

At the ECR Conference in Turin, Tesco surprised many by describing how they built a nationwide home shopping service in the UK based on picking in store, rather than in dedicated warehouses. John Browett, CEO of Tesco.com, describes how it came about and why they are convinced others will follow this route to delivering directly to customers' homes.

When did you first start thinking about home shopping at Tesco?

After Terry Leahy, our Chief Executive, visited the Andersen Smart Store in 1995,

we realised the Internet would enable us to deliver groceries to people's homes. For years our quantitative research and focus groups told us customers wanted home delivery.

Now the Internet would allow us to process their orders for a fraction of the cost of doing so by telephone.

What else influenced your thinking?

We immediately set to work with suppliers, such as Microsoft, to work out how to do it, and to learn from pilot trials, beginning in December 1996.

Tesco.com: Delivering home shopping

CASE STUDY

by Daniel T. Jones
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Tesco has been experimenting with Internet-based home shopping since 1996. But, explains Tesco.com CEO John Browett, its real breakthrough came from industrialising the picking process.

By early 1997 we arrived at three fundamental insights. First we looked at whether we should deliver to the home from a warehouse, from a store, or a combination of the two. Looking at the picking economics put forward by the proponents of warehouses, and based on the penetration level, we recognised we couldn't actually deliver groceries economically. The reason was that drive times were just too long. We wouldn't be able to achieve enough deliveries per hour. This showed we had to deliver from a store.

The second insight was that our initial data showed people wanted to buy from the full range. You couldn't just offer 10,000 lines. We were appealing to the top half of our customer base, whose members would not accept that they couldn't buy what they normally bought. It would effectively destroy the offer for them.

It also affected the economics of the business because one couldn't drive basket size and average-order value, which are critical to all direct businesses.

The third insight was that even if we'd picked out of a warehouse, and could make the delivery economics work, we

would have a real problem with geographic reach outside London.

Few cities are big enough to support a warehouse at low levels of penetration. Unless you have at least a 10 per cent market penetration, you will not be able to serve cities such as Plymouth and Ipswich.

Why did everyone else not come to the same conclusion?

Because they did not do their homework properly. Iceland came to the same conclusion as us. But the rest built theoretical models based on several "what ifs", such as a 10 per cent penetration within a very short time, without thinking how they were going to get from A to B or how they could pick in store cost-effectively.

It is true that when we started our in-store picking, costs were horrendous! Our view was that we had faced problems like this before and what we needed to do was to work out how to make an industrial process out of it – which was the real breakthrough.

As store operators, we have, in the past, dramatically cut costs by looking at the impact through the whole supply chain.

John Browett is chief executive of Tesco.com. Prior to that, he was development director for Tesco responsible for corporate and strategic developments

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An example of this is our merchantisable units, filled at the end of the production line and rolled through our cross-docks right to the store fixture, whose impact on the costs of those lines has been dramatic.

How were you organised in the early days?

We started with a small team of six managers based at the offices in Welwyn Garden City, a few miles from the Tesco headquarters. The group was led by a store manager and was very operationally focused. Its members spent all their time thinking how to get the economics right. They had no budget, spent very little money, and the Chief Executive would ring up once a week to hear how things were going.

It was all very informal. We worked in 12 different stores until we had a working model of how to pick in store at an acceptable cost. It was just like McDonald's working out how to industrialise the process of preparing a standard meal.

We knew the delivery economics would work if we could get the goods on the van at the right price. By August 1999 we had a business which would work at scale. We

then rolled it out to 100 stores. But we still did not know whether demand would be there.

How far has this spread?

Once we saw we had enough demand we rolled it out to 240 stores across the UK, providing 90 per cent coverage of the population. The reason we only needed 240 out of our 650 stores in the UK was that for home shopping we effectively extended the drive time from 15 minutes for a normal store to 25 minutes for home delivery.

Our run rate is now more than £250 million a year – from a turnover in food of about £14 billion, or two per cent.

Are you still a small group?

No, we now have at least 100 people. But we are constantly increasing our offering beyond groceries – into books, CDs, baby and toddler, wine, flowers and a growing range of 1,500 electrical goods, more than in most out-of-town superstores.

Many people are already used to buying these goods over the phone and know what they want to buy. When your washing machine breaks down, you do

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your own independent research before you go to the store, because you will find it difficult to get any help with your choice – especially on a Saturday!

What have been the surprises from your experience?

Customers will tell you, before they use the service, that they will buy big and bulky items on the Net – such as replenishing the cat food and washing powder – and then separately buy their fruit and vegetables.

But that is not what people actually do. Quite the reverse, in fact. The proportion of fresh food is higher on-line than it is in store. Of our top 10 selling lines, seven are fresh – and the top-selling line is skinless chicken breasts!

