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ВЫПУСК 4

The art of life
is a constant
readjustment to
our surroundings

OKAKURA KAKUZO

Предисловие

Когда я думаю о проблемах, с которыми сталкивались наши клиенты в этом году, а также о статьях, которые мы публиковали, мне начинается казаться, что над многими розничными сетями в России и за рубежом сгущаются грозовые тучи. И здесь необходимо помнить, что умение изменяться и в самом деле является «искусством жизни». Похоже, что мы достигли переходного периода между двумя важными этапами. В прошлых выпусках мы говорили о том, что история розничной торговли – это история взлетов и падений различных концепций, форматов и каналов. Возникают новые модели, которые оказывают давление на участников рынка; рынок приспосабливается и формируется новая розничная среда. Среди примеров подобных изменений – появление «суперцентров» в Северной Америке и гипермаркетов в Европе. Российский рынок все еще развивается, поэтому на нем только ожидаются крупные изменения; тем не менее, исследование потребительского восприятия, которое мы снова провели в этом году, демонстрирует четкие признаки трансформации рынка.

В данном выпуске издания Oliver Wyman, посвященного розничной торговле, мы рассматриваем тактические подходы к расширению возможностей, лежащих в основе успешного розничного бизнеса. В этом году мы решили обратить взгляд в будущее, чтобы лучше понять источники дальнейших потрясений – этому вопросу мы уделяем особое внимание. Часто достаточно небольшого общего давления на продажи, чтобы компания оказалась в ситуации, при которой доходность добавочных капиталовложений в магазины становится отрицательной, и дальнейшие затраты приводят лишь к уничтожению ценности. Это горькая правда, особенно в случае с обычной, а не интернет-торговлей. И она является началом долгой и медленной смертельной спирали.

Катастрофа, которая может произойти лично с вами, зависит от рынка и сектора. В продовольственной рознице есть очевидная конкурентная угроза, которой мы уделяем много внимания. «Жесткие» дискаунтеры продолжают активно развиваться в различных регионах и теперь должны рассматриваться как основная долгосрочная стратегическая угроза. Очевидно, что они трансформировали розничную среду в Германии, но их влияние и ошеломительный успех, которым они пользуются в последние годы на новых рынках (например, на рынке Великобритании), преподносят нам наглядные уроки. Как только дискаунтеры преодолевают барьер на пути к доверию потребителей, они становятся практически неудержимыми. Тем не менее, первые попытки создать в России «жесткие» дискаунтеры пока не принесли плодов.

В то же время экономические показатели формата «жестких» дискаунтеров настолько привлекательны, что сильнейшие розничные сети, работающие в данном формате, почти наверняка будут стремиться рано или поздно выйти на все значимые рынки. Как и в случае со всеми революционными форматами, их экономическая модель настолько отлична от других, что устоявшимся компаниям не остается ничего другого, кроме как тратить непозволительно большие суммы на ответные меры. Эта динамика настолько важна, что мы посвятили ей две статьи. В одной из них ветеран немецких ценовых войн делится опытом борьбы «на передовой». В другой мы говорим о том, что угроза, которую представляют собой дискаунтеры, является одним из факторов дальнейшей консолидации европейского продовольственного сектора.

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Помимо продовольственной розницы, еще одним революционным элементом является онлайн-торговля. Мы рады представить вам результаты недавнего исследования восприятия потребителями интернет-торговли, проведенного Oliver Wyman в Германии. В нем мы сравниваем интернет-магазины с онлайн-предложениями традиционных розничных сетей. Почти все интернет-магазины выше оцениваются потребителями, что ставит перед участниками рынка некоторые важные вопросы.

В данном выпуске издания Oliver Wyman, посвященного розничной торговле, мы также обсуждаем как всегда актуальную тему лояльности. Наш опыт работы в данной сфере показывает, что программы лояльности, основанные на получении баллов за покупки, больше не являются оптимальными. Покупатели заинтересованы в более увлекательном и персонализированном взаимодействии, и развитие технологий упрощает решение этой задачи. С этим связаны не только угрозы, но и возможности. Розничные сети, у которых есть возможности и желание изобретать что-то новое, обладают огромным потенциалом для создания и поддержания устойчивых отношений с покупателями за счет реализации привлекательной и полезной системы лояльности, решающую роль в которой играет работа с различными каналами. Но это будет нелегко. В данной сфере уже появились новые, агрессивные конкуренты – от интернет-гигантов до платежных систем и электронных кошельков, – каждый из которых пытается занять место между традиционными розничными сетями и их клиентами. Мы полагаем, что эти игроки могут представлять непосредственную угрозу в течение следующих 5–10 лет, и российский рынок не является исключением.

Как всегда, я надеюсь, что вы найдете в издании Oliver Wyman, посвященном розничной торговле, полезную информацию к размышлению.

Philip Gudgeon

Филип Гаджен

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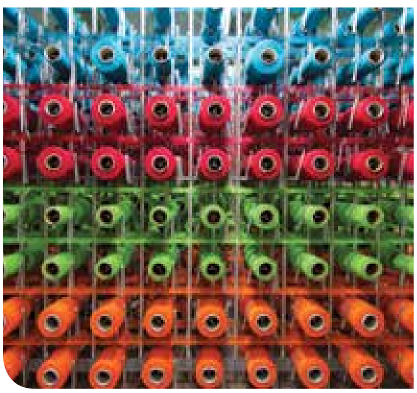


FRONT-LINE CONVERSATIONS

РОССИЙСКИЙ РЫНОК ПРОДОВОЛЬСТВЕННОЙ РОЗНИЦЫ

ФОКУС НА ВОСПРИЯТИИ ПОТРЕБИТЕЛЕЙ

В конце 2014 г. компания Oliver Wyman ввела понятие «график восприятия потребителей» (CPM) для российской продовольственной розницы и проанализировала ситуацию на рынке.

Тогда мы утверждали, что скоро наступят сложные времена и что розничным сетям необходимо улучшать восприятие потребителями ценности и предложения, если они хотят быть успешными на конкурентном, насыщенном рынке.

Ровно год спустя мы снова провели опрос среди 2 200 потребителей, которые регулярно совершают покупки более чем в 20 крупнейших розничных сетях в 7 макрорегионах европейской части России. В данной статье мы приводим основные результаты обновленного опроса.

РОЗНИЧНАЯ ТОРГОВЛЯ ПРОДОВОЛЬСТВЕННЫМИ ТОВАРАМИ В РОССИИ: РЫНОК НА ЭТАПЕ ИЗМЕНЕНИЙ

Последние два года российская продовольственная розница развивается в условиях экономического спада и санкций. Отрасль встречает новый этап развития, уже достигнув определенной «зрелости» (по крайней мере, в крупных городах), с усиливающейся дифференциацией сетей на насыщенных и не полностью освоенных рынках. Для укрепления позиций ведущие розничные сети стараются вырабатывать индивидуальные подходы, оптимальные для работы в том или ином регионе.

И хотя российский рынок продовольственной розницы по-прежнему отличается от многих других неоднородностью и особенностями развития, в последнее десятилетие он проходит через те же этапы, что и остальные рынки по всему миру: от расширения к консолидации.

КАРТА ВОСПРИЯТИЯ ПОТРЕБИТЕЛЕЙ

В России, как и на любом другом рынке, долгосрочный успех будет способствовать только тем розничным сетям, которые смогут добиться устойчивого преимущества по части привлекательности для клиентов. Как правило, данное утверждение верно уже на этапе расширения сети, но особенно важно помнить об этом на этапе консолидации. Впрочем, степень привлекательности непросто определить: для этого необходимо тщательно проанализировать, как потребители оценивают посещаемые ими магазины с точки зрения цен, промо-акций, ассортимента, представленности товаров, удобства расположения магазинов и т.д.

В приложении 1 приводятся основные понятия, с которыми у потребителей ассоциировался российский рынок продовольственной розницы в 2015 г. Проанализировав полученные ответы, относящиеся к конкретным розничным сетям, мы смогли выделить некоторые статистически значимые параметры и понять, каким образом восприятие потребителей по каждому из них влияет на общую степень удовлетворенности розничной сетью.

Приложение 1: Основные характеристики российской продовольственной розницы с точки зрения потребителей, 2015 г.

РАЗМЕР ШРИФТА ОТРАЖАЕТ ЧАСТОТУ, С КОТОРОЙ ВСТРЕЧАЛСЯ ДАННЫЙ ОТВЕТ

В течение последних двадцати лет компания Oliver Wyman проводит анализ потребительского восприятия в различных регионах и секторах розничной торговли. Мы регулярно обнаруживаем, что на самом простом уровне потребительское восприятие можно разделить на две большие категории: предложение (которое включает в себя ассортимент, качество и уровень обслуживания) и ценность (цена, эффекты промо-акций и программ лояльности розничной сети). Совокупность этих элементов мы называем графиком CPM (Customer Perception Map).

ГРАФИК CPM РОССИЙСКОЙ ПРОДОВОЛЬСТВЕННОЙ РОЗНИЦЫ ЗА 2015 Г.

График CPM российской продовольственной розницы за 2015 г. составлен для 21 розничной сети и 7 макрорегионов (Центральный, Северо-Западный, Южный, Приволжский, Уральский, а также Москва и Санкт-Петербург с прилежащими территориями). Мы опросили более 2 200 покупателей, каждому из которых задали более 40 вопросов, и провели оценку на основании полученных ответов. В результате мы распределили розничные сети, как показано в приложении 2.

Приложение 2: График CPM российской продовольственной розницы за 2015 г.

В прошлом выпуске издания Oliver Wyman, посвященного розничной торговле, мы анализировали график CPM за 2014 г. и говорили о том, что на рынке наблюдается недостаточная дифференциация по форматам с точки зрения покупателей и большинство игроков рынка в рамках определенного формата воспринимаются потребителями одинаково. На сегодняшний день мы имеем более обширную базу для сравнения благодаря наличию графика CPM за 2015 г. Можно отметить, что покупатели стали сильнее ощущать различия между основными форматами розничных магазинов и между магазинами одного формата.

Супермаркеты раньше рассматривались как достаточно однородная группа, теперь же в рамках этой группы наблюдаются наибольшие изменения. За немногими исключениями, они по-прежнему считаются менее привлекательными с точки зрения ценности, чем гипермаркеты или «мягкие» дискаунтеры, но уже сокращают этот разрыв. При этом с точки зрения предложения они находятся на том же уровне, что и гипермаркеты.

Судя по восприятию потребителями, ведущие «мягкие» дискаунтеры продолжают компенсировать ограниченность своего предложения высоким уровнем предлагаемой клиентам ценности.

Что касается гипермаркетов, исторически сложившееся сочетание исключительного предложения и высокого уровня ценности в данном формате теперь менее явно выражено по сравнению с супермаркетами (в части предложения) и «мягкими» дискаунтерами (в части ценности).

Мы также отмечаем, что ситуация отличается от региона к региону, и ни один из игроков рынка не может утверждать, что занимает лидирующую позицию по всем направлениям.

Приложение 3: Лидеры с точки зрения восприятия потребителями предложения, 2015 г.

	Регион					
Формат	**Москва**	**ЦФО**	**СПб**	**СЗФО**	**ПВФО**	**ЮФО**
Гипермаркеты	Metro C&C	Metro C&C	Metro C&C	О'Кей	О'Кей	О'Кей
	Лента	О'Кей	Лента	Лента	Metro C&C	Metro C&C
Супермаркеты	Азбука Вкуса	Билла	Перекресток	Билла	SPAR	Перекресток
	Виктория	SPAR	SPAR	Н. Семья	Перекресток	Магнит Сем.
Эконом-класс	Магнолия	Верный	Магнит	Магнит	Монетка	Пятерочка
	Магнит	Пятерочка	Верный	Дикси	Пятерочка	Магнит

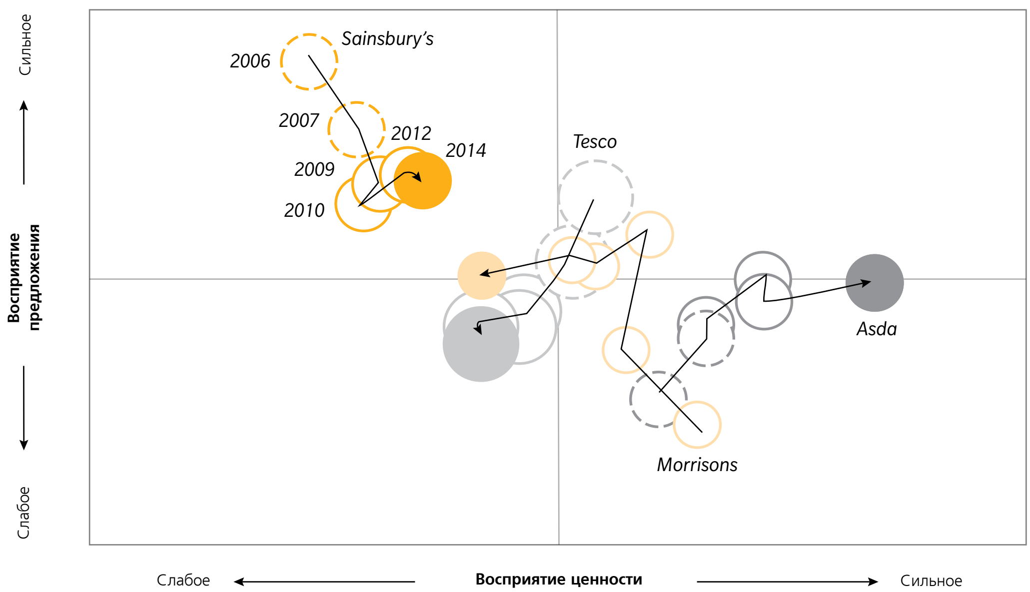
Приложение 4: Лидеры с точки зрения восприятия потребителями ценности, 2015 г.

	Регион					
Формат	**Москва**	**ЦФО**	**СПб**	**СЗФО**	**ПВФО**	**ЮФО**
Гипермаркеты	Ашан	О'Кей	Ашан	Лента	Ашан	Лента
	Metro C&C	Ашан	Лента	Ашан	Карусель	Metro C&C
Супермаркеты	Атак	Билла	Н. Семья	Билла	Перекресток	Перекресток
	Билла	Перекресток	SPAR	Н. Семья	SPAR	Магнит Сем.
Эконом-класс	Пятерочка	Монетка	Магнит	Монетка	Пятерочка	Пятерочка
	Монетка	Пятерочка	Верный	Верный	Монетка	Магнит

ЗАРУБЕЖНЫЙ ОПЫТ

Сеть TESCO (Великобритания) является хорошим примером того, как ухудшение потребительского восприятия приводит к неблагоприятному развитию событий. Эта компания в течение долгого времени считалась лидером по восприятию потребителями ценности и предложения в Великобритании. Однако руководство компании уделяло слишком много внимания финансовым результатам деятельности, что привело к росту цен и увеличению доли промо-акций, проводимых поставщиками. По результатам многолетней оценки можно отследить, как компания Tesco постепенно сдавала свои позиции по восприятию ценности и предложения, а потом и вовсе отстала от своих конкурентов. Однако всю серьезность ситуации компания осознала лишь тогда, когда уже наблюдался значительный спад сопоставимых продаж и снижение показателя EBIT.

Приложение 5: График CPM для крупнейших супермаркетов Великобритании, 2006–2014 гг.



ВЫВОДЫ

Потребительское восприятие крайне важно для оценки позиционирования и прогнозирования доходов розничных сетей. Графики CPM, которые мы готовили в течение последних двух лет, показывают, что на российском рынке происходят изменения. Будущие победители определяются уже сегодня, и некоторые сети на шаг ближе к победе, чем их конкуренты: они знают, чего хотят потребители, и предлагают им более высокое качество обслуживания.

THE FUTURE OF LOYALTY

BUILDING A NEXT-GENERATION REWARD PROGRAMME

In a world of new technology and high customer expectations, standard customer loyalty schemes based on transactional rewards will soon be recognised for what they really are: undifferentiated, underutilised, loss-makers.

Usually, retailers justify the cost of their loyalty programme by the data it yields: data which can be used to inform business decisions, sold to suppliers, and used to develop targeted campaigns. But on closer inspection these additional benefits often do not materialise nor justify the investment in the scheme. Our analysis shows that a transaction-based loyalty scheme – where the customer is rewarded with a 1% return of the value of their shop – can cost a $10 BN retailer $30–60 MM in reduced margin every year. Add to this the considerable cost of running the programme, and these costs will likely never be recouped with the gains made by utilising the data from the scheme.

