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Mini-Case: Graze

Innovation vs. Internationalisation

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Graze

Abstract

Founded in 2007 by Graham Bosher (co-founder of LOVEFiLM), Graze is an e-commerce subscription service delivering healthy food by post. Having experienced rapid growth in the UK snack market under the current CEO and former marketing manager at innocent smoothies Anthony Fletcher, the company is now pondering how to achieve its next phase of growth. Having invested hundreds of thousands of pounds into cutting edge research on non-preservative based techniques for new lunch concepts, a new product market could present a lucrative new category in which to apply the graze business model. Equally, following graze's UK success, the snacking concept could be applied overseas; the USA representing a high growth market with some attractive characteristics. Fletcher faces an important decision going forward. Should he scale up the new lunch concept or should he take its existing snack delivery model to America? He couldn't decide on whether they should do one of them, none of them or potentially even both.

This case was prepared by Chris Corbishley under the supervision of Professor Gerry George. The authors acknowledge the support of Graze, in particular the cooperation of CEO Anthony Fletcher for his invaluable assistance in gathering the material for this case study.

This case is for educational purposes and is not intended to illustrate either effective or ineffective management of an organisational situation. The situations and circumstances described may have been dramatized or modified for instructional purposes and may not accurately reflect actual events.

Background

Graze was founded in 2007 by Graham Bosher, a serial entrepreneur who at the age of 21 had dropped out of university to start LOVEFiLM, a mail-order film subscription service. Having made his exit, he was looking for the next big opportunity, which he saw in delivering healthy snacks by post.

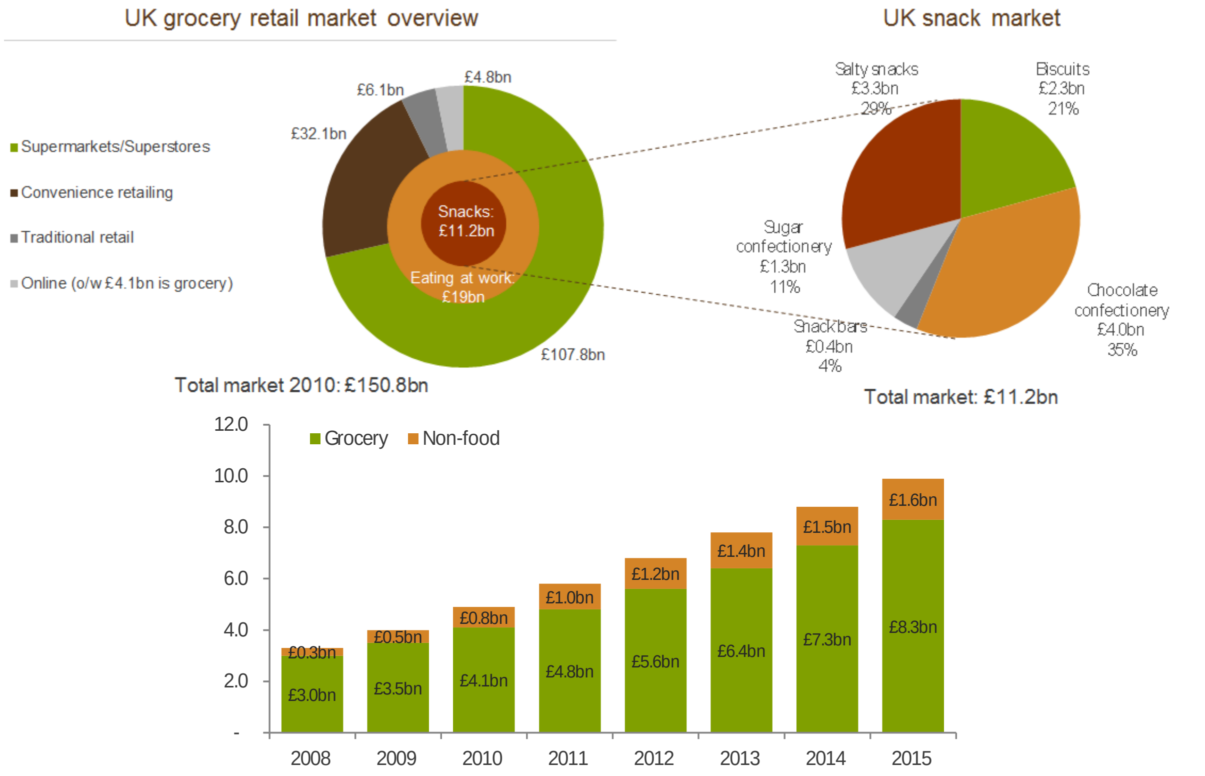
Three things attracted Bosher to the food market: its enormous size (Figure 1), the latent customer needs associated with it, and the fact that no one had yet attempted to disrupt the market through technology.

