

# STRATEGIES TO SURVIVE

KEEPING CUSTOMERS AND GROWING PROFIT  
THROUGH THE NEXT DECADE OF UPHEAVAL IN RETAIL



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## KEEPING CUSTOMERS AND GROWING PROFIT THROUGH THE NEXT DECADE OF UPHEAVAL IN RETAIL

*For years, retailers occupied a privileged position in the value chain. With direct access to customers and clear visibility of the choices they made, they effectively had a monopoly on customer relationships – simply because they had the physical locations customers visited. This put them in a powerful position relative to their suppliers and allowed many of the most successful retailers to widen the scope of their business by serving ever more of their customers' needs.*

*But this is coming to an end. Technology has reduced the role of bricks-and-mortar sites by making responsive, two-way, information-rich relationships possible at a distance. The old world in which customer relationships were the sole domain of retailers with physical stores is disappearing and a new battle for customers has begun. In this perspective, we describe how these changes are challenging traditional retailers and what they need to be doing now to still be profitable in ten years' time.*

## A NEW BATTLE FOR CUSTOMERS

Consumers now have more choice about where, how, and from whom they buy; how products get to their homes; and with whom they share information about their shopping behaviour. This is a fundamental change and although in some markets its impact is only beginning to be felt, it will ultimately affect retailers everywhere. Online retail has allowed customers to easily search for products from any source, opening up a route to market for any manufacturer or retailer almost irrespective of geography. This has enabled the rise of retailers – such as Amazon – with unprecedented reach across countries and categories, whose scale enables them to offer a huge catalogue of products. But it has also allowed tiny retailers to access the global market, often via intermediaries or marketplaces.

Simultaneous with this growth in competition, the nature of customer relationships is changing. E-commerce is sometimes characterised as being more transaction-focused than bricks-and-mortar retail, but this isn't always the case and some of the giants, including Amazon, are building customer relationships far deeper than traditional bricks-and-mortar retailers, precisely because they can't rely on location to bring in customers.

These changes are disrupting the retail value chain in major ways: for example, manufacturers are reaching consumers directly, asset-light business models are becoming more common in retail, and there is growing competition to own the last mile.

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*Manufacturers' delivery costs can often be lower than retailers' margins, giving them a strong financial incentive to build direct relationships with customers*

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## MANUFACTURERS CAN REACH CONSUMERS DIRECTLY

A few years ago, most manufacturers were still pondering whether they wanted to sell direct to consumers: many were wary of trying to circumvent their retail partners. But today there's little debate about whether this is the right strategy and many manufacturers are building successful direct-to-consumer businesses.

For example, sports brand Nike has been growing its direct-to-consumer business and this now accounts for about 20% of its sales. Procter and Gamble's e-store sells bulky items like washing powder and detergents as well as smaller products like razor blades. The fact that their delivery costs can often be lower than retailers' margins gives manufacturers a strong financial incentive to build direct relationships with customers.

## ASSET-LIGHT BUSINESS MODELS

An interesting trend in recent years has been the evolution of asset-light business models, which disintermediate traditional service providers from their customers by making better use of information, providing better front ends, and offering better customer experience. This has already caused real disruption in some sectors such as travel, where businesses such as TripAdvisor and Priceline have had a transformative impact. While there are no fully formed models of this type in retail today, it doesn't take much imagination to see that this may soon change:

- **Digital wallets** have been launched by some payment providers, who are also making a play to own customers via deeper understanding of their spending habits across sectors. How long will it be before businesses such as PayPal and Google Wallet make recommendations to customers, provide price comparisons, and enable purchasing all from within their own apps?
- **Price comparison websites** already exist in most retail markets, either in the shape of giants like Google Shopping or as sector-specific solutions such as mySupermarket. Today, most of these send customers to the retailer to complete the transaction but how long will it be before this changes?
- **Visual discovery tools** like Pinterest allow users to curate picture boards of products under a theme and share with other users. Such tools also send users to the retailer to complete the transaction but, again, could this change soon?
- **Apps** exist that help customers to plan their meals to a budget or plan a weight loss programme, or just to save time. These typically generate shopping lists or feed into grocers' online stores, but will the businesses that operate them soon be looking to cut the retailer out completely?