Even if your scheme isn’t analogous to the one shown in Exhibit 1, we still think the best loyalty programmes in retail can be better and, indeed, need to improve fast.

In the first half of this article, we articulate the case for change and, in the second part, we explain what retailers need to be thinking about when it comes to customer loyalty programmes.

- **Part 1: The case for change**
  - New competitors are disrupting the market and challenging the status quo
  - Customer expectations are changing, and they want different things from their loyalty scheme
  - The right technology used in the right way can help meet customer needs in a new and innovative way
- **Part 2: Getting it right in the real world**
  - A future-flexible approach to technology, with the retailer owning the overall loyalty ecosystem but not necessarily every specific component within it
  - A start-up mindset to enable long-term investment in the loyalty proposition

PART 1 | THE CASE FOR CHANGE

NEW COMPETITORS ARE DISRUPTING THE MARKET

The pressure comes from the need for traditional retailers to find new ways to stay close to their customers in a world where disruptive new entrants are trying to own the customer relationships that retailers once took for granted. Retailers face an assault on their status as the owner of the customer. Be it online pure-play retail competitors, manufacturers selling direct to consumers, or payment providers and digital wallets, many businesses are now trying to develop direct customer relationships. If they do not respond, retailers will find that over time their customer loyalty decreases as other players join the party.

So reinventing loyalty is not some passing trend; it is fundamental to continued survival and future success.

Exhibit 1: The economics of a typical loyalty programme

Loyalty scheme cash profit input at a $10 BN retailer, loyalty scheme gives 1% return on spend as points

VOLUME UPLIFT DUE TO SCHEME
IN PERCENTAGE

	0	10	20	30	40	50
3.0	-$13 MM	-$6 MM	$2 MM	$9 MM	$16 MM	$23 MM
2.5	-$23 MM	-$15 MM	-$8 MM	-$1 MM	$7 MM	$14 MM
2.0	-$32 MM	-$25 MM	-$18 MM	-$10 MM	-$3 MM	$4 MM
1.5	-$42 MM	-$34 MM	-$27 MM	-$20 MM	-$13 MM	-$6 MM
1.0	-$51 MM	-$44 MM	-$37 MM	-$30 MM	-$23 MM	-$15 MM
0.5	-$60 MM	-$53 MM	-$46 MM	-$39 MM	-$33 MM	-$25 MM

AWARDED POINTS GOING UNSPENT
IN PERCENTAGE

Most likely outcome is a $27–60 MM loss

Source Oliver Wyman analysis

CUSTOMER EXPECTATIONS ARE CHANGING

It's not just that customers want more rewards; it's that they want a different kind of relationship with the businesses they choose to interact with. As such, loyalty schemes are changing from transaction-based exchanges between a retailer and a customer to an ongoing relationship with the customer at the centre (Exhibit 2). Our sister firm Lippincott, specialising in brand and design, studies these trends in depth in the report *Welcome to the Human Era: The new model for building trusted connections, and what brands need to do about it.*

Many companies are starting to update how their loyalty schemes provide shared benefits with customers. Some of the most important trends we would pick out include:

- Increasing use of exclusive promotions and a move away from points
- Non-monetary rewards and symbols of belonging, such as free coffee at UK grocer Waitrose, or childcare and frozen yoghurt at Ikea
- Charity-based rewards and points, such as Kroger's community awards in the US or Pets at Home animal charity scheme in the UK
- Services to improve the shopping experience, such as Neiman Marcus' shopping app that incorporates shopping, blogging, events, and loyalty points management
- Broader lifestyle applications, such as Walgreens' Steps programme

In these examples, customers are happy to give the retailer access to their data, not because they are getting points in return, but because they are being rewarded or helped in other ways.

Once this virtuous cycle is started, it can be very powerful – customers are prepared to allow more detailed use of their data and more intimate analysis of their habits so long as they are getting useful products and services in return. For the retailer, this extension of brand permission and increase in the number of customer touch points will boost customer loyalty today and can be monetised in the future (as it increases the range of commercial opportunities in the retailer-customer relationship). Interestingly, many traditional retailers are some of the most trusted brands in their home market, giving them more opportunity to drive this virtuous cycle than many other companies, such as financial services firms or internet giants.

Exhibit 2: Characteristics of loyalty programmes, past and present

	OLD WORLD REWARDS	NEW WORLD AFFINITY
Foundation	Formulaic deal	Relationship and belonging
Assessment	Transparent criteria, with no discretion	Role for serendipity and judgement
Time horizon	Present and future	Recognition of the past
Programme language	Points, statements, terms and conditions	Symbols of belonging (without overstepping the mark)
Identification	Plastic card	Crosses all channels and platforms
Customer benefits	Economic	Broader
Feeling	**Entitlement**	**Appreciation**

THE RIGHT TECHNOLOGY USED IN THE RIGHT WAY

Technological advances are rapidly changing the loyalty playing field. In the old world, customers would typically have a plastic card scanned on payment, then rewards would be received as coupons or offers through the post and by email.

In recent years, smartphones and other new technologies have transformed this playing field. Customers are always connected and the online and physical worlds are being merged, with customers expecting seamless integration across channels.

Real time or time-limited offers are becoming much more common, for example fashion shoe retailer Meat Pack in Guatemala has GPS embedded into its app and tracks when users enter competitors' stores. At certain times during its "Hijack" campaign, this triggered a promotional discount for Meat Pack, which started at 99% and decreased every second until the customer entered a Meat Pack store. The discount and subsequent purchase were then automatically shared on Facebook, sending the app viral.

There is much more two-way communication with customers, for example social media is now a key channel for customers to complain and they expect their issue to be resolved via the same channel. Additionally, customers are more in control of how they interact with loyalty services; they can choose to share Facebook data to access a discount or enter a competition.

Online services are being brought in store. For example, there are apps to help customers navigate and find products as well as smartphone technology to accelerate self-scan and payment.

Underpinning much of this technology are more sophisticated analytics on much bigger datasets. These, along with rapid iterative app development, are becoming important new capabilities for retail IT teams.

PART 2 | GETTING IT RIGHT IN THE REAL WORLD

In reality, an exceptional, original, and effective loyalty scheme is much easier to describe than it is to deliver. But, it can be done. One example is Balance Rewards by US health and beauty retailer Walgreens. The scheme is built around unique, non-purchase rewards and creates additional value for both customer and retailer. In Exhibit 3, we summarise how loyalty programmes like the one at Walgreens operate.

Today, some retailers are making successful changes to their loyalty programme while others are not. Although no two situations are identical, we would pick out two themes that separate the leaders from the laggards:

1. A future-flexible approach to technology, with the retailer owning the overall loyalty ecosystem but not necessarily every specific component within it
2. A start-up mindset (and often organisational structure) that enables long-term investment in the loyalty proposition

Exhibit 3: Loyalty programme from a customer's perspective

CUSTOMER VIEW

I WANT...

- ...personalised rewards
- ...rewards wherever I interact with a company, 24/7
- ...an easy way to see my loyalty status and redeem rewards
- ...rewards for things other than purchases
- ...mobile interaction
- ...real-time offers
- ...two-way communication
- ...control over my experience and data

HOW TO MEET THE CUSTOMER NEED

- Provide relevant rewards for the customer to choose from
- Perform big data analyses using multiple sources of data to provide rewards based on consumer behaviour and life cycle, with a focus on cross-selling and retention

- Deliver multichannel loyalty with consumer insights and a loyalty programme that goes across all sales channels, including in stores, brands, and online

- Enable the customer to manage rewards in one place, for example by bundling miles, points, or rewards into a single app or website

- Give rewards based on the customer sharing more information about themselves, for example interacting on social media

- Replace loyalty cards with apps
- Push product updates to the customer
- Distribute benefits and coupons direct to a mobile device
- Be flexible to adapt to new consumer technology (phones, tablets, glasses,watches, etc.)

- Make offers made based on geolocation and customer activity or microsegment

- Reward customers with more personalised offers when they share their likes and dislikes

- Introduce a user-friendly platform to change and settings that control contact information, preferences, and so on

1. A FUTURE-FLEXIBLE APPROACH TO TECHNOLOGY

Twenty years ago, the first retail loyalty schemes relied on expensive in-house systems and technology and were very inflexible in how they operated. Back then, the only alternative to this model was partnering with third-party providers such as Aimia, based in Canada, and Payback, in Germany, but such a move essentially ceded control of much of the loyalty programme and data.

Today, flexibility is the watchword. The cost of the technology required to run a loyalty scheme is much less than it once was and there are a plethora of specialist providers offering solutions to each different area in the loyalty ecosystem. This gives retailers many options for how to set up the loyalty programme: either in-house or outsourced, or a mix, each covering a different aspect of the programme.

CONTROL THE LOYALTY ECOSYSTEM BUT NOT EVERY COMPONENT

Our view is that retailers' interests are best served if they take control of the overall loyalty ecosystem – rather than outsource it to a single provider – but are comfortable partnering with a number of specialist vendors where they add powerful or differentiated capabilities. Taking a leaf out of Apple's book and applying this "designed in California" mindset allows retailers to maintain control of their loyalty scheme without having to develop internal capabilities in every single area of activity.

BE FUTURE FLEXIBLE, NOT FUTURE PROOF

Given that customer expectations and technologies are changing rapidly, it is tempting to try to future proof the loyalty ecosystem: by thinking ahead and designing solutions for every eventuality. This is unlikely to be able to address the as-yet unknown challenges and opportunities ahead. Far better is to design a future-flexible loyalty ecosystem, which allows for new components to be plugged in within a modular architecture.

DELIVER EXCELLENCE IN CUSTOMER ANALYTICS AND ITERATIVE DEVELOPMENT

Long-term, competitive differentiation will come from better customer analytics – underpinning more innovative products and services for consumers – as well as improved decision making in the core business.

Linked to this, the fast and continuous development of customer services and apps is an important capability: customers expect the products they use to improve rapidly.

2. A START-UP MINDSET

It's a simple fact that an effective loyalty programme and the IT that enables it require investment. Most retailers keep tight control on such expenditures and need clear business case justification for investments.

This mindset, though, can be an issue in the loyalty arena. For example, a new menu management app for a food retailer might cost $5 MM to develop and launch. Although supported by a strong hypothesis that it would improve customer loyalty and "stickiness" over time, the direct sales benefit of such an app might be difficult to quantify. Understandably, this makes it difficult to raise support for the large initial investment.

In contrast, by using a start-up mindset, the proposition around this app could look quite different. For example, by assigning a $50 value to each customer who downloads the app, you create a way of assessing the app's cost-benefit, which is much more tangible. Here, it would take 100,000 downloads to cover the app development costs (a small number relative to the millions who shop at large grocers) and would build a much more appealing business case.

We would encourage retailers to think about their loyalty products in this way and develop new KPIs to measure them accordingly. Doing so will enable them to make – and justify – the investments needed to make the loyalty schemes successful.

Exhibit 4: The future of loyalty looks very different from the past

	15–20 YEARS AGO	TODAY	THE FUTURE
Core proposition	• Points in return for data • Vouchers	• Points • Points plus bespoke offers and rewards (For example, Waitrose in the UK offering loyalty card holders a free coffee on each visit)	• Wider variety of methods of recognition • More emotional content
Purpose and focus	• Observing customer behaviour from a distance • Capturing data and segmenting • Sending things infrequently	• Understanding behaviour and feelings closely • Building a 1:1 relationship • Frequent, two-way contact	• More personal • More frequent • More directly beneficial to the individual
Who is involved	• Only a few or the largest retailers	• Many retailers of all sizes and sectors	• Almost every retailer
Customer interaction	• Swiping card at till • Mailing paper statements	• Multiple ways to interact and capture data • Move to online (for example, email updates)	• Anywhere, anytime, and on any platform
Nature of ecosystem	• Invented and built largely in-house • Large one-stop-shop loyalty providers	• Established loyalty providers • Multiple specialist "component" providers • Lower entry or development costs	• Retailer-controlled third-party ecosystems • Flexible, continuously changing architecture

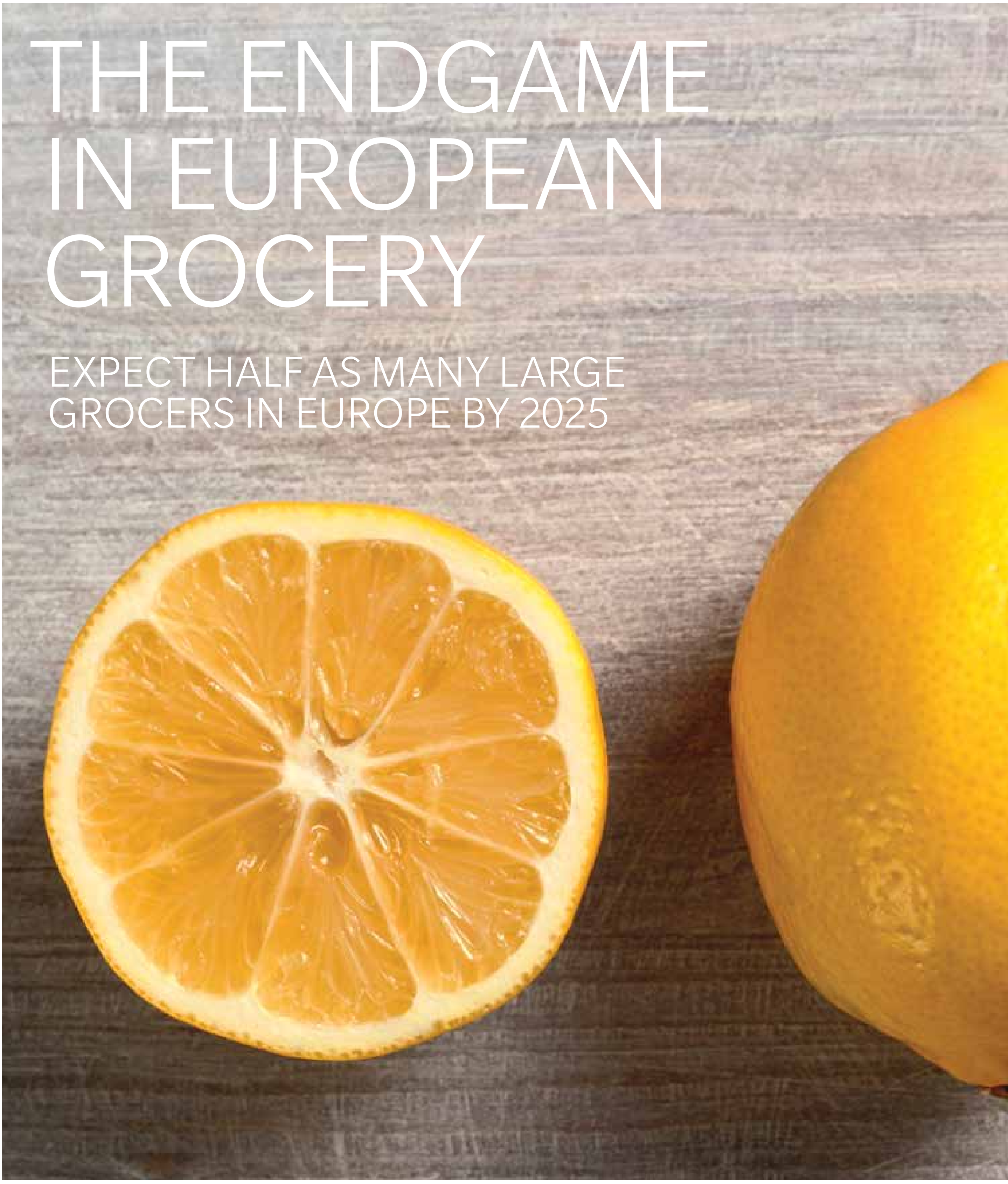
CONCLUDING REMARKS

The leaders in customer loyalty are moving away from transactional points-based schemes towards more varied, flexible customer engagement systems (Exhibit 4). Technology is at the heart of this change. Retailers must ensure their schemes are set up in a way to support and enable the technology innovations they will need to deliver the loyalty programmes of the future. In the new world, many retailers will require new KPIs to assess the returns they make in their loyalty programmes to make long-term investments possible.

For retailers who succeed, an improved loyalty scheme can deliver significantly better customer engagement and stickiness. It can also act as a defence against disruptive new entrants trying to get between retailers and their customers.