One thing graze did very quickly as a result of the make-up of its founding team, was to build a technology platform capable of delivering items through the post at incredible speeds. What they couldn't get right early on however, was the product. Preliminary market research had suggested the starting point for graze should be delivering healthy snacks, fresh fruit specifically. It became clear that no matter how fast pots of fruit could be delivered, the product simply didn't match consumer food instincts and customer insight.

The founding team was very technical, and as such had no experience of the food industry. They had developed patents for the sophisticated ways in which they could present pineapples in the post but they lacked market intuition.

Anthony Fletcher, Chief Marketing Officer at innocent smoothies at the time, came across a graze box after one of his colleagues received it in beta form. He instantly recognised the potential of this extraordinary concept, but the product needed a lot of work. Having come to the end of his time at innocent, he immediately went to the graze offices to ask for a job.

<u>Figure 1: Size of the UK snack market</u>



UK Growth

In January 2009, Fletcher joined graze as Managing Director. He understood the secret was in coming up with a snacking solution before the consumer knew they wanted it. This was also where the idea of subscription-based snack provisioning worked well.

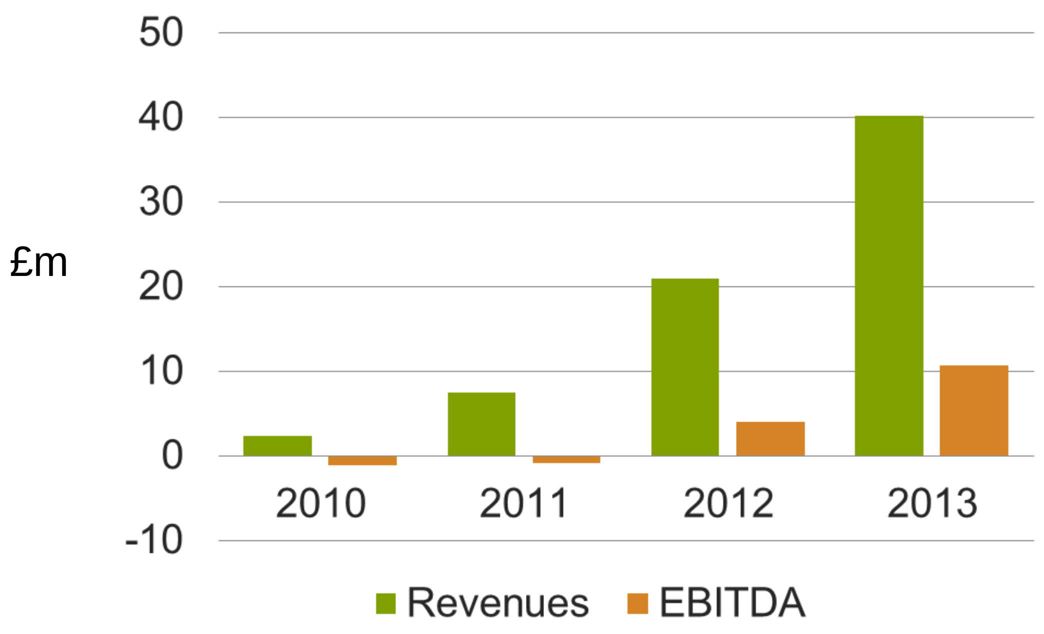
Fletcher immediately began to try out a new range of snacking products. By 2010, real-time data could provide information on consumer preferences, which helped the company learn what were good or bad snacks in the eyes of consumers almost immediately. Rather than relying on market research, preferences could be established by analysing actual behaviours.