Because people plan their home-shopping order, we capture a higher proportion of their shop, so they don't need to go to the supermarket that trip. It is a complete substitution.

This is why we think home shopping will actually grow market share for us. Around 50 per cent of our home-shopping sales are brand new to Tesco. If you are not in this business, you are going to lose market share.

What implications does this have for supermarkets in future?

Our view is that home shopping is a fundamental customer need, and as everyone gets on to the Web, anybody with children will migrate to shopping this way.

We all know how difficult it is to take children around a supermarket. They get bored. And we have all got better things to do with our time than the standard shop. It is too early to gauge the long-term impact on store traffic. Our perspective is that it will not stop people going to stores – we think they will do both – and that weaving the two things together is absolutely essential.

Let me give two examples to show why. When you register with Tesco.com we will, after a day or so, download all past store purchases from our Clubcard records. This means when you place your order, you do not have to search for the right size of tissue. Everything you previously purchased is logged on your site. How can web-only retailers, or those who have abandoned loyalty card databases, compete with this service?

Home shopping also dramatically expands the range available and allows us

“...As everyone gets on to the Web, anybody with children will migrate to shopping this way”

to access customers we were not able to reach before. Every one of our customers now has access to an even bigger range than we can stock in our largest store.

We call the non-food side of the business “stores without walls”. For instance, we cannot carry the full range of CDs in each store, whereas on-line we can offer 150,000 titles – and at 1.3 million books, our range is the same as Amazon UK.

Developing our web site, and adding features such as offering suggestions, is relatively straightforward. However, we have no cost of acquisition compared to web retailers – because we can advertise our services in our stores. Half the UK population goes through our stores every 12 weeks.

So your on-line store becomes an on-line high street? Is any area of retailing unaffected by this?

We don't think so. Take electrical goods, for example. Existing electrical retailers have done so much to confuse their customer base. Their store assistants do not know what they are talking about, and have been trained to directionally sell you into things which are good for the

retailer to sell – including expensive, extended warranties and finance. (Remember, if you fail to make a payment on a nought per cent finance deal you end up paying 30 per cent interest). In addition, they have expensive store structures and provide poor service.

We are achieving a much lower incidence of problems and fewer returns by selling customers exactly what they need, and by supplying the product directly from the manufacturer, rather than risk damage occurring as it passes through three warehouses from the factory to the home.

The Internet makes any failures to supply the complete basket of goods ordered painfully visible, whereas in the store, customers might find a substitute for a missing item. Does this not put more pressure on you to achieve 100 per cent availability?

That's right. We see it as a completely positive challenge, which we must meet. Yes, customers will buy substitutes, but we know they do not want to do so. We also know our sales would increase if we had 100 per cent availability.

There is still a lot to do to achieve this,

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but our benchmarking data tells us we already have higher basket availability than most dedicated warehouses.

What the Internet does for the first time is give us a real measure of how well we are fulfilling our customers' wishes. And for the first time we also know which items they failed to find and went to look for elsewhere.

Is Tesco.com profitable yet?

Yes. We've just had our finance team carry out an appraisal of our operations, making all the cautious assumptions and fully allocating costs, as they would with any such new business – and they confirmed we are making a profit.

There is no point in fooling yourself with the numbers. Sceptics should take note that Tesco's profits have continued to rise, unlike our competitors, which, given our growing size, also reflects our positive contribution to the bottom line.

How fast will home shopping grow?

No-one knows. It all depends on uptake of the Internet. This is a significant hurdle for the over-40s, who account for two-thirds of consumer expenditure. We have to train them how to use computers

and the Internet – and digital TV – which is no easier to use!

Where next? What are the constraints?

We have launched in Ireland, and are taking it to South Korea. Internet penetration is higher in Korea than in the UK and the country experiences much colder winters and very hot summers.

We would love to move into North America if we could – but we will need to find a store to partner with. Many retailers are offering home shopping, but the winners will be those who know how to make this model work and who can provide the biggest offering to customers. There will be an inevitable shake out in every market.

What are the thresholds beyond which you would have to modify this model?

We have enough capacity in our current store network to do 10 times our current sales volumes. I recently looked at the US market and our belief is that all the American e-retailers will pull out of dedicated warehousing and that all the web-only retailers will close. It is the wrong model. A big danger in this business is increasing your costs ahead of

“Our benchmarking data tells us our availability in store is already higher than in most warehouses”

growth in demand. Last year saw a massive increase in supply, before the customers were ready.

Finally, are you ever going to be spun off?

We did look at selling off Tesco.com at the beginning of last year. But it became clear to us that it would be very hard to run the two businesses separately.

We also think this is the future of retailing – so why sell it? We always thought that sales and profit would ultimately drive valuations and not expectations. It just happened faster than we thought!

“A big danger in this business is increasing your costs ahead of growth in demand”