THE ENDGAME IN EUROPEAN GROCERY

EXPECT HALF AS MANY LARGE GROCERS IN EUROPE BY 2025



Against a weak economic backdrop, old growth models based on store expansion, national consolidation, and diversification are no longer delivering the like-for-likes board members and investors want to see. As well as a saturated marketplace, there is increasing competition from discounters and newer online retailers like AmazonFresh. In response, we believe that the European grocery market will begin consolidating internationally so that, by 2025, the total number of large grocers in Europe will have halved.

Weak demand, a decline of traditional growth engines, and the aggressive growth of specialist competitors such as discounters (Exhibit 1) will continue to drive the next ten years' of change in European grocery. As the pressure mounts, expect to see more headlines about price wars, stock value erosion, races to form buying alliances, and even the occasional market exit. With this in mind, we think there are four questions grocers should be considering today to ensure a successful future, listed below and explained in more detail in the rest of the article:

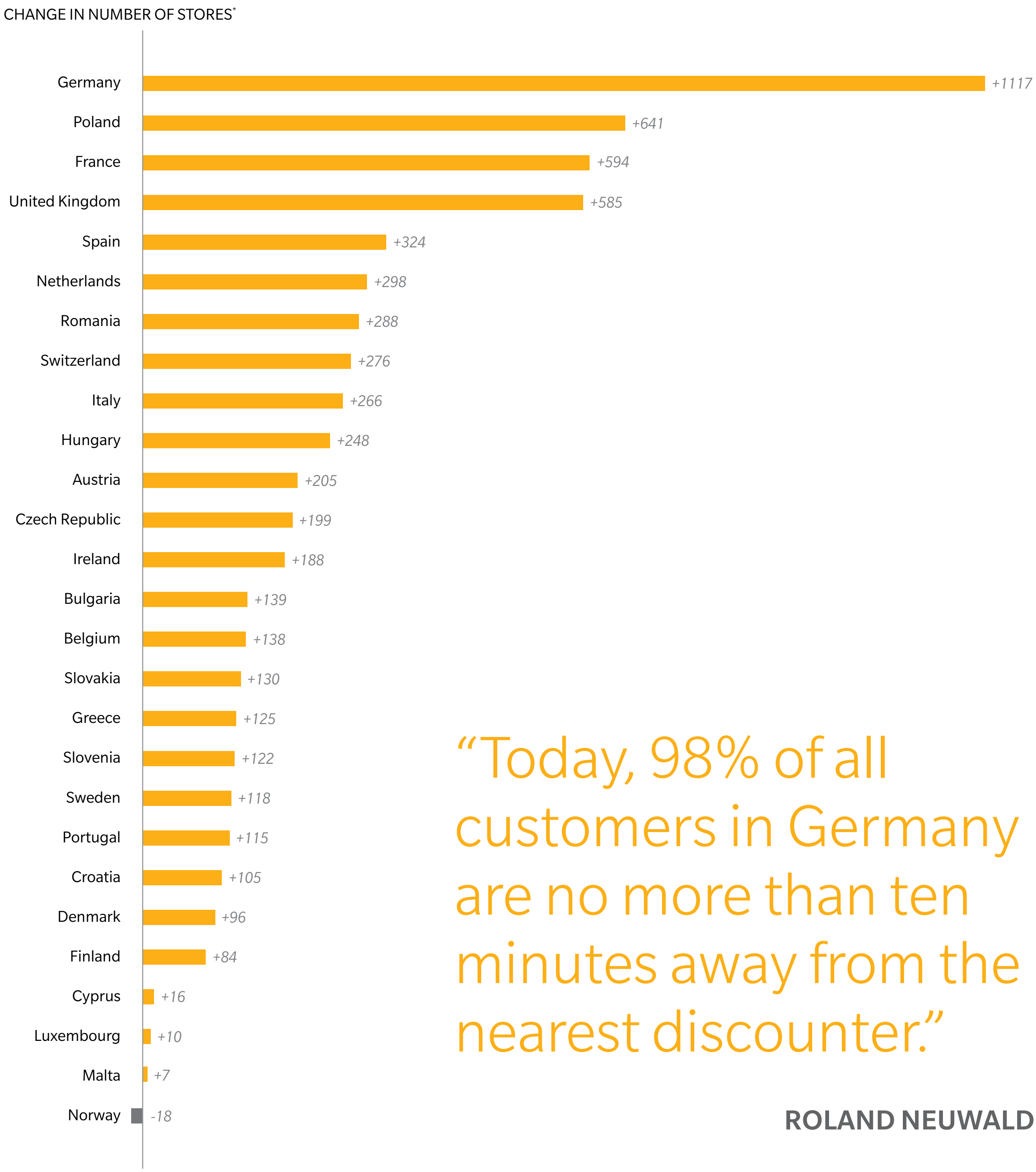
1. **How can we deliver a step change in our approach to cost?**
   Cost leadership is becoming a necessity.

2. **How can asset productivity be increased?**
   Only business models with high levels of asset productivity will survive.

3. **What are our options to grow internationally?**
   Scale matters – and international growth is one of the few ways to drive scale.

4. **What more could we be doing to hold on to and build customer relationships?**
   With new competitors on the scene, increasing the 'stickiness' of customers is crucial.

Exhibit 1: Aldi and Lidl growth in Europe 2004 versus 2014



“Today, 98% of all customers in Germany are no more than ten minutes away from the nearest discounter.”

ROLAND NEUWALD

* Aldi Nord plus Aldi Süd plus Lidl
Sources Planet Retail and Oliver Wyman analysis

1. HOW CAN WE DELIVER A STEP CHANGE IN OUR APPROACH TO COST?

In all areas of the cost base, adapting incrementally is unlikely to be enough. Successful businesses will be those that deliver a clear step change; those who watch and then react will fall behind.

The majority of retailers understand the importance of cost only too well and incremental cost reduction is a core element in most businesses' strategic plans, year in, year out. However, we suspect that for many these efforts do not go far enough and that becoming a cost leader will come down to step changes in two areas: buying power through scale, and leaner, smarter operations.

To achieve the scale needed to negotiate improved terms from suppliers, buying alliances like those shown in Exhibit 2 will continue to form and grow, and we think all retailers should review their options for joining or building an alliance. Retailers not participating in these buying groups must ensure they are able to deliver world-class procurement, for example by using data to create a real advantage in supplier negotiations (see our report *Smarter Arguments for Higher Profits: Reversing the Information Asymmetry*).

Exhibit 2: European grocer buying alliances

EMD
- Axfood
- Groupe Casino
- Markant
  - dm
  - Globus
  - Kaiser's Tengelmann
  - Kaufland
  - Müller
  - Rossmann
- Norges Gruppen
- SuperGros
- ...et al.

ALIDIS
- Edeka
- ITM Entreprises
- Grupo Eroski

COOPERNIC
- Coop Italia
- Delhaize Group
- E.Leclerc*

Since 2014
- Groupe Auchan
- Metro Group

In France
- Carrefour + Dia + CORA
- Groupe Auchan + Systeme U
- ITM Entreprises + Groupe Casino

AMS
- Ahold
- Booker
- Dansk Supermarked
- Esselunga
- Hagar
- ICA
- Jeronimo Martins
- Kesko
- Migros
- Morrisons

CORE
- Colruyt
- Conad
- Coop Switzerland
- Rewe Group*

Strategic partnership announced in June 2015
- Rewe Group
- E.Leclerc

* E.Leclerc and Rewe Group announced in June 2015 their own strategic partnership

Note Status as of June 2015

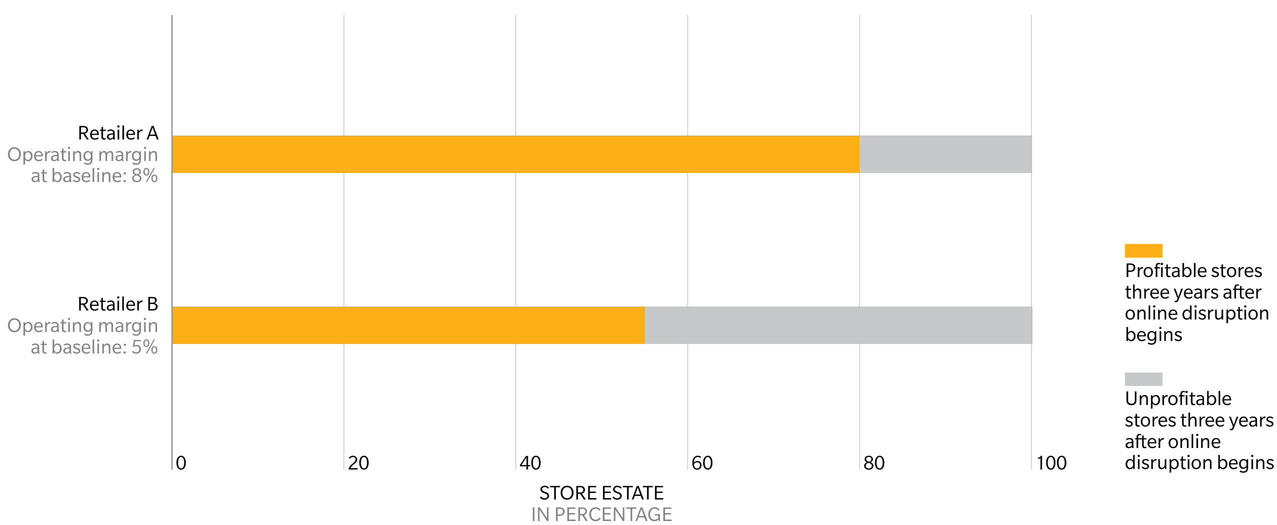
To truly outpace the competition, fresh thinking will be required to take cost out of other areas of the business. For example, you could behave like a discounter and ask if some product ranges could be rationalised in order to reduce cost and complexity in the supply chain. Or you could consider how automated algorithms like those used by lean online retailers could be used to manage more of the day-to-day pricing decisions. These approaches will doubtless involve asking difficult questions and challenging the status quo, but the profitability advantages they create will provide a degree of protection against volume losses other grocers may not have, as shown in the example in Exhibit 3 and explained in more detail on page 68.

2. HOW CAN ASSET PRODUCTIVITY BE INCREASED?

With margins shrinking and the future looking uncertain, underperforming stores will be scrutinised, with closures not ruled out. While in many cases long-term leases will prevent outright closures, there are still innovative ways in which the productivity of such sites can be improved. For example, they can serve as pick-up points and host collection lockers, including for other non-competing retailers. In the UK, for years customers have been able to pick up their John Lewis homeware order from a local Waitrose supermarket (both are members of the John Lewis Partnership), and now they can also collect their eBay purchases from one of thousands of Argos stores.

These collaborations can allow one partner to deliver low-cost points of presence and the other to make use of excess space. This is exactly what UK grocer Sainsbury's is doing by opening up Argos outlets in its stores, and the idea doesn't have to be limited to retailer-retailer relationships: P&G allowed Amazon to set up fulfilment operations within its own warehouses in the US to reduce transportation costs and speed up delivery.

Exhibit 3: Example of how small profitability advantages can reduce the impact of volume loss from online disruption



Source Oliver Wyman analysis

Driving asset utilisation can be a very powerful way of strengthening the economic model of the business. Making better use of the costs you have can be just as important as reducing those costs in the first place.

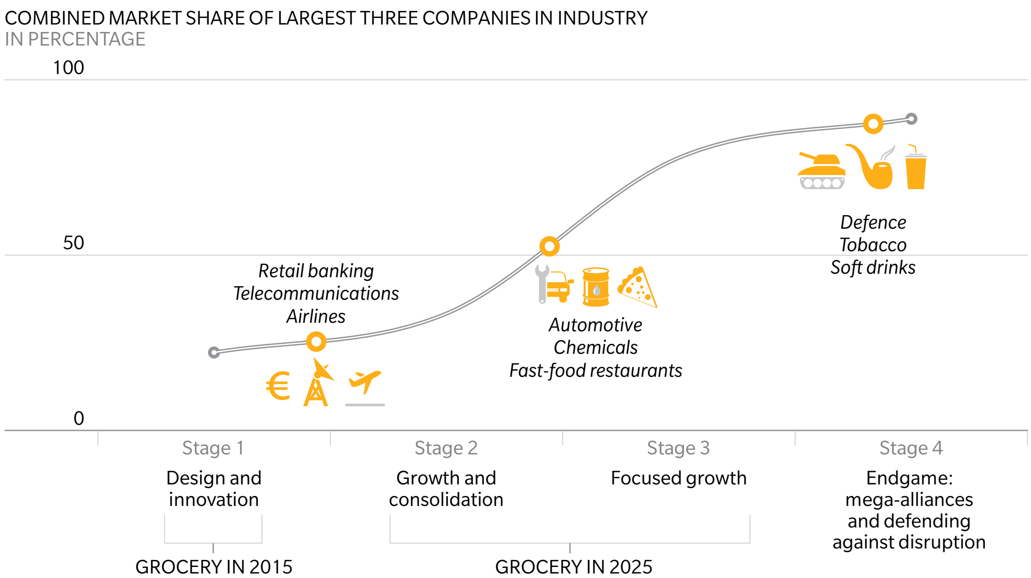
3. WHAT ARE OUR OPTIONS INTERNATIONALLY?

It's clear that scale will continue to drive financial strength. However, in many European countries national consolidation has reached saturation point and some regulators are unwilling to allow further take-overs or mergers among the remaining large retailers. The alternative is a strategy long considered out of fashion in grocery retail: international consolidation.

Most industries consolidate as they mature (Exhibit 4), with major players expanding and often buying up competitors – initially within national markets but eventually across borders. On the way, underperformers and slower movers are targeted and absorbed. In grocery, we've seen cross-border consolidation successfully deployed by hard discounters, warehouse clubs, and cash-and-carry stores. For example, Aldi has expanded across Europe and has grown Trader Joe's in the US since it purchased the business in 1979.

In a world of one-to-one, bespoke customer interactions, taking an international view could also open up new and very specific customer innovations. Technology will be a key enabler of this type of innovation: for example a great meal planning app for those on specialist diets would be popular regardless of geography. After all, a gluten-intolerant customer in Spain has more in common with a gluten-intolerant customer in Finland than they might with the average Spanish grocery shopper. Once customers are served in this way, national boundaries will break down even further.

Exhibit 4: Consolidation will play out in grocery in a similar way to other industries



A small number of large companies reign in industries such as tobacco, soft drinks, defence, and automotive – and we expect to see grocery starting to move up this consolidation curve in the next decade. In other areas of retail, we already see examples such as furniture (IKEA), clothing (Inditex and H&M), and luxury goods. Given this pattern, a company's long-term success depends on how quickly and successfully it moves up the consolidation curve. Slower movers will disappear or become targets. Staying out of the contest or ignoring it does not increase your chances of survival.

Sources Harvard Business Review and Oliver Wyman analysis

4. WHAT MORE COULD WE BE DOING TO HOLD ON TO AND BUILD CUSTOMER RELATIONSHIPS?

For Europe's major grocery chains, owning the customer relationship is crucial to their long-term future, and traditional retailers will need to fight to keep the customer relationships they once took for granted. New business models have been causing market disruption by fulfilling the traditional retail role in a new way (AmazonFresh, Google Shopping) and by positioning themselves as the final and personal touchpoint in the value chain (Shutl, DPD, Uber). Success and failure will be driven by how well grocers can counter these newer competitors – such as online aggregators and last-mile distributors – to maintain the all-important customer contact.

In such an environment, knowledge is power and asking the right questions of your customer data is essential if you are to successfully develop relationships on an individual basis and build "sticky" proprietary ecosystems with differentiated customer experiences.

Judicious analysis and use of data are key, and an important strength will be the ability to quickly develop apps and information-driven services that are better, more exciting, and more relevant. For example, the menu and diet management app mentioned earlier could provide exceptional personal value for a subset of customers, radically increasing their brand loyalty to that particular business.

THE ENDGAME

As European grocery markets move toward consolidation, we believe retailers will eventually split into two camps: superpowers and nimble local winners (Exhibit 5).

In this market, there will be fewer grocers than today. Right now there are 25 big names each with over €10 BN in revenue. By 2025, we suspect this will have fallen by half – although the survivors will be much, much larger.

Exhibit 5: What grocery retailers will look like in 2025

	THE SUPERPOWERS	THE NIMBLE LOCAL WINNERS
Geography	Strong pan-European presence	National and local
Proposition	Mostly specialists. A few generalists who differentiate through better customer connections and efficient management and operations	Offer tailored at a local level
Survival advantage	Economies of scale	Innovation and creative strategies that can quickly adapt

WHAT WILL IT TAKE TO BE A WINNER?