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*Owning the last mile and offering rapid, reliable delivery is a great way to build deep customer relationships*

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## GROWING COMPETITION TO OWN THE LAST MILE

Last-mile distribution is a problem – one that traditional retailers solved for manufacturers by building stores and consolidating demand into them. Until recently, the only option for online retailers was to rely upon existing distribution networks, sending products by mail or using firms such as UPS and DHL, and many still operate in this way. But for some products and markets this isn't possible: for example, with fresh food where temperature control is critical.

Some online retailers have built their own distribution networks, and these (along with their expertise and technology) are becoming real business assets in themselves. In the UK, online-only grocer Ocado has just licensed its platform to Morrisons, one of the biggest bricks-and-mortar supermarket chains.

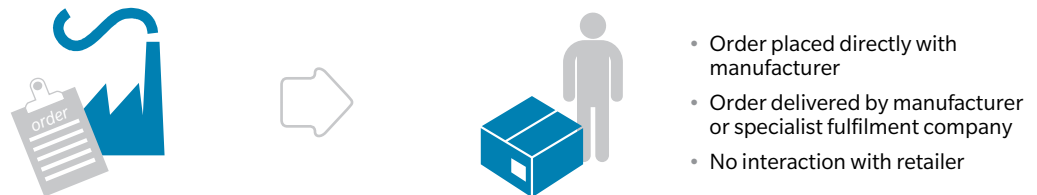
Companies are also recognising that owning the last mile and offering rapid, reliable delivery is a great way to build deep customer relationships. For example, part of the logic behind AmazonFresh is that the delivery encourages shoppers to add other non-food items to their basket from across the Amazon range. At the same time, the increased scale it brings moves Amazon significantly closer to being able to provide same-day delivery.

Google Shopping is perhaps even more interesting, as it is a “retailer agnostic” proposition, and could easily also start carrying products direct from manufacturers. Exhibit 1 shows a couple of examples of how future purchasing experiences could entirely circumvent a traditional retailer.

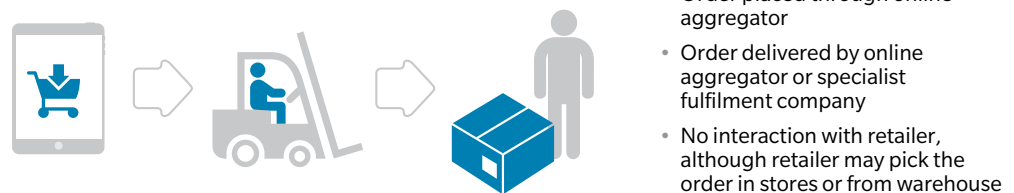
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### Exhibit 1: How future customer journeys could entirely remove retailers from the value chain

#### BRANDED GOODS



#### RETAILER'S OWN-LABEL GOODS





## RETAILERS' TRADITIONAL STRENGTHS ARE BEING ERODED

Many retailers may not yet be worried by these emerging trends. After all, they are used to dealing with changes in customer behaviour as well as new retail formats and models. And traditional retailers' business models are underpinned by some real strengths.

The problem this time is that not only are these emerging trends intensifying the battle for customers, but the new competitive environment that is taking shape is also eroding many of these traditional strengths.

### PHYSICAL STORE ASSETS ARE NO LONGER ENOUGH

Many retailers' greatest strength was the combination of choice and convenience: choice from efficiently aggregating products from many suppliers and manufacturers under one roof and convenience from having locations easy for customers to access. But this is no longer enough: if customers can get the same products more conveniently or cheaply via another route, some of them will.

Of course, this won't put large retailers out of business overnight. In the short term, its effect will probably be limited to a greater tendency towards basket splitting – where customers obtain some products by another route – perhaps direct from some manufacturers or via niche online retailers. But even this is a worrying trend as the economics of most retailers are very sensitive to small volume losses due to the fixed costs in their stores and supply chains and, as ever, the highest margin products are likely to disappear first.

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## OFFERING THE LOWEST PRICES IS GETTING TOUGHER

Value-focused retailers have succeeded by being the local price leader for commodity items or branded products on the basis of a very low-cost supply chain between manufacturer and store. But in most sectors this is becoming ever harder to do. Now that customers are able to shop anywhere, it's a lot harder to be the "local" price leader and new competitors may be able to build even lower-cost operating models. Online-only models have therefore been able to undercut established retailers in many sectors because of their leaner costs and lower margin expectations.

Being the value leader has always involved high stakes: if customers are choosing you only based on price, those customer relationships will change quickly when a better offer comes around. In the future, bricks-and-mortar retailers in most sectors are likely to find it much harder to win and retain customers this way.