Building on these capabilities, as well as borrowing elements from the innocent model, there was pressure from the shareholders to help growth and scale up operations by outsourcing. They wanted graze to become a sales and marketing company and let other firms worry about the product. This approach turned out to be a disaster. Even the very best third party manufacturers in Europe couldn't provide the level of quality or velocity that graze required to execute their business model.

By the end of 2010, everything had been brought back in-house. Graze procured the largest and most sophisticated equipment in its class, and began to carry out its own manufacturing to develop fresh snacking products at speed. It was in new experiences and new taste profiles like these that graze could make its margins – taking commodities and combining them in a way that is more valuable to the customer.

It was the right move, and the company began to take off in a huge way. Between 2010 and 2013, revenues grew from £2.3m to £40.2m, and EBITDA from -£1.1m to £10.7m (Figure 2). It was clearly a profitable business model.

Figure 2: Strong growth in revenue and EBITDA (2010-13)



Graze's business model

The strength of Graze's business model could be attributed to the following capabilities and characteristics:

- *Subscription model* – enables predictable, recurring revenues and the fact that customers exhibit highly consistent behaviour over time.
- *Online business* – provides centralised economics as well as capacity for rapidly scalability from a single distribution centre.
- *Large addressable market* – has a broad demographic appeal e.g. 69% of boxes are shipped outside of the South East of England. Pricing point is also affordable across a wide range of socioeconomic groups.
- *Vertically integrated* – capacity to source, make and sell graze products directly to the end consumer, bypassing food retailers and controlling pricing.
- *Strong brand* – Graze is an exciting and much loved brand with growth driven by positive word of mouth and good rates of returning customers.
- *Operational complexity* – bespoke manufacturing and fulfilment which is designed, engineered and built by graze. Packaging equipment has also been custom-developed and is not available off the shelf.
- *Business Intelligence and technology platform* – development of DARWIN, a world class platform that connects all aspects of the business. Extensive subscription model learning from LOVEFiLM.
- *Food Innovation* – driven by a continuous cycle of innovation with new and exclusive products every 8 weeks. Ground-breaking new product development enables the delivery of healthy meals through the post.

Having demonstrated strong organic growth in the UK snacking market, Fletcher faced a big decision on the company's next big growth phase - should he apply the graze model to the US market or should he invest more in the UK by entering adjacent product categories?

New product categories

Graze is recognised predominately as a snacking company, a category in which consumers unknowingly place very little value. As Fletcher put it "when you approach consumers by telling them how much they spend day to day on snacks, they're horrified but for meals, they seem a lot less concerned, which suggests they value them a lot more highly".

Their product team had carried out a significant amount of R&D into deliverable lunches. Having spent years of effort and hundreds of thousands of pounds on cutting edge research into non-preservative-based techniques and new lunch concepts, it seemed an obvious route to take.

Meanwhile, the marketing team was also considering how to move into the meal occasion rather than simply remaining a snacking company. They had become particularly interested in meal-related price points. Market research suggested that delivering healthy lunches to the customer's door could be a lucrative new product category in the UK food market.

According to Data Monitor, portion-controlled, healthy eating is currently the fastest growing food trend in the UK, driven by factors such as the 5-a-day campaign; rising obesity levels, (at its highest ever at 23.9%) and current lifestyle aspirations - for instance, only 11% of people believe they currently have a healthy lifestyle, whilst 67% aspire to having one. Convenience is also one of the fastest growing food trends in the UK as consumers are more time-poor than ever. In fact, the UK has the longest working hours in Europe, whilst the average lunch break is just 27 minutes.

The capabilities required to deliver lunches were not far from graze's existing competences. However, the challenge was how to carry out the transition without cannibalising or compromising their existing product offering.