Companies who move first and move fast will obviously be in a strong position, but they must ensure they are travelling in the right direction. Regardless of whether your business will be a superpower or a nimble local winner, we think there are three key areas to focus on to help you survive and thrive in the future.

1. THINK LONG TERM AND INVEST IN STRATEGY

We encourage retailers to think about where they need to be in five or ten years' time, rather than focussing on where they are starting from today. The aim is to move beyond short-term, incremental steps and instead plan step changes across the whole organisation. This way, you will be able to tackle the latest market disruptions and quickly adapt to ones you may not see coming.

To make a realistic assessment of your position and the options open to you, model the European grocery market as a whole and simulate the biggest, most dramatic changes that could occur. Perhaps the most significant threat to your business will be consolidation, or perhaps it will be a local challenge: either way, forewarned is forearmed.

Study what happened as other industries moved up the consolidation curve in Exhibit 4 and learn from what worked and what didn't. Our article *Trading Places* in the second volume of *Ten Ideas From Oliver Wyman* expands on the benefits of this kind of cross-industry thinking.

2. DO THE BASICS, AND DO THEM WELL

As discussed earlier, in a saturated market, like-for-like growth has to come from reconfiguring the existing business to make it more productive. This is why there is so much focus on improving the proposition, increasing operational efficiency, and reducing costs.

A strong unique proposition can reduce customer turnover and be a first step in winning market share. Whether online or in store, identify what customers want and how to give it to them in a way that the competition cannot. Find out what they don't value and look at ways to remove it from your proposition and save both you and them money.

Many retailers are overrun with data yet have not managed to unlock the performance improvement this data can deliver. For example, the right category management app can increase the time that category managers spend pricing products rather than processing the insight data, enabling them to make better decisions and react faster. Similarly, armed with the right supplier negotiation tool, we've helped grocers integrate dozens of different data sources, perform sophisticated value-added analyses, and generate easy-to-consume reports in a format suited to supplier discussions.

3. SHAPE THE FUTURE – DON'T LET IT SHAPE YOU

We've mentioned previously the importance of being a leader rather than a follower. Customers don't typically notice copycat strategies, and a rushed response to an unforeseen change usually leads to poor execution at a higher cost. For most organisations, taking control of their own future will mean building more experimentation, risk taking, and agility into their culture. This will help you become "future flexible" rather than "future proof", which we believe is the best way to meet the changes coming over the next decade.

CONCLUDING REMARKS

The European grocery market will not be significantly larger in 2025 than it is today. What will be different is its composition. After intense international consolidation, there will be fewer large retailers, with those remaining each controlling a greater proportion of the market. If your business doesn't go down this route, perhaps it will be one of the smaller – but still profitable – nimble local grocers who are able to quickly and efficiently meet the needs of a smaller subset of customers.

Either way, to emerge as a winner in this new ecosystem, actions must be taken today. The future will favour those who move now and move boldly – the time for small incremental change is over.

Grocers who can identify where they want to be in 2025, and are bold enough to make the right early moves to get there, have a very exciting future.

THE NEW IT HORIZON

HOW THREE YEARS FROM NOW CHANGES EVERYTHING YOU DO TODAY

Tomorrow, IT's business innovations will be a major contributor to a retailer's on-going success. For some retailers, tomorrow has already arrived and IT is helping the company move at the speed of their digital consumers – simultaneously repositioning IT from an enabler of operations to a creator of business value. The timing of when a CIO moves his or her organisation to be a source of business innovation is largely determined by the level of consumer demand for a digitally-enhanced retail experience. We believe this consumer shift has broadly happened, changing the question for every retailer from when to shift the organisation to how to shift it. From our discussions with retail CIOs, they concur but are uncertain as to how to make the move without breaking either the business or their organisation.

The arrival of digital enterprises has meant a fundamentally different role for IT: in most of these companies, IT doesn't just enable the business, IT creates the business. For retailers such as Amazon and Instacart (and other online businesses such as Uber and Airbnb), IT is at the very core of how they operate.

Below is our checklist highlighting the top four goals a retail CIO will need to achieve to lead the business through this transformation. The rest of this article explains in depth the way each question should be approached.

TOP FOUR GOALS FOR THE CIO

Be a creator of value, not a taker of orders

Articulate a clear future operating model

Breed the next generation of technology pentathletes

Focus on where you need to be tomorrow, rather than where you start from today

BE A CREATOR OF VALUE, NOT A TAKER OF ORDERS

CIO CHECKLIST

- ✓ Identify how IT will act as value creator in your business, and move away from being a function that takes orders
- ✓ Develop a point of view on how to drive business value by:
  - ✓ Winning new customers
  - ✓ Running the business more efficiently
  - ✓ Driving innovation

WINNING NEW CUSTOMERS

In digital businesses, dedicated teams of IT experts focus on finding new ways to serve customers. They continually develop new products such as applications for healthy eating, or portals for personalised product generation. And just as importantly, they are constantly looking for ways to use information to make the customer experience easier, more engaging, and more consistent across all channels.

This approach is not unique to Silicon Valley start-ups. In supermarkets, augmented reality apps that provide shoppers with additional product or promotion information are now widespread, and for customers who participate in smart loyalty programmes this information can easily be personalised. Recently, non-food retailers such as Shiseido, De Beers, Topshop, American Apparel, and IKEA have created offerings for shoppers to interact with products electronically, simplifying and enhancing the shopping experience.

Just as Amazon uses all the information it has on shoppers browsing its website to devise upselling and cross-selling offers, bricks-and-mortar retailers can identify shoppers entering their stores, access their preference data and virtual shopping carts automatically, and create personalised offerings for them.

In today's retail IT leaders, these customer-facing technologies can be built rapidly and iteratively, with quick-fire beta versions – a development path that is in many ways the opposite of what traditional IT departments are used to. And since new technologies are always being designed, the IT ecosystem has to be flexible enough to accommodate them.Tools such as SAP HANA for CRM and Business Intelligence applications can be used to process unprecedented amounts of data quickly, in turn feeding additional IT applications to react to this information ("real-time retail").

RUNNING THE BUSINESS MORE EFFECTIVELY

Learning from digital players to develop the customer proposition and create an appealing, reliable multichannel shopping experience is critical, but for mature retailers technology has the potential to deliver much more besides. The low margins and large store estates that typify most sectors make every drop of economic benefit critical. IT can help retailers achieve this in three ways: greater task automation, better operational algorithms, and better business intelligence.

GREATER TASK AUTOMATION

Building apps to support customer self-service and automating repetitive tasks can significantly drive down labour costs. Although there are already many examples in stores, from classic vending to digital signage to checkout automation, untapped potential remains.

Automation can be applied to individual service tasks such as refunds, store navigation, and beyond, to reinvent whole elements of the retail process for further improved efficiency. For example, retailers are already streamlining the checkout process through self-scan and point of sale (PoS) applications, and in the future robots may be capable of shelf stacking more cheaply than humans. Even today, retailers such as Nespresso, Best Buy, and The Body Shop are experimenting with the automation of entire shops.

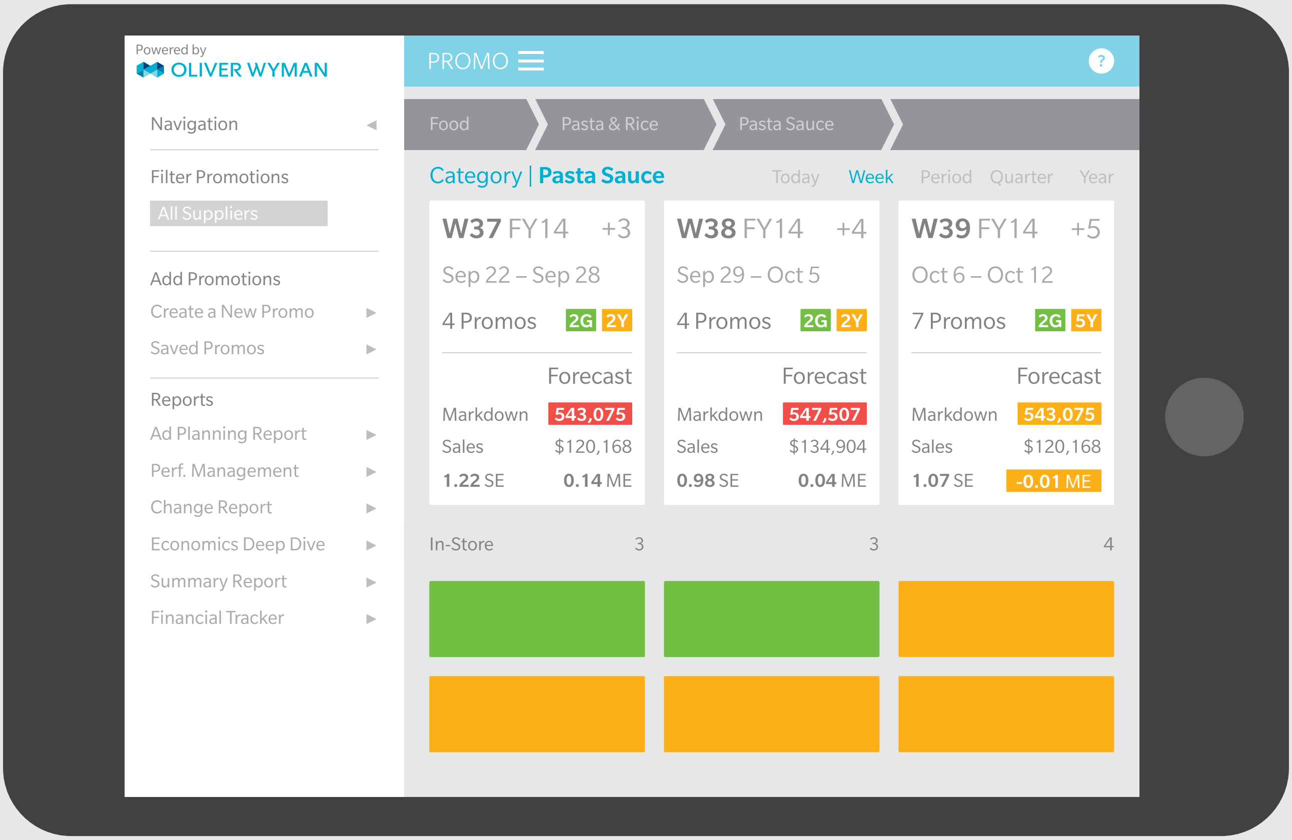
BETTER OPERATIONAL ALGORITHMS

Retailers already use the vast amount of data they collect to deliver efficiency improvements in real time by building algorithms that can make detailed decisions without intervention by store managers. For example:

- Checkout labour can be managed automatically by using infrared sensors to count the number of shoppers entering a store
- Replenishment instructions can be generated automatically when sales data tell the retailer stock is low

EXHIBIT 1

USING ADVANCED BUSINESS INTELLIGENCE TO UNLOCK $MM OF VALUE



BACKGROUND

A retailer was facing imminent crisis with its prices 25% more expensive than online competition.

A promotions programme was needed to generate sustainable funding for price reductions.

IT INTERVENTION

Using an agile approach to IT, Oliver Wyman created an elegant user-friendly app that collated and presented information for better decision making around promotions and competitive pricing.

The app was successful in integrating industry knowledge and analytical insights and models into the existing commercial processes.

BUSINESS OUTCOMES

- High-quality, analytically-based decisions
- Traders in control and accountable for results
- Time-efficient
- Ability to learn and inform strategy
- Cash from IT

However, further optimisation opportunities still exist, with one UK retailer reporting $150 MM of supply chain savings in 2014. Further areas of big data interest include weather-driven demand and predicting product returns.

BETTER BUSINESS INTELLIGENCE

In many ways, the biggest opportunity for IT will be in the application of business intelligence: delivering management information systems that allow retail executives to make decisions better and faster. Managers in trading and operations departments need to make hundreds of important decisions every week and, since they are under huge time pressures, having the right information at the touch of a button in an accessible, user-friendly format can make a huge difference.

Exhibit 1 provides an example, highlighting how a more advanced approach to business intelligence can transform decision making in trading.

DRIVING INNOVATION

With IT playing an ever more central role in customer proposition development and core business process execution, its overall position in the business will also evolve. In this fast-changing world, the IT department becomes central to the strategy and transformation of the business, and driving innovation. This is very different from the historical role of many retail IT departments, which were focused on making sure things don't break, or on incremental optimisation of existing technology processes to make them 10% better, faster, or cheaper.

All of these changes impact on the role of the CIO more than anyone, so much so that there's an argument for splitting the job into two separate positions: Chief Technology Officer and Chief Innovation Officer.

In any case, CIOs need to become strategic partners for the board and the CEO, educating them on the benefits of digital approaches. They need a deep understanding of market dynamics, customer preferences, competitive landscape, opportunities, and threats. Additionally, they need to be able to identify and prepare for seismic changes before they happen and navigate them safely when they do.

Overall, IT and the CIO need to move from being enablers to being creators. To put it another way, although operational efficiency and business as usual are still important, they are irrelevant in isolation. In the evolving world of multichannel retail, it is just as important for a CIO to focus on developing innovative and creative solutions that will confer a real competitive advantage.

This move from enabler to creator implies a revolution in the activity of many IT departments. Thankfully, in parallel, the evolution of the IT industry has opened up new possibilities in how IT can be delivered. Together, these two developments mean the retail IT department of the near future will look very different.

ARTICULATE A CLEAR FUTURE OPERATING MODEL

CIO CHECKLIST

- ✓ Define your view on becoming a smaller, leaner, better IT department:
  - ✓ Have a clear vision on the future operating model
  - ✓ Identify what will become a commodity and what will be the technology differentiators for the business
  - ✓ Know which processes to keep in house and which can be outsourced
  - ✓ Identify where the layers of intelligence will be
  - ✓ Invest in beating the competition on the differentiators while reducing cost of the commodity elements by at least 20%
- ✓ Collaborate to design a clear map of the transformation you need to truly deliver long-term, value-adding strategic goals

IT no longer needs to be something you own and run. Instead, it can be a service you purchase. In infrastructure, server hardware ownership is obsolete. The browser has become the universal interface, with applications ever more decoupled from infrastructure. Development environments, incorporating backup and recovery, database setup, and web-based code development in the cloud, can all be procured in a single transaction. Meanwhile, production environments can be replaced with platform-as-a-service (PaaS) or vendor hosting, and even software development can be bought as a service, reducing the need for internal hiring and skill development.

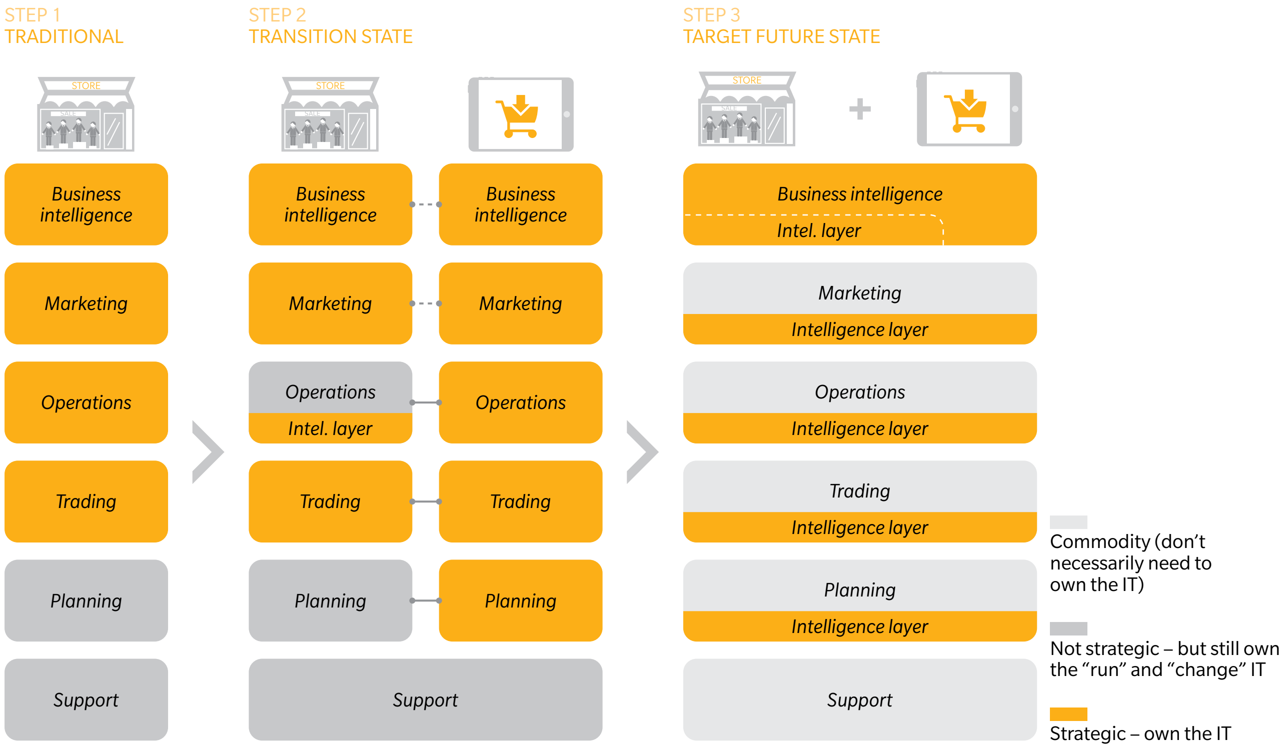
Routine, non-strategic core and support applications – in areas such as space management, selecting goods, checkouts, and taking goods home – can almost always be outsourced to service providers. Most applications will be available via the cloud, with retailers moving to a software-as-a-service (SaaS) model.