## TECHNOLOGY IS CHANGING SERVICE AND ADVICE

Some retailers are built around old-fashioned principles of service and advice. In certain markets, these models may be resilient in their current form, particularly when face-to-face contact remains an important element of the shopping experience. But it is also true that information-based services are either replacing or improving on service and advice in many customer-facing businesses. An obvious example is in books, where store-based advice and service have been almost entirely replaced by internet reviews and recommendation engines.

Because technology can have other advantages besides cost, this trend may well extend much further. The success of self check-in terminals and apps in the airline business suggests that some customers might actively prefer to avoid face-to-face contact in some situations. Overall, retailers need to be alert to the possibility that there may be a better or cheaper way of providing the advice and service that wins them customers today, and this is likely to involve new technology.

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## HOW CAN RETAILERS FIGHT BACK?

In ten years’ time, what will the world of retail look like? Which of today’s successful retailers will still be the key players in their markets? Without wishing to be alarmist, we think everything we’ve just described suggests that – sooner or later – there will be fundamental changes in every retail sector. Some retailers are better placed than others to cope with these changes, but over the coming decade all are likely to face real challenges.


To hang onto the kind of customer relationships they now have, many retailers will need to redefine themselves by asking why customers need them and how their business model needs to change to remain viable.

The uncomfortable truth is that the lines between manufacturers and retailers and between retailers and logistics providers are becoming ever more blurred. As such, there are cases in which the role of the retailer itself may be in question: if customers can get products via a cheaper or more convenient route, eventually some of them will. Some retailers risk being turned into “dumb supply chains” that provide fulfilment for asset-light information-based services that are one step closer to customers.


Faced with diffuse or long-term trends and threats such as these, a common reaction is to assume that they’re too uncertain or too far in the future to matter. This is understandable but it’s a mistake: retailers need to act before they start losing large numbers of customers, because once they do their strategic position becomes much weaker.

There are three things we believe retailers should do to meet the new challenges they face:


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1  Boldly play the movie forward for your sector

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2  Identify new ways to win customers and own customer relationships

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3  Think more like an agile start-up – and start innovating and experimenting right now

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# 1. PLAY THE MOVIE FORWARD

The first step is to make a candid assessment of your real strengths and weaknesses. This means asking some searching – and uncomfortable – questions about your customers and your business.

## Fundamental questions:

- How do customers see us today, compared to our competitors (both new and traditional)?
- What is the core thing that we do that customers can't get elsewhere? Will this still be unique in ten years?
- Which other businesses are (or could be) closer to our customers than we are?
- How easy (or difficult) is home delivery for our products?

## Example detailed questions:

- What role does information and advice play in our sector – and how can customers best access it?
- What about other incursions into the value chain, such as payment providers and digital wallets?
- Which parts of our business – categories, geographies, stores – will be profitable in five years' time?

These are tough questions. But it's crucial to be realistic, not optimistic, about the future of your business because, too often, wishful thinking means that management teams don't understand the potential impact of the threat until it is too late.

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## Exhibit 2: Example survival strategies for a large food retailer

**The overall aim is to continue to own the customer and consolidate spend by serving all of their food-and-nutrition-related needs in a differentiated and highly convenient way, while at the same time developing a separate business line as a branded manufacturer.**



**Information-based services:** Start offering customers a wide range of sophisticated information-based services, such as diet and nutrition management, menus and suggestions, as well as self-scan and product finder apps in store. The aim is to drive customer retention within the existing ecosystem.



**Last mile:** Make a big play for the last mile by investing in a home delivery network, while at the same time leveraging physical store assets by offering "click and collect" shopping.



**Subscription:** Launch a subscription-based offering with reduced prices in return for a monthly fee.



**Product differentiation:** Continue to push product differentiation through excellence in own-brand ranges and start selling these products through a range of channels, including third-party channels for ambient products.



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Online and mobile technology is continuously unlocking new ways for retailers to create value for customers

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## 2. IDENTIFY NEW WAYS TO WIN CUSTOMERS

To stand a fighting chance, traditional retailers will need to take full advantage of the new strategic possibilities that technology has opened up.

Value-added services are one example. These have been around for a while but have typically been narrow in scope – perhaps being limited to installation, credit cards, or personal shopping. But technology has revolutionised what can be offered. Retailers can now reach customers across the whole of the shopping experience and start building a relationship with them before they even decide to make a purchase, let alone visit a store. In addition, they can more easily maintain this relationship long after a purchase has been made.

