profit and leading customer experience.
- Store operations assessment across both store performance (sales and margin) and store productivity (costs) to deliver a better customer experience and operational efficiency.
- Store locations, formats, sizes and rents assessment to eliminate loss-making stores, renegotiate rental agreements to deliver improvements to EBITDA and geographic network optimisation.
- Marketing effectiveness to analyse and improve marketing effectiveness and efficiency to save costs and optimise budget spend to provide the best return.

A&M: Leadership. Action. Results.SM

A&M has worked with some of the largest European Retail businesses to stabilise financial performance, transform operations, capture profitable growth and accelerate results through decisive action. When traditional improvement activities are not enough, A&M's restructuring and turnaround heritage rings fact-based, action-oriented leadership to transformation and delivers rapid results. Our professionals have both operational and advisory experience together with a proven track record in leading businesses though tough, complex situations.

KEY CONTACTS

David Benichou
Managing Director

+33 (0) 7 69 46 80 65
dbenichou@alvarezandmarsal.com

Bob Rajan
Managing Director

+49 (0) 897 1040 6061
brajan@alvarezandmarsal.com

Erin Brookes
Managing Director

+44 (0) 782 353 3676
ebrookes@alvarezandmarsal.com

ABOUT ALVAREZ & MARSAL

Companies, investors and government entities around the world turn to Alvarez & Marsal (A&M) for leadership, action and results. Privately held since its founding in 1983, A&M is a leading global professional services firm that provides advisory, business performance improvement and turnaround management services. When conventional approaches are not enough to create transformation and drive change, clients seek our deep expertise and ability to deliver practical solutions to their unique problems.

With over 6,000 people across four continents, we deliver tangible results for corporates, boards, private equity firms, law firms and government agencies facing complex challenges. Our senior leaders, and their teams, leverage A&M's restructuring heritage to help companies act decisively, catapult growth and accelerate results. We are experienced operators, world-class consultants, former regulators and industry authorities with a shared commitment to telling clients what's really needed for turning change into a strategic business asset, managing risk and unlocking value at every stage of growth.

To learn more, visit: **AlvarezandMarsal.com**

Follow A&M on:

395872/February 22