It is already possible to purchase whole processes – such as “procure to pay” or “hire to retire” – as services, and this market is only likely to grow. This means lower costs as the investment and operational burden is pooled and utilisation of both hardware and software is increased through dynamic capacity alignment. It also enables new levels of flexibility, which is vital in itself. It is only by adopting the PaaS and SaaS approaches that IT can become flexible enough to cope with total mobility and the need for end-to-end connectivity, or to plug in different elements to the ecosystem (such as new customer front-ends) to dynamically add capacity as needed.

However, even in so-called non-strategic areas, retailers may still choose to manage the key micro-processes that comprise the critical “intelligence layer”. The intelligence layer is where the information, insights, and orchestration reside.

With the model evolving from ownership to procurement, the role of IT is moving to one of sophisticated specifier and purchaser of services – with the design of risk and benefit-sharing mechanisms a critical capability. Only strategically important, differentiating applications should remain in house.

Exhibit 2: The three stages of retail IT evolution



Some such applications – covering areas such as customer management, pricing, promotions, and proposition development – should still be developed, operated, and maintained in the traditional in-house way. But while retailers keep ownership of the mega-processes, they can buy in many of the supporting micro-processes, such as market testing, product range planning, and customer analytics. Overall, the new model for IT in retail involves much less in-house development than in the past.

The challenge for the CIO is to know which areas should receive the investment of precious internal resources – and must in turn provide real differentiation – and which can be safely and cheaply outsourced. The key is to understand the relative importance of resilience, innovation, and cost in different parts of the business.

Exhibit 2 gives an example of a migration map showing the desired end-state and migration sequence. In this case, a bricks-and-mortar retailer wanted to migrate to an omnichannel offering over two or three years. In the traditional world, the in-house IT team owned and ran proprietary systems to support all business functions. Here, the CIO understood the need to identify and differentiate between those elements that were strategic (and would require in-house focus) and those that could be outsourced as a commodity.

A learning period was necessary to develop future-state processes and systems for the online world. However, over time, a single set of systems, with many off-the-shelf elements, and differentiating, proprietary intelligence layers were developed across all channels using a portfolio approach.

BREED THE NEXT GENERATION OF TECHNOLOGY PENTATHLETES

CIO CHECKLIST

- ✓ Understand what you don't need in the new world of IT
- ✓ Ensure your team members each have multiple capabilities to excel in the new world
  - ✓ Architecture and technology delivery
  - ✓ Business process know-how
  - ✓ Commercial acumen
  - ✓ Partner management
  - ✓ Strategic thinking

The portfolio approach to IT strategy has clear implications for the work of the IT department: some responsibilities will disappear, while others will become much more important. As a result, the size and shape of the IT department will change.

In the past, routine maintenance and repair has accounted for much of the work of a retailer's IT department. This responsibility will shrink as systems are outsourced and PaaS and SaaS approaches continue to become more prevalent. The new focus will be on developing and managing critical applications, integrating services from a diverse set of suppliers, and managing the relationship with these suppliers.

For strategic core applications, the IT department will need to act as in-house demand managers, with excellent functional and business knowledge. Given the need to coordinate numerous external vendors, architecture management will also be kept in house, with the enterprise architects themselves becoming more business savvy as well as hands-on technical and practical.

For non-strategic and support applications, the IT department will act as a separate service management organisation, overseeing the relationship with external providers to ensure that the business retains ultimate control of IT service delivery and that costs don't creep up over time.

As some roles disappear, others emerge. Increasingly tasked with delivering strategic initiatives that can transform the whole business, IT now needs to become a full partner in business decision-making, and to think and communicate in business terms. This means new positions will be needed, dedicated to looking for new IT-driven business ideas and IT-created business process efficiencies.

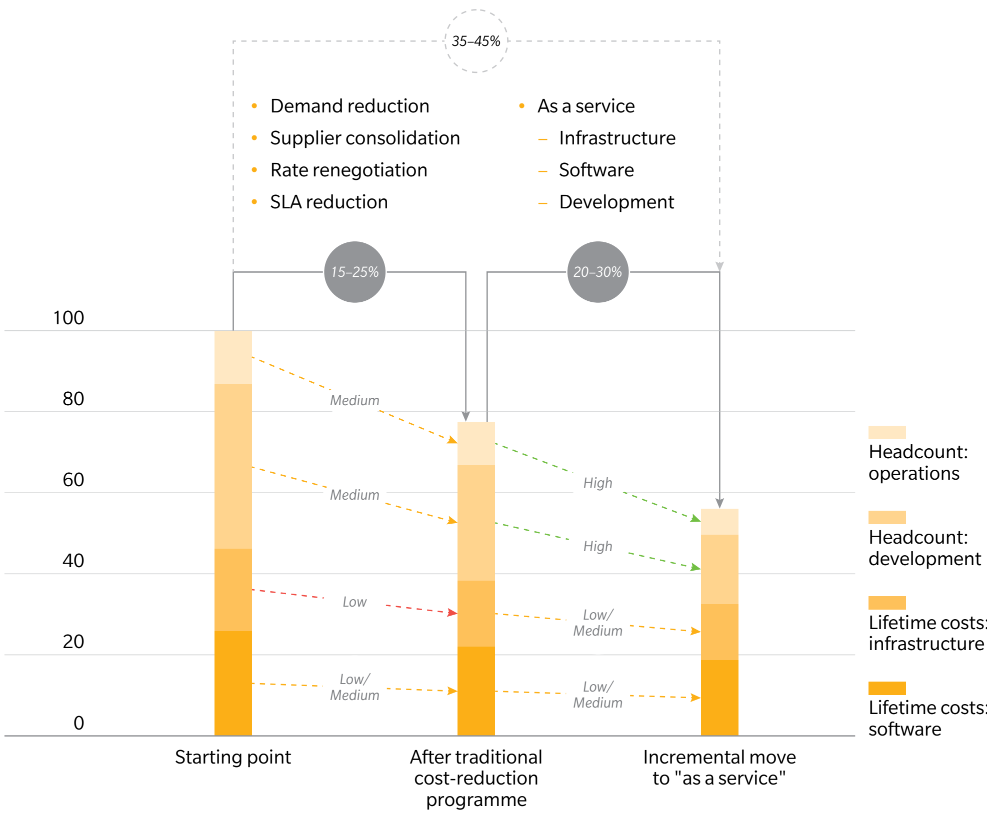
Meanwhile, day-to-day ways of working are changing, moving from traditional waterfall to more agile approaches, where the outcome is not necessarily known before work starts and flexibility of thinking and tools will be needed.

All this means that the job description of the internal IT team will change dramatically. In the future, retailers will need a cohort of "IT pentathletes" who can source, procure, and integrate across a broad range of service partners – a more highly skilled but smaller IT department.

The changes in how IT is delivered will transform retailers' IT cost structure. Today, typical cost levels in the sector are around 0.7–1.0% of revenue. Using a mix of traditional cost-reduction techniques and the "as a service" principle, we believe IT cost can be driven down by up to 50% – as Exhibit 3 explains in more detail.

Exhibit 3: "As a service" operating models and role alignment drive IT costs down

IT BUDGET NORMALISED VERSUS INITIAL SPEND
IN PERCENTAGE



Source Oliver Wyman analysis

FOCUS ON WHERE YOU NEED TO BE TOMORROW, RATHER THAN WHERE YOU START FROM TODAY

CIO CHECKLIST

- ✓ Get your team and the C-suite to move beyond the three-month horizon and start planning backwards from where you want to be in three years
- ✓ Be the architect behind a plan that really moves the strategy and innovation for the whole business
- ✓ Understand the personality of your organisation (for example: in denial, business as usual, eager for change) and adapt your plan accordingly

The changes we've described present a huge challenge for a mature retailer: it will be difficult to turn today's IT approach, capabilities, and infrastructure into something that meets the needs of tomorrow's multi-channel business.

In our experience, retail CIOs and their organisations are sometimes in denial about the changes required, continuing to play an enabling role without confronting the need for reinvention; or they believe that the transformation can be handled as business as usual, relying on the tried-and-tested approach of incremental cycles of tactical optimisation to get them somewhere better.

Even in cases where they understand the need for radical change, it's rare to meet a CIO who feels this can actually be achieved, understandable given day-to-day responsibilities and constant pressure on both operating and capital expenses.

One of the biggest problems is the incrementalism trap: thinking that the way to build an effective IT architecture is through a succession of small steps. Retailers are great at driving incremental execution and delivering on never-ending loops of marginal optimisation. Until very recently, this was the key to success in an industry with fierce competition where the impact of technological change tended to be limited. But in the face of the threats posed by e-commerce, incremental changes aren't enough to give the business the support it needs to survive now.

The solution is to focus on where you need to be tomorrow, rather than where you start from today and insist on bringing perspectives from other industries. This type of thinking begins with the position the retailer needs to be in in three to five years in order to be competitive: working backwards from this target defines the sequence of changes required to achieve it. This deceptively simple approach can be surprisingly effective in forcing the business – and the CIO – to face up to the true scale of the challenge and understand that even perfectly executed incremental change will leave the company fully prepared for the wrong future.

CONCLUDING REMARKS

It's hard to overstate the impact the current changes to the retail industry will have on IT departments. The CIO's job will be transformed from supporting and enabling, to shaping the strategy of the business as a whole, with a focus on innovation and value creation. IT architectures will be unrecognisably different from those of a decade ago and will be built and supported in different ways. As a result, retail IT departments will need radically different capabilities than they have today – or are currently building.

Success in multichannel retail relies on a radically different IT architecture and a radically different role for the CIO. It requires nothing less than the reinvention of the IT approach: incremental improvements can never deliver the changes required.

THE SUSTAINABILITY GAP

THE MISSING PIECE IN GROCERY RETAIL STRATEGY

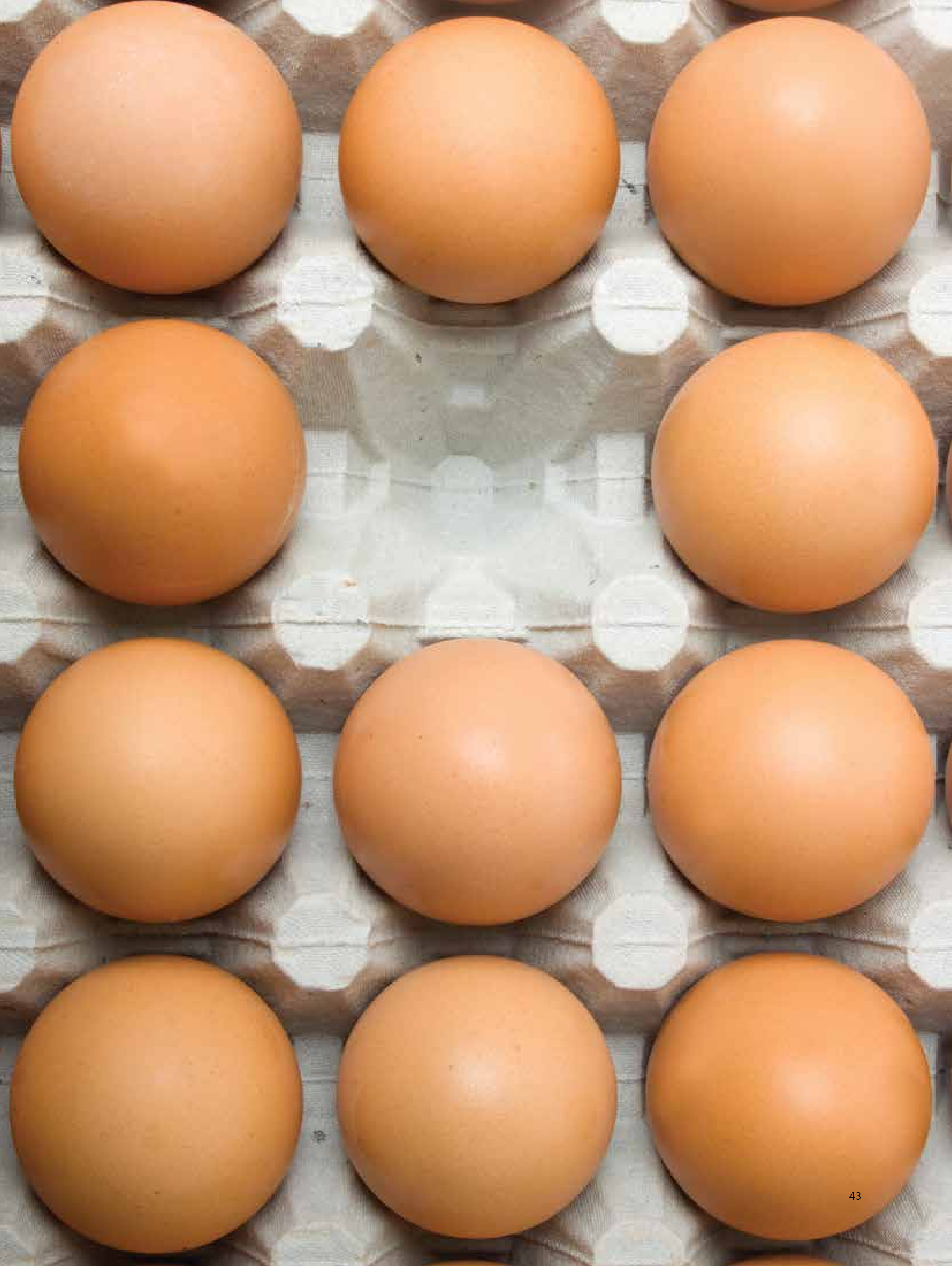
Most retailers agree that sustainability will be a key competitive advantage in the future. Unfortunately, there is a wide gap between their ambitions and reality.

A growing mismatch between supply and demand could erode the profits of the entire food industry within four decades. Global demand for agricultural production is expected to grow by 70% by mid-century and the global average per capita caloric intake is projected to increase by about 40%. The problem is that global food production already utilises about 50% of the arable land surface available and the global agricultural sector already consumes about 70% of the freshwater available for human use.

Our research shows there is a broad consensus among retailers that they will almost certainly face wrenching cost and availability problems as a result of the divide that is developing between supply and demand. Most also believe that they will be confronted with very different demand patterns as customer priorities and regulations change. Ninety percent of the top 50 global grocery retailers market their own private-label organic products, and 68% publish a sustainability report (see Exhibit 1). In their annual reports, 82% of grocery retail CEOs cite sustainability as a key priority. More than one in three has opened "green" pilot stores.

Nevertheless, the reality behind these flagship initiatives continues to be largely unsustainable. While sustainability now routinely figures in evaluating investment decisions and corporate projects, it has had little effect on the key commercial activities of the business – buying, store operations, or supply chain decisions. In most cases, sustainable product lines account for only a small fraction of sales revenues and, with new product development and space decisions still dominated by other priorities, change will be slow.

Although retailers' advertising campaigns are increasingly built around green messages and products, their in-store price promotions largely ignore them – and these account for a very significant proportion of sales. The vast majority of new stores also have little to do with their green concept stores. More than 99% of all stores are still traditional, non-green formats.



82%

Grocery retail CEOs who cite sustainability as a key priority

WHY SUSTAINABILITY IS NOT STICKING

Retail is characterised by low margins, pressing daily challenges, and global, complex supply chains. As a result, retailers focus on pressing, urgent matters, leaving sustainability in the back seat. Even deeply committed retailers often struggle to achieve real impact.