Online and mobile technology is continuously unlocking new ways for retailers to create value for customers. Credit cards are being replaced by mobile wallets and physical shopping is being made easier with “scan and go” applications. Meanwhile, personal shopping is being brought to the masses through recommendation engines, and lifestyle management apps are being created to help manage food spend, budget, and health goals. Individually these might look like modest changes but together they are starting to add up to something significant – and new applications are being invented almost every day.

Owning the last mile also offers new opportunities. Historically, retailers won by having convenient store networks. These days, convenience means something different, with home delivery and localised collection points becoming the key points of differentiation. With competition for owning the last mile becoming fierce, Amazon and Google have begun building their own in-house services and some retailers may themselves be well placed to enter this market – particularly high-frequency, large-basket retailers, such as grocers.

Exactly which combination of strategies makes sense will clearly depend on the characteristics of your business and customer proposition and will be very different for different retailers, as Exhibits 2 and 3 suggest.

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### Exhibit 3: Example survival strategies for a design-led home furnishings retailer

**The overall aim is to move closer to being a pure design and manufacturing business.**



**Third-party channels:** Start selling products through a range of third-party channels such as internet giants and other larger retailers.



**Online:** Rapidly develop an excellent in-house online offering.



**Store estate:** Dramatically reduce the size of the store estate, keeping only flagship stores and showrooms.

### 3. THINK MORE LIKE AN AGILE START-UP

Many of the things established retailers will need to do are far from their standard operating procedures and current core competencies. This puts any new business models at risk of being crushed by the existing organisation before they have a chance to grow. To beat competition from dynamic start-ups, established retailers will need to think like them. Defensive behaviour by the core business, the wrong metrics and success criteria, and the difficulty of recruiting and retaining the right people are all obstacles that must be overcome.

One way of doing this is to create a new business unit that isn't constrained by the rules and culture of the core business and where success will be measured on a different basis:

**Example 1:** If it's important to develop and drive the adoption of information-based apps and services, it may well be best to build a separate business that operates at arm's length to the parent company. This would enable it to recruit people with the right skills and pay them on a different basis from the core enterprise, and to operate with different practices – for example, adopting rapid agile approaches to IT development. Its success could also be judged on different metrics, with the new venture being valued as a start-up would be: on customer acquisition and retention, rather than short-term financial performance.

**Example 2:** When there is a strategy to push own-label products into new third-party channels, a separate business unit structure would help protect the new venture. There may be some in the core organisation who would, understandably, focus on the cannibalisation from "their" existing channels and stores and undermine what the strategy is really trying to achieve.

It takes time to develop new skills and capabilities, which makes it essential to start figuring out how to transform your business as soon as possible. Trial and error is a requirement when it comes to developing, testing, and honing new business models so, if selling through third-party channels will be part of the answer, start trying it now, even if you think demand will be initially low. If sophisticated data-based apps are going to become important, launch beta versions as soon as possible, even if at the beginning not many customers use it. Remember: there is simply no substitute for accumulated experience.

## CONCLUDING REMARKS

Over the past decade, the retail value chain has changed significantly and the next few years will bring even greater disruption. Having lost the privileged access to customers they once had, retailers today face a much broader and more diverse set of competitors from manufacturers to payments providers, logistics companies, and internet search engines. In some cases, they risk becoming little more than fulfilment operations for others or being driven out of business.

To meet this existential threat, bricks-and-mortar retailers need to build capabilities that stretch far beyond their traditional areas of competence, and to be as aggressive as their new set of competitors in seizing the opportunities technology offers. Taking an honest view of the prospects for the business is a vital first step. Retailers then need to find ways to innovate as fast as their competitors can – which may require significant changes to the way the business is organised, to foster a genuinely entrepreneurial culture within a large and established business. They need to start now, and act fast and decisively.

These changes won't be smooth or painless. And because this is unfamiliar territory, there will inevitably be a significant element of trial and error. But the unvarnished truth is that time is not on the retailers' side – and though making quick decisions always carries risks, not making them may spell disaster.

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## ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialised expertise in strategy, operations, risk management, and organisation transformation.

In the Retail practice, we draw on unrivalled customer and strategic insight and state-of-the-art analytical techniques to deliver better results for our clients. We understand what it takes to win in retail: an obsession with serving the customer, constant dedication to better execution, and a relentless drive to improve capabilities. We believe our hands-on approach to making change happen is truly unique – and over the last 20 years, we've built our business by helping retailers build theirs.

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