Internationalisation

Fletcher's previous experience at innocent had taught him much about what could go wrong in the internationalisation process. He recalled his previous company making a mess of some international launches, having entered 14 different markets in Europe, where the number of offices seemed to change every 6 months: "It was chaos - every market had their own dynamics, different cost structures, very different consumer values and ways of doing business. The phone was constantly off the hook".

Graze analysed both the attractiveness of different markets and how to serve them profitability, devising the following criteria:

Factors determining market attractiveness:

- High value placed on natural health
- High value placed on convenience
- Established snacking occasions
- Online shopping penetration
- Credit card penetration

Factors affecting market profitability:

- Reliable postal service
- Low cost of delivery
- Favourable tax laws
- Market can support pricing
- Competitive landscape

Fletcher had already come to the conclusion that he was in no hurry to enter the European market. If you grouped the entire continent together it seemed like an exciting place, but from a food perspective it was too fragmented and led to too many questions, such as do the French snack? Are the Italians going to be happy having olives sold back to them? The USA on the other hand had a large credit-card penetration, loved to snack, demonstrated food values closely aligned to those of the UK and offered a reasonable postal service.

Entering the US market

The US market was still viewed with a deep sense of unease. Having been the graveyard of so many British businesses - especially food business - it required a depth of capital and an element of risk most investors found hard to stomach.

Various consultants had tried to advise them that there was a right or wrong way of doing it, suggesting various segmentation strategies, or the possibility of seeking investment from a monster west coast investment firm who might also possess the secret to successfully cracking the US market.

Aside from financing, there were two big concerns that worried Fletcher, which were portion sizes and the reliability of the US postal service. Most US businesses would deliver a large parcel once a month, paying for a premium delivery service; graze however was hoping to deliver a weekly parcel at less than $6. This hadn't been done since the days of Netflix, a company with 32 warehouses across the USA and an 'illegal' deal with the USPS which ended up in Congress. The key questions were: Would the concept fly in America? What problems might graze face in logistics? And should they begin by concentrating their efforts on specific locations/regions or was there a way to successfully penetrate the market as a whole?

People

Another concern at the front of Fletcher's mind related to people, teams, organization and processes. If graze was to launch in the US, how fast would the team have to grow? How should he communicate with them? Would their approach be global or local? Would it be characterised by autonomy or control?

Out of all the decisions, this is what stressed him the most. He knew it would mean a step change for the business, which would become a much larger organisation overnight, presenting significant people challenges. As graze has grown, people have had to leave, but he was more concerned about the coordination challenge. He would be overlapping two different time zones, working with teams highly dependent on him – how would he support their success?

Financing

Graze shipped its first box on the day that Lehman brothers collapsed - a child of the recession. It is also an unusually profitable business with a highly transparent business model. The subscription service meant it always knew expected volume. This brought some amazing deals in financing their capital expenditure, two years interest free in some cases.

Thus far, the company had been careful not to broadcast their success, learning from innocent, which had attracted some very difficult competitors early on. If they were to go to America, the last thing they wanted to do was to give an investment case to a load of Silicon Valley entrepreneurs.

Now it was expanding however, graze needed to work a lot more on their story. They had carried out no PR and there was a general perception that it was the kind of business that might have started around the kitchen table. In the past, to get investors interested they had to take them down to the factory and show them the heavy automation processes and fulfilment tools. It was a hard sell to explain the business model in a consumer space and convince them of how exciting it was.

By the end of 2012 graze had sold a majority stake to the Carlyle Group which also marked the exit of the original founder, Graham Bosher as the professionalization of the business meant he didn't want to continue. At the same time, one of the original investors, Octopus Investments, decided to stay invested in the business. Both investors preferred low risk options. They wanted to help graze on their growth journey but whichever decision Fletcher decided to put forward had to be carefully considered with managed risks.

Next steps

The two growth options for graze were either to scale up the new lunch concept, or to take their existing snacking concept to America. An important consideration was what kinds of capabilities would be required to pursue one growth route over another? It was a difficult decision, and there was also the choice of whether it would be best to do one, none or potentially even both of them.

This paper has been produced by Imperial College Business School for the ELITE programme, commissioned by the London Stock Exchange

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