In our experience, there are two reasons that this keeps happening. Firstly, retailers fail to incorporate sustainability into their daily decision making. In many (and perhaps even most) retailers, decision making is spread out across hundreds of buyers, category managers, procurement managers, store associates, logistics specialists, and ordering managers.

While 42% of the top 50 global grocery retailers have established a sustainability function, and 14% now have a Chief Sustainability Officer, only 10% measure and incentivise personal performance against key performance indicators of sustainability. In this context, it's not surprising that sustainability often remains limited to a few corporate "lighthouse" projects, and rarely trickles down into decisions such as which products to carry, or what to promote next month. If sustainability is not an important factor alongside sales, volumes, and margins, decision makers will tend to ignore it.

Secondly, another challenge retailers face is that they can't manage what they don't measure. In order to make their core business model sustainable, retailers must understand the financial impact of sustainability initiatives. But only 16% of the top 50 grocers evaluate how sustainability efforts translate into financial outcomes. As a result, it is hard to define realistic targets, shape decision making, and measure progress. Identifying and generating the right key performance indicators can be a difficult undertaking. Often, there is insufficient data. And even when such data exists, disentangling the link, for example, between improving a company's ecological footprint and its economics, is far from straightforward.

MAKING SUSTAINABILITY HAPPEN

10%

Grocery retailers who measure and incentivise personal performance against sustainability key performance indicators

Nonetheless, leaders in sustainability have shown that it is possible not only to find ways to measure the impact of their efforts, but also to use this knowledge to achieve their ambitions. Given how decentralised decision making is in a typical retailer, making sustainability a reality requires "getting into the bloodstream" of the whole organisation, particularly the decision makers in trading and operations. Our work with clients points to five important success factors.

FACTOR 1 | CLEAR, STRATEGIC INTENT

Organisations must establish a clear strategic plan that is regularly reinforced over multiple years. Achieving this requires continuous and unambiguous top-level support. A company's management team must acknowledge the organisational and cultural challenges involved in targeting longer-term and more holistic objectives – while not losing focus on short-term sales, costs, and margins.

FACTOR 2 | GREATER TRANSPARENCY

Measuring the ecological and social footprint of an organisation's products and operations is very difficult, especially on the product side, since most resources are used earlier on. But the task is not impossible. To date, most retailers have focused on availability, cost, and time-to-market in their attempts to better understand upstream supply chains. In the future, supply-chain management and supply-chain collaboration will need to put as much, if not more, emphasis on resource usage, renewable resources, and social standards.

FACTOR 3 | DEFINED TARGETS

Realising a sustainability strategy requires quantified, operationalised objectives for functions and individuals, for both the short and the long term. For sustainability to become a reality, decision makers need to place it on a par with financial performance – and not just a "nice to have". This requires setting specific goals.

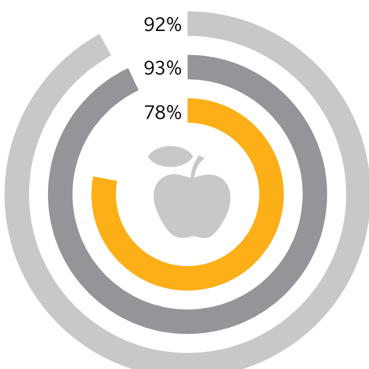
FACTOR 4 | INCLUDING SUSTAINABILITY IN DAILY DECISIONS

Sustainability needs to be incorporated into daily decision making in a dispassionate, transparent, and quantitative way. To be effective, there needs to be a detailed understanding of how, when, and by whom decisions are being made, as well as how to influence and change them. Just throwing more data at buyers and at category and operations managers is not enough.

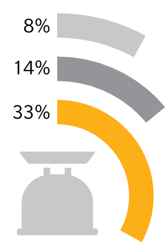
FACTOR 5 | MEASURING THE IMPACT

Organisations must be vigilant in measuring detailed and quantified results delivered against the targets set. As described earlier, ongoing measurement using key performance indicators is a vital part of embedding sustainability into the organisation. Without that, it is very difficult indeed to know how successful the strategy has been, or to ensure that sustainability remains foremost in the minds of those making day-to-day decisions.

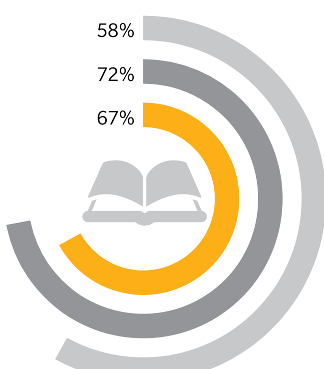
Exhibit 1: Sustainability in the world's top 50 grocers



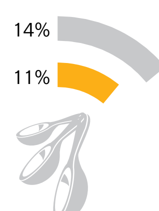
90% of the top 50 grocers worldwide offer an organic private-label product range



16% of the top 50 grocers worldwide measure and communicate the financial impact of sustainability initiatives



68% of the top 50 grocers worldwide publish a sustainability report



10% of the top 50 grocers worldwide systematically measure personal performance against sustainability key performance indicators

North America | Europe | Rest of world

Source Oliver Wyman analysis

CONCLUDING REMARKS

Building a sustainable retail business model is not easy. It costs money, and is not without risk. The argument for becoming sustainable is fundamentally underpinned by a need: to cope in a world of finite resources and increasingly stark trade-offs. The business case for sustainability is fundamentally long term, driven by the need to address emerging but anticipatable realities – ones that only become obvious over time.

But even today, sustainability offers tangible opportunities to drive growth and to reduce costs. In Switzerland, sales of the Coop Group's private-label sustainability brands and quality labels have reached $2 BN – more than 18% of its food revenues. Coop's market share in Switzerland in organic products exceeds its overall market share by more than 100%. In the UK, Marks & Spencer has generated more than $168 MM in net benefits by reducing packaging, decreasing landfill waste, improving transport, and adopting energy efficiency initiatives.

These and other pioneers have shown there is a path to profitability in sustainability. Over the next four decades, companies that follow in the footsteps of these early pioneers, as opposed to those that do not, may find the key to prospering in an increasingly harsh landscape lies in doing the "right thing".

IN-STORE OPTIMISATION

A NEW APPROACH TO REMOVE SILOS AND REDUCE COMPLEXITY

There is potential for a typical €10 BN retailer to unlock €100 MM in additional efficiencies within a period of six to twelve months.

Retailers in every sector have already squeezed stores with optimisation programmes, but we think many have missed the role played by central functions in helping stores become more efficient. By making the fundamental parts of stores' day-to-day operations simpler and faster, head office has a key role to play in creating front-line efficiencies, improving customer experience, and improving staff morale. In this article, we explain in more detail why this needs to be done and use case studies to share best practice.

The need for cost-efficient retail operations has never been higher, with low-cost internet and discounter competition affecting most retail sectors and markets in one way or another.

Most often, retailers try to deliver cost savings by looking at purchasing, category management, logistics, and operations separately. In the stores, head office squeezes labour budgets and hopes that store managers will find local solutions to keep on delivering. In fact, the result is often degraded customer service and disgruntled and demotivated employees, or else activity-based labour scheduling and budgeting is introduced that often cannot cope with the diversity of the store network and employee base.

We think there is a better way to achieve savings: by breaking down department silos and taking a store-centric approach to simplifying tasks and reducing costs. The heart of this approach involves taking the perspective of the customer and the staff on the front line, and asking what head office and other departments can do to simplify their lives and, consequently, take cost out of the operations. In our experience, there is potential for a typical €10 BN retailer to unlock €100 MM in additional efficiencies within a period of six to twelve months. The beauty of this approach is that customer outcomes and staff morale can often be improved at the same time.

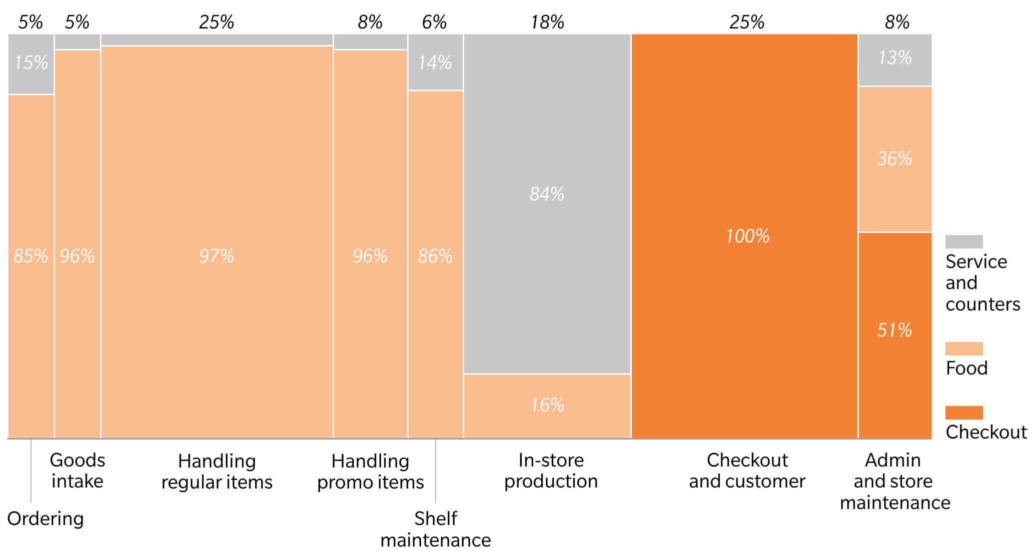
HOW TO DESIGN COST-SAVING SOLUTIONS AROUND STORE NEEDS

To design and deliver store-centric cost savings, central departments must first do their homework and take the stores' perspective, looking at what causes hassles to customers and staff, and aiming to address them head on.

The first step is often to get a clear understanding of how staff time is indeed spent in stores, as shown in Exhibit 1. Transparency can be hard to come by; therefore the starting point is an intense period spent on the shop floor fully engaging with the front-line challenges. This process should also develop key hypotheses on potential improvements. It might involve asking:

- What are the most annoying time wasters?
- How many hours are allocated in particular processes within a certain department?
- What further measures of optimisation could be achieved?

Exhibit 1: Staff activities by department



Source Oliver Wyman analysis

Exhibit 2: Solving in-store hassles

HASSLE	EXPLANATION	SOLUTION
Long distances walked by staff	Distances walked by staff in stores are unnecessarily long, for example during replenishment or updating price labels on the shelf.	Shorten replenishment distances by positioning containers in the warehouse in the same order as the standard store layout. Allow flexibility for stores to create customised routes for various tasks, such as price label updates. See Case Study 1.
Waiting times at tills	Checkout processes lack efficiency due to system mistakes, frequent calls for store manager overrides, or products with barcodes that are difficult to scan – also resulting in waiting times and unsatisfied customers.	Comprehensively check the scanning efficiency of products in terms of barcode performance and placement, check tills regarding efficiency: regulations, technical infrastructure, and qualification of cashiers. See Case Study 2.
Poor on-shelf availability	Out-of-stocks are often caused because automatic or semi-automatic ordering systems are too complex and ordering tools for staff are not helpful; hence sales may not be backed by sufficient supplies.	Screen most common reasons for out-of-stocks and check forecasting systems and inventory tools for weaknesses – if possible adjust system parameters and simplify tools. See Case Study 3.
Complex promotions	Weekly handling of promotions is often a major driver of store complexity. Promotional stock is often ordered several weeks in advance and forecasting systems (if available for promotions on a store level at all) are far from perfect.	Forecasting of promotions should be solved centrally using advanced algorithms to give stores accurate forecasts for promo items.
Reporting overkill	Reports and KPIs lack usability, are time consuming to look at, and are rarely or not at all used to drive improvements. Often they are redundant.	Implement a simplified cross-silo point of view on your reporting structure. See Case Study 4.
Poor logistics	Delivery is not within the promised time window or is missing items, and packing within containers is often poor.	Implement strict service level agreements that give stores more certainty in operational planning and higher delivery standards. This may increase costs in the supply chain but the savings in store will more than compensate.
Manual labour scheduling	Store managers plan their staffing "on the back of an envelope". Often, labour-planning tools are not user friendly or too theoretical.	Collect local best practices from stores and develop a pragmatic user-friendly labour-scheduling tool, linked to individual store needs and taking into account activity-based labour requirements.
Training programmes not fit for purpose	Training for store staff contains lots of theory and guideline sessions and lacks practical coaching and training of best practice processes and tips and tricks.	Engage store staff in designing training programmes. Ideally training should take place on the shop floor and be based on real-life examples and best practices. Make sure that HR and central sales departments collaborate regularly with stores in order to have best practices and tips and tricks included and up-to-date.

Exhibit 2 shows some examples of typical hassles and solutions that are often unearthed by this type of process.

It is crucial to follow a detailed systematic process to identify, prioritise, develop, and implement opportunities, such as that shown in Exhibit 3.

Following this process, the results can usually be seen and measured within 6–12 months. Typical outcomes include:

- Up to 10–20% fewer staff hours required due to higher labour efficiency and fewer time wasters in the stores
- An increase in on-shelf availability and sales by 5%+
- Improved customer experience
- Lower total costs along the supply chain
- Reinvigorated staff engagement with the business

Exhibit 3: A step-by-step guide to addressing store inefficiencies

1. Understand the status quo and collect and validate a long list of suggestions for improvements in stores
2. Prioritise the list in terms of an overall optimum, for example being careful when weighting issues with higher costs in particular departments, but lower costs across the whole business
3. Institutionalise collaboration across different teams and functions
4. Begin to implement the improvements and monitor: establish KPIs and clearly designate responsibility
5. Measure the progress of each improvement initiative

CONCLUDING REMARKS

We believe that retailers can unlock substantial cost savings by identifying and removing barriers to front-line efficiency created at a corporate level or by a lack of cross-silo working. Impressive results can be delivered with this approach within a period of six to twelve months. 10–20% store staff time can be saved or assigned to other activities, such as improving customer experience; on-shelf availability could increase more than 5%, significantly reducing the volume of lost sales. In addition, when store staff and customers are listened to and where employees' hassles are solved, there will also be a tangible uplift in employee satisfaction. Over time, this will drive further business improvements.

CASE STUDY 1

REDUCING THE TIME AND EFFORT SPENT ON REPLENISHMENT

THE CHALLENGE

A retailer analysed the time and distance from the stockroom to shelves that needed frequent restocking. It found that staff were spending up to 25% of their time carrying out replenishment activities.

THE SOLUTION

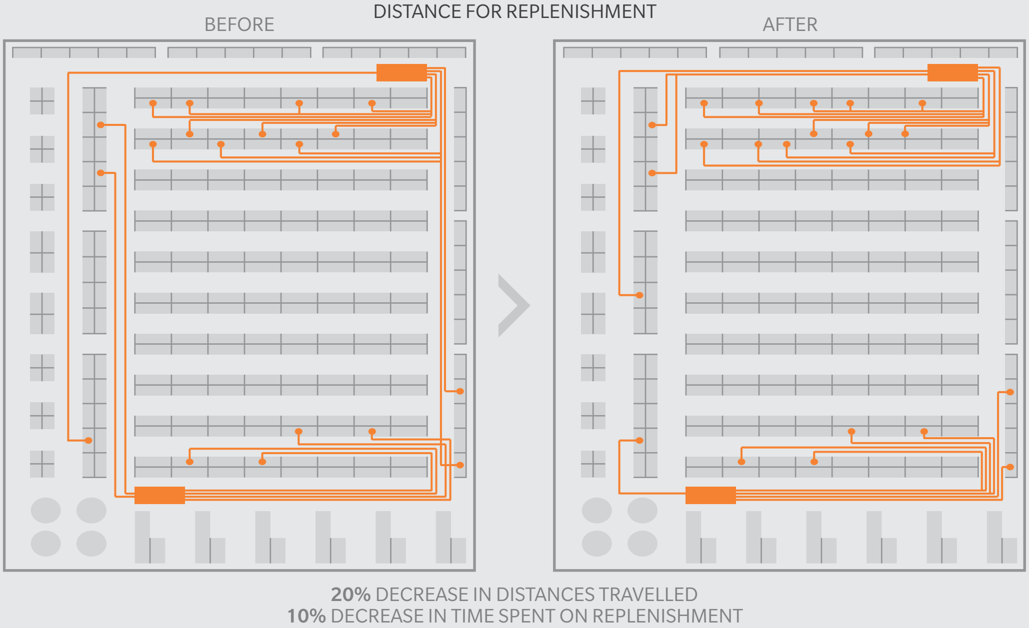
The logistics team and store managers collaborated to find the best way of optimising both the picking effort in the store room and the replenishment distances on the shop floor (Exhibit 4).

The business reorganised its warehouses by aligning the order of products to a typical store layout. To do so, it defined clusters of products located close to each other in stores and ensured they were placed in the same picking area in the warehouse.

THE OUTCOME

The results included a 20% drop in distances covered by staff during replenishment and almost a 10% decline in time spent on replenishment activities per week per store. Regular tracking of product clusters ensured new listings and seasonal changes in the range could be easily reflected.

Exhibit 4: Reducing distances travelled when replenishing stock



Source Oliver Wyman analysis

CASE STUDY 2

REDUCING WAITING TIMES AT TILLS

THE CHALLENGE

Most retailers have checkout systems with security measures to avoid misuse and theft. These measures can require frequent manager overrides and supervision, extending the time customers spend waiting at tills.

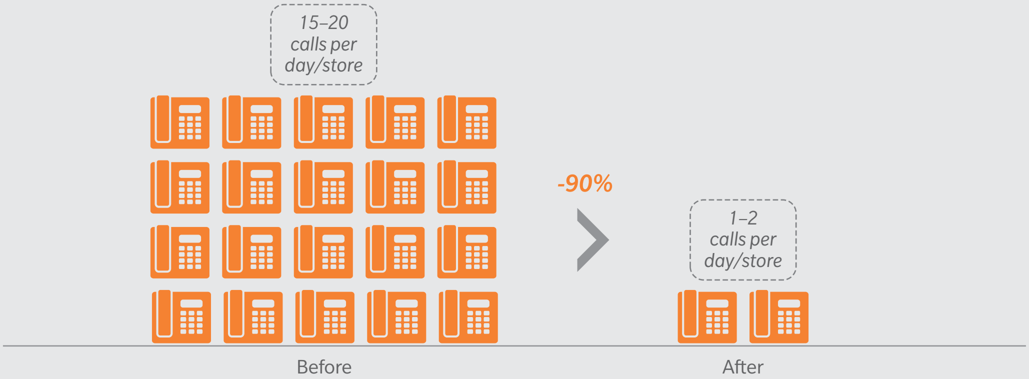
THE SOLUTION

We recommend listing all the checkout activities that require a store manager and recording how often they occurred and how long they take to deal with. Till regulations issued by head office were then updated so only those really needed were kept. For example, some override alerts were removed and the head office guidelines for minimal values for change held at each checkout were revised.

THE OUTCOME

As shown in Exhibit 5, by adjusting these regulations – while at the same time keeping the risk of misuse flat – we achieved 90% fewer checkout calls for store managers. At this retailer, this was equivalent to 5–10 hours of manager and cashier time per week and, importantly, shorter waiting times for customers of a similar amount.

Exhibit 5: Updating central regulations reduces checkout inefficiencies



Source Oliver Wyman analysis

CASE STUDY 3

REDUCING THE NUMBER OF OUT-OF-STOCKS

THE CHALLENGE

High product availability is a key driver of satisfied customers and prevents a loss of sales (Exhibit 6). The reasons for out-of-stocks can be many and varied. At one particular retailer, while 60% of out-of-stocks were caused by the stores themselves (for example, by problems with replenishment, manual order management, or shelf maintenance), 40% of all out-of-stocks had their origin in head office processes (Exhibit 7).

THE SOLUTION

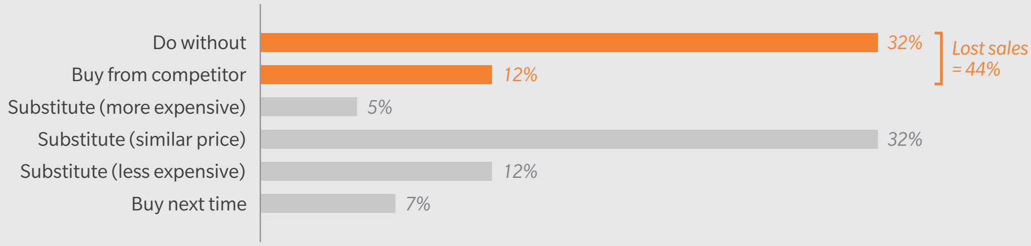
Head office made adjustments to the product forecasting systems, optimised delivery frequencies, and delivered better tools for inventory management. In-store training complemented the improvements and allowed all employees with an influence on availability to role-play the most critical scenarios and to learn new tips and tricks to avoid out-of-stocks.

THE OUTCOME

On-shelf availability increased by several percentage points, especially during critical periods such as before national holidays or events. The improvements made to the automatic forecasting systems resulted in fewer manual interventions being required. Overall, the process for restocking and replenishing became much leaner.

Exhibit 6: How customers respond to out-of-stocks

SHARE OF TOTAL



Source Oliver Wyman analysis

Exhibit 7: Why do products go out of stock?

Source Oliver Wyman analysis

CASE STUDY 4

USING DATA TO MAKE BETTER DECISIONS

THE CHALLENGE

For most retailers, using huge amounts of data to generate a host of reports is not a challenge but getting the right set of useful insights can be. In many instances, the KPIs and reports sit within silos. We've even seen cases where reports from two departments were thought to show the same KPI but it transpired that each had been generated using different calculations. Siloed reporting does not reflect the impact of decisions on other departments – such as decisions taken in sales that affect logistics – and so the business is unable to drive improvements across silos. We saw one example, shown in Exhibit 8, where the modification of store planograms by category managers did not reflect in-store effort required to reorganise all the shelves.

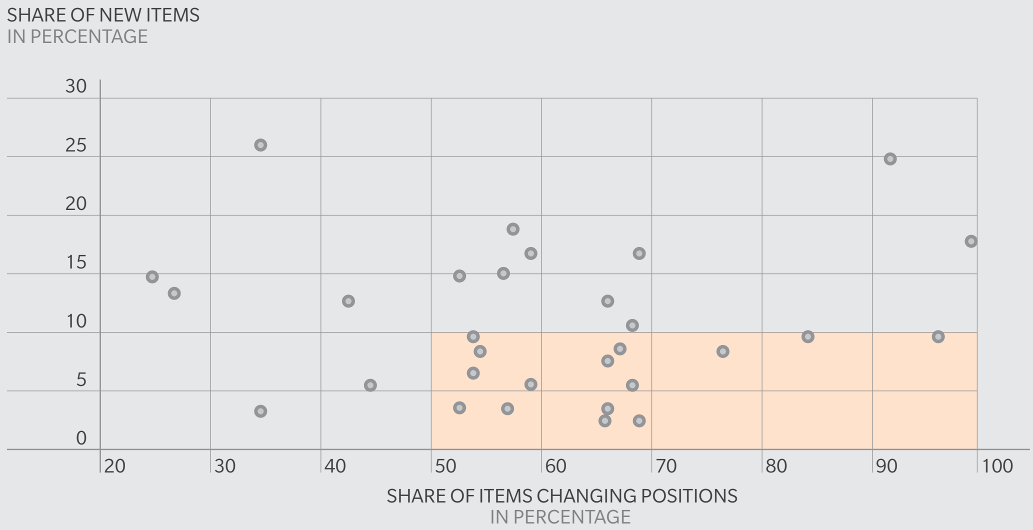
THE SOLUTION

We tested a radical way to improve matters: shutting down all existing reports to start from scratch. The aim was report simplification and harmonisation. In the case of the planogram changes, we introduced a KPI that illustrated to the category managers in head office the true cost of category changes in-store: 50% of planogram changes moved more than 50% of items, but included fewer than 10% new products.

THE OUTCOME

The result was a giant leap towards greater transparency in decision-making processes.For category managers, the KPI helped them to change their practices: very few listings or delistings caused a large portion of products to have their shelf positions changed, and any modifications that were needed were bundled together to limit inefficient modifications in the stores.

Exhibit 8: Identifying inefficient category modifications made over a three-month period



Note Each point = 1 planogram change

Source Oliver Wyman analysis

FAST FASHION

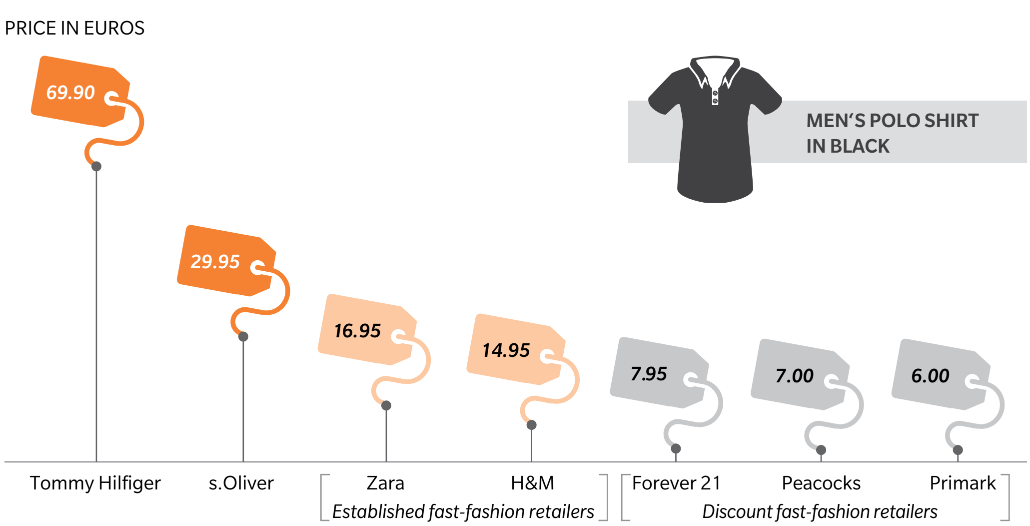
STAYING ON-TREND WITH A NEW STYLE OF SUPPLY CHAIN

In clothing retail, the battle of the supply chains is underway. In response to consumer trends, products can now reach the high street in record time and at bargain prices, all thanks to supply chains custom designed to support a high-volume, more flexible model. In this article, we look at how retailers should react and know how they can rethink their own supply chains to compete. With this type of supply chain becoming more relevant to other non-food sectors over time, there is much to be learned, regardless of whether you sell shirts, high heels, toys, or jewellry.

Over the past 30 years, the textile industry in Europe has experienced disruption from two types of new business model. In the 1980s, the fast-fashion business model first emerged. Then, 5–10 years later, the ever more aggressively priced fast-fashion discounters arrived and began driving a step change in customer expectations with their ability to undercut traditional clothing retailers by 50% or more (see Exhibit 1 and Case Studies 1 and 2).

As a consequence, numerous multilabel retailers operating a traditional two season business have been forced out of the market and many verticalised players who have not yet adopted fast-fashion supply chain principles – at least on some of their products – are suffering.

Exhibit 1: A comparison of price points across fashion retailers



Source Oliver Wyman analysis

DIFFERENTIATED SUPPLY CHAIN LINKS

As discussed in Case Study 1, the supply chains in fast fashion rely on being the most cost efficient, flexible, and timely for each specific product type. As such, the product range is broken down into clearly defined segments, such as evergreens, traffic generators and image products (see Exhibit 2), and each segment's supply chain needs are clearly defined.

EVERGREENS

These can be transported from Asia by boat in a cost-efficient manner and in predictable volumes. These products are not fashion driven so it is not worth paying for a fast and flexible supply chain.

TRAFFIC GENERATORS AND HEADLINE GRABBERS

These items often have concept-to-shelf times below 20 weeks. For such fast-tracked items, the final production steps often have to be done in Turkey or North Africa for European retailers, or Mexico for the US and Canada, and the goods are often transported by air. To ensure reliable manufacture, production capacities are frequently reserved in advance and pre-coloured fabrics prepared up front. The final steps validate the item, fine-tune the fit, and so on.

Combining this fast-track approach with increased frequency of new collections ensures that fast-fashion retailers can manage the freshness of their assortment. This, in turn, increases consumer sales and results in improved price realisation and lower markdowns. These benefits usually exceed the extra supply chain costs and, indeed, our experience shows that the cost of markdowns in a traditional multibrand retailer can be reduced by 25–50% using a fast-track approach.

CASE STUDY 1

THE FAST-FASHION MODEL

Fast-fashion business models are all underpinned by a segmented value chain that carefully juggles cost efficiency, flexibility, and speed across product types. Their supply chain normally comprises three parts, as described in Exhibit 2. The most sophisticated go beyond this by putting in place a fourth process to capture missed trends. Once set in motion, this supply chain can deliver an item from concept to shelf in less than ten weeks.

The supply chain is tightly managed by direct feedback mechanisms from the shop floor, known as "read and react". By tracking a collection's hot sellers and slow movers, the retailer can adapt to ensure precise make-to-demand production, which optimises for – and outclasses the traditional make-to-stock and make-to-forecast models.

Combining a fast-track approach with frequent new collections enables fast-fashion retailers to ensure that their range is always up to date. This increases sales velocity and thehigher stock turn allows them to sell at prices significantly lower than other high-street fashion retailers, with the additional volume more than making up for higher supply chain costs.

The most sophisticated textile retailers go beyond this, putting in place an additional final step: this is a separate process that swings into action if a trend is missed. Once set in motion, this "chase" stream can produce an item from concept-to-shelf in less than ten weeks.

This breakdown of the value chain into category roles is complemented by a direct feedback mechanism, "read and react". Each day the stores report back on the collection's hot sellers and slow movers and this process enables the product line to be constantly optimised for sell-out. This results in an optimised make-to-demand production operation that outclasses traditional make-to-stock and make-to-forecast models in many regards. A number of catalogue and multichannel retailers have already taken a cue from this approach and have introduced a form of read and react for their product ranges.

HOW TRADITIONAL MULTIBRAND RETAILERS CAN FIGHT BACK

When fast-fashion retailers and discounters first arrive, many multibrand retailers start by increasing investment in the shopping experience, both in terms of product mix and visual merchandising, as well as in complementary inserts such as coffee bars, DJs, and complementary beverages. The result is often unsatisfactory, as selling space is sacrificed for aspirational elements of experience that simply do not justify their cost.

Exhibit 2: Three categories in a differentiated supply chain for clothing retail

EVERGREEN PRODUCTS

Supply chain requirements

- Cost efficiency
- Planning security
- Supplier reliability
- Dependable supplier basis

IMPLEMENTATION

- ✓ Uses long-term strategic suppliers
- ✓ Production in Asia
- ✓ Ocean freight

TRAFFIC GENERATORS

Supply chain requirements

- Flexibility
- Option for smaller order sizes
- Fast implementation

IMPLEMENTATION

- ✓ Uses multiple suppliers
- ✓ Production in Asia and Europe

HEADLINE GRABBERS

Supply chain requirements

- Relies on reliability of processes
- Flexibility and speed
- Shortened process steps and faster handover

IMPLEMENTATION

- ✓ Strategic, high-performance suppliers
- ✓ Production in Europe
- ✓ Land and road transport

CASE STUDY 2

THE FAST-FASHION DISCOUNT MODEL

The business model used by discounters such as Primark or Forever 21 is a modification of the proven fast-fashion formula. Compared to the standard formula, the fast-fashion discounters have a markedly lower gross margin (less than 40%), an even higher level of standardisation in material purchasing and product development, and a supply chain that relies even more heavily on efficiency. Combined with extremely lean personnel and marketing cost structures, these factors generate moderate single-digit EBIT margins, meaning fast-fashion discounters can only cover their fixed costs with high sales volumes.

This strategy has been profitable. With the help of unbeatable prices, including fashionable T-shirts that sometimes sell for just €3, they have concocted a price level that established fast-fashion players and traditional multibrand retailers can only dream of. The point of such a price model is clear: it is all about acquiring market share and establishing superior value perception.

Fast-fashion discounters are already well established in the UK and Ireland, but in the rest of Europe, their impact has not yet been fully felt. Though Primark has almost 50 stores in Iberia and half that number in the Netherlands, it has just 15 scattered across Austria, Belgium, France, and Germany. Peacocks has a limited number of franchise outlets in Greece and a number of Eastern European countries. Forever 21, with just a dozen stores in mainland Europe at present, is still in the first stages of its planned European expansion.

A more sustainable response is to take on the fast-fashion players on their own turf. To do so, retailers need to answer a number of analytically challenging questions:

- For which parts of the product range does a fast-track model represent an economically sensible option?
- What is the maximum markdown for a garment? At what point at which is it more profitable to use a conventional supply chain solution than the more expensive fast-track model?
- How can previous decisions be subjected to constant review (on an SKU basis), taking into consideration the dynamic cost factors within the supply chain?

The answer to these questions requires a metric-driven comparison of the additional costs of a fast-track supply chain with the increased amount of sales produced by it. Three sources of data are generally required to enable this:

1. Historic price-to-sales ratios per style
2. Average markdowns throughout the product-range cycle
3. Costs for the various purchasing or supply chain models

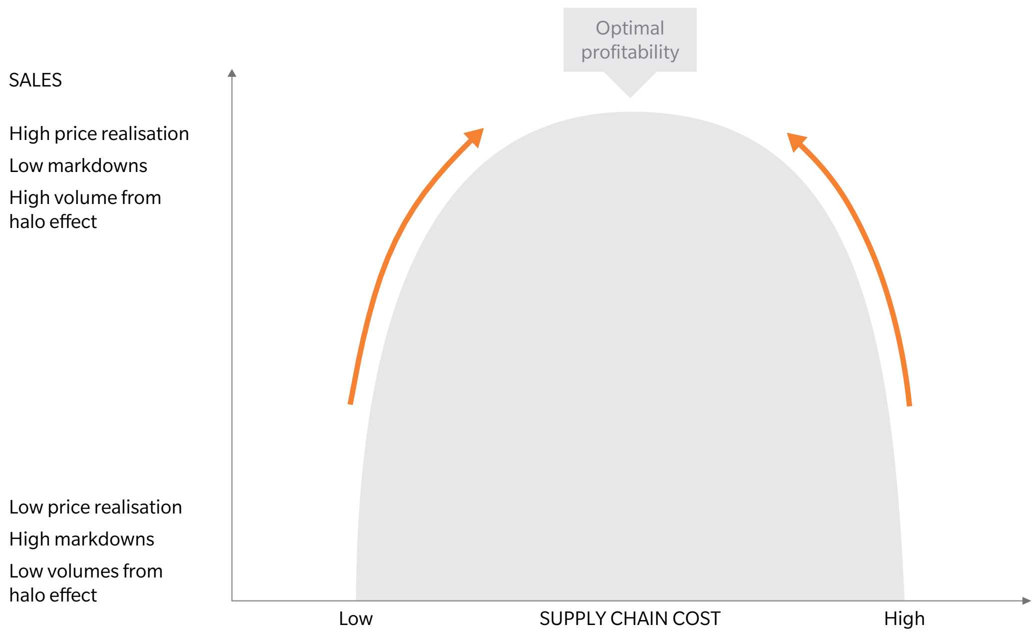
With this information in hand, the retailer can put in place a product-range management solution that increases a collection's profitability product line by product line. As Exhibit 3 shows in simplified form, the supply chain can be optimised on the basis of fact, without getting bogged down in a simplistic debate about the uselessness of fast supply chains for white T-shirts and black socks.

Of course, it is not just as simple as segmenting the products. The organisation will also need the skills to implement the required modification of the supply chain. This applies both to the precise management of production capacities at various locations and to the design skills that are necessary for expanding its line of own-label products.

WHEN WILL YOU NEED TO ACT?

Clothing is not the only retail sector where changes to the supply chain are likely to play a critical role in the coming years. An increasing number of non-food segments already fine-tune product supply and range, in terms of both speed of delivery and the highest possible level of cost efficiency.

Exhibit 3: Critical factors of supply chain optimisation



Source Oliver Wyman analysis

This is most obvious in footwear, accessories, and toys, where the share of trend-led products has been steadily climbing for many years. All these sectors are subject to decreasing fashion cycles.

So how ready are non-food retailers to take the next step in supply change management? To answer this, retailers should focus on the following four areas:

1. Examine the opportunities for differentiation along the value chain and the costs entailed, including those from near-sourcing
2. Develop a comprehensive plan to restructure the supply chain, including streamlining SKUs, improving automated processes, and optimising long-term capacity planning and lead times
3. Identify the supplementary skills that will be required, including read and react systems and negotiating closer partnerships with suppliers in exchange for sales data
4. Make an honest assessment of whether or not the high degree of resolve necessary to implement the required changes exists within the organisation

CONCLUDING REMARKS

Fast-fashion business models are already revolutionising the clothing industry, and we suspect that other segments of non-food retail where fashion-led products are prevalent will be next. Retailers can get ahead of this trend by segmenting their own products and supply chains and, where the trade-offs make sense, moving to fast-fashion sourcing. While these changes can add complexity to the business, they will also deliver a significant step up in competitiveness that more than justifies the effort.

OMNICHANNEL OPERATIONS

SOLUTIONS FOR A NEW RETAIL ECOSYSTEM

While e-commerce sales accounted for just 8% of retail sales in the US in 2013 and 2014, cross-channel retail contributes to more than half of total sales today, a tipping point in omnichannel retail.[1]

At its core, omnichannel retail is about a gradual but important shift in consumer behaviour. Today, consumers increasingly expect to discover, search, buy, pick-up, and return items seamlessly from various physical and digital access points.

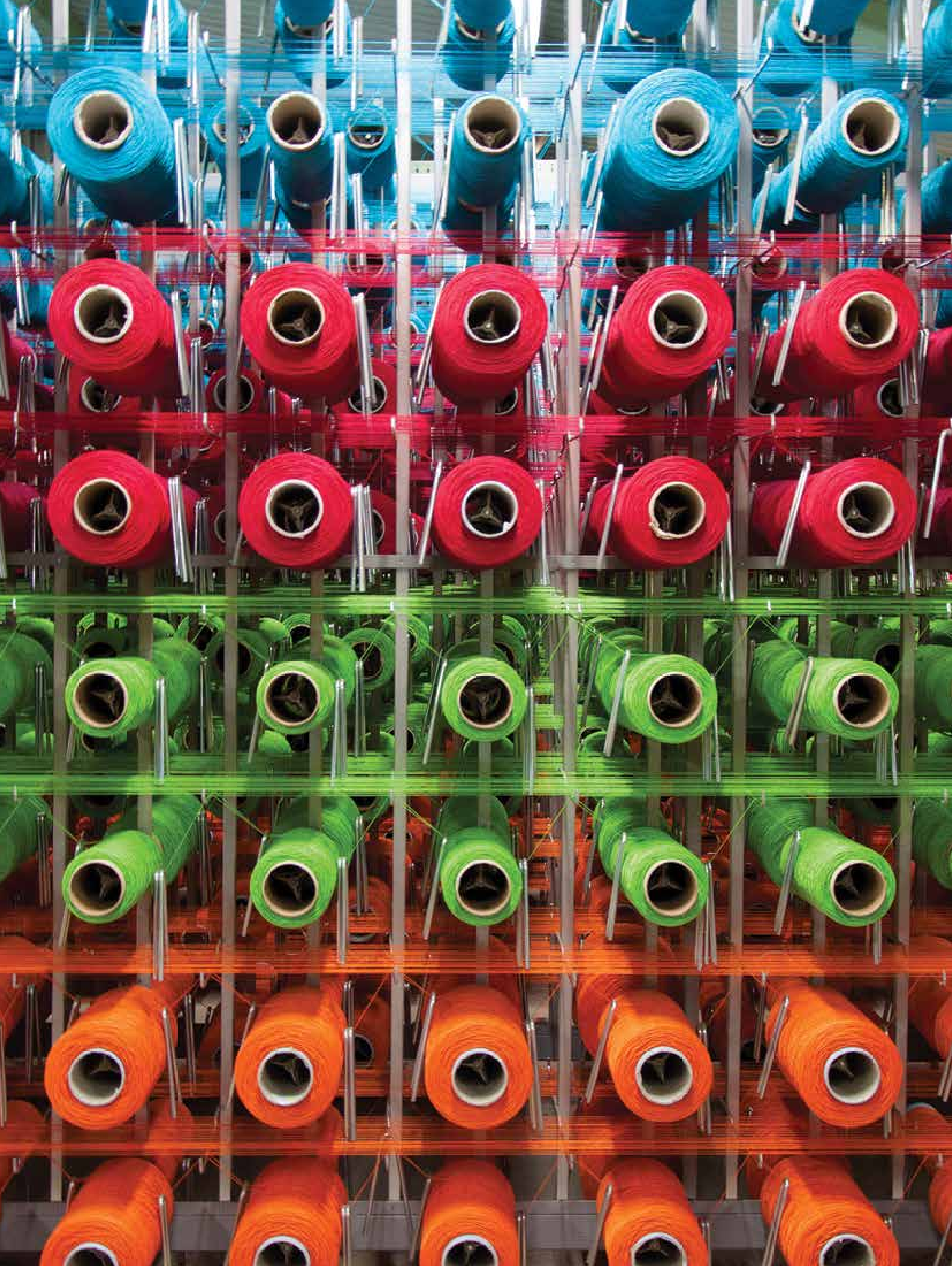
Both established companies and start-ups have made significant investments in building omnichannel capabilities. For all players, omnichannel requires a dramatic and fundamental shift in mentality from cost-centric, largely hidden supply chains to front-and-centre, customer-centric operations. As customers' expectations are evolving, retailers are testing a series of initiatives, including:

- More access points: online, mobile, stores, drives, lockers, pick-up and drop-off points, parcel shops
- More delivery options: after-hours, week-end delivery, time slots
- Shorter lead times: pick-up within two hours, same-day delivery
- Flexible delivery points: at train station for commuters, work place
- More in-store and drive-through pick-up services: reserve online, self-collect, pick-up in drive, endless aisles, etc.
- Seamless experience across access points and channels

This paper presents a new way of thinking about the operational implications of omnichannel retail and two steps retailers should take to survive and win in the new world:

1. Focus on four plays – that will drive customer-centric operations
2. Think and build agile – design your organisation and infrastructure to be flexible, innovative and one that embraces change rather than runs from it

1 Source: Forrester Research



PART 1 | FOCUS ON FOUR KEY PLAYS

While almost every retail process is or will be impacted by omnichannel, we believe that there are four key strategic "plays" that are critical to support the transformation in the eyes of the consumer: dynamic network design and order fulfilment; existing asset utilisation; owning the last mile delivery; and integration with suppliers.

PLAY 1 | DYNAMIC NETWORK DESIGN AND ORDER FULFILMENT

The growth of new services will force retailers to develop dynamic networks. To fulfil orders faster, they could leverage or combine their existing distribution centres (DCs), platforms, and stores with third-party providers.

Beyond traditional DCs, retailers are increasingly relying on a more diverse set of models to accommodate different combinations of product range, CAPEX requirements, pick-pack-ship volumes, access points, and lead time (Exhibit 1).

PLAY 2 | UTILISE EXISTING ASSETS BETTER

Physical stores come with high capital and human costs, putting retailers at a disadvantage against their leaner online competitors. However, stores could also become a key advantage. By using these physical assets as platforms for supply chain services – such as order fulfilment, pick-up and drop-off points, returns, ship-from-store, lockers – retailers could get ahead of the race to provide customers with fast and local services.

Exhibit 1: Dynamic network design and order fulfilment

APPROACH	RATIONALE	USE CASE
Store picking	• Offering a broad range of SKUs within two hours with minimal investment	• Click-and-collect • Ship-from-store
Dark store	• Higher picking productivity on a narrower range, for pick-up or delivery within two hours	• Click-and-collect • Same-day home delivery
Fulfilment centre	• High picking productivity on a broad range of SKUs for next day delivery • Can be dedicated to online or shared with bricks-and-mortar operations	• Home delivery
Drop-shipping	• Expanding range to SKUs not sold in store by partnering with suppliers and wholesalers	• Home delivery • Endless aisles
Fulfill from supplier's DCs	• Cut costs and inventory by shipping very high-volume products straight from the supplier	• Home delivery

With current systems, processes, and layout, in-store picking productivity for grocery products rarely exceeds 40–60 items picked per hour – compared with 180–300 in a fulfilment centre or dark store. Yet we believe retailers will close part of the productivity gap through advanced inventory management, improved fulfilment systems and technologies, and picking methodologies. This would provide them with a vital competitive advantage against online pure players.

PLAY 3 | OWN THE LAST MILE

Delivery costs and services are important for customers choosing where to shop online. This has turned the last mile into one of the most powerful ways to differentiate in the market.

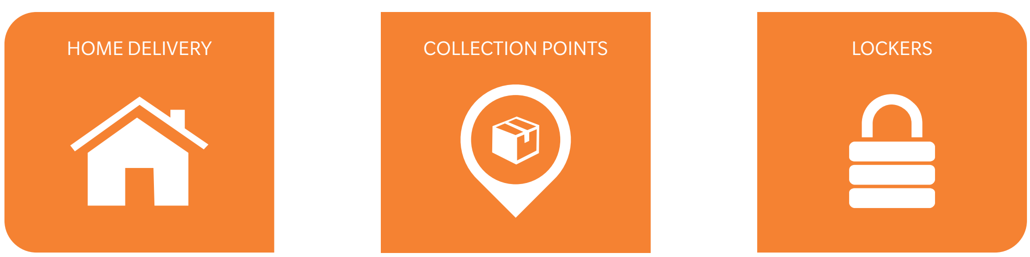
Traditional delivery companies have for decades built hub-and-spoke infrastructures and offered customers fixed delivery times. This model will increasingly become irrelevant.

Online leaders such as Amazon and Google have invested more aggressively in last-mile innovation than retailers and are shaping the way suppliers and transportation companies redesign their operations. Reflecting on how this affects their own business model, retailers will have to consider three options to innovate in this space:

- Build their own proprietary delivery capabilities where they have volume and density
- Leverage new solutions offered by start-ups such as Deliv', Collect+, and Instacard (Exhibit 2)
- Push their traditional suppliers to innovate more and rethink delivery models

Our article *Disruptive Logistics: The New Frontier for E-commerce* discusses these challenges in greater detail.

Exhibit 2: New players competing to own the last mile



HOME DELIVERY
- UberRUSH
- Deliv
- Postmates
- Peapod
- Google Express
- Instacart

COLLECTION POINTS
- Collect+
- Amazon.co.uk
- Curbside

LOCKERS
- Amazon.com
- ByBox

PLAY 4 | INTEGRATE WITH SUPPLIERS

As part of Amazon's Vendor Flex programme, P&G allowed Amazon to set up fulfilment operations within its own warehouses in the US to reduce transportation costs and speed up delivery. While supplier-managed inventory and other collaborative projects have existed for decades, this partnership is among the first for online operations. Target's alleged reaction to this partnership (moving P&G products to less-prominent places in their stores) emphasised the importance and complexity of supplier-retailer partnerships both online and offline.

Suppliers are making considerable investments in direct-to-consumer capabilities and partnerships. Given the scale required to serve consumers, we believe that it will be in both suppliers' and retailers' interest to better integrate and collaborate to achieve the critical mass required to best serve clients. Areas of focus will include:

- End-to-end distribution approach, drop-shipping
- Integrated planning and forecasting, leveraging big data
- Real-time visibility on inventory and orders
- Real-time replenishment
- Differentiated packaging for online versus in-store

PART 2 | THINK AND BUILD AGILE

Traditionally, retailers have laid out and executed expansion plans over several months or even years. However, with rapidly evolving consumer tastes and technology, this approach comes at a cost. It is becoming more difficult to predict what the landscape will look like in two to three years, much less define and plan for an unknown end state.

Not only will consumer needs continue to evolve, but omnichannel will likely mean different things to different consumers in various markets and sectors. For example, in grocery retail, click-and-collect accounts for over 90% of online orders in France but has only recently started to take off in the US.

If the only constant is change, then building flexibility and evolution into the organisation and infrastructure is paramount. To be agile, retail operations will need to:

- Think of the end state as an evolving target and adopt a continuous improvement mindset
- Focus more on incremental steps and sprints rather than a marathon, where it is better to make progress frequently and tangibly in weeks and months, rather than years
- Use meeting customer needs as the primary measure of progress
- Plan for experimentation and failure, fail quickly and cheaply
- Place a high value on simplicity, speed, and nimbleness
- Constantly reflect on progress and be faster, simpler, and more efficient

Omnichannel requires a dramatic and fundamental shift in mentality from cost-centric, largely hidden supply chains to front-and-centre, customer centric operations.

New and innovative approaches to systems and technology are also necessary in an agile organisation. Omnichannel presents a radically different set of challenges to retailers which require solutions incompatible with most legacy systems and technologies. For example:

- The product, inventory, customer, and order data are visible across every channel and to each stakeholder
- Real-time decision making
- Orchestration of multiple stakeholders such as suppliers, third-party logistics providers, transportation companies, ecommerce platform, ERP, etc.
- Enhancing services and productivity through technology: picking technologies and automation, in-store kiosks, etc.

How can retailers evolve their systems to enable customer-centric omnichannel operations? Walmart is showing one possible way: it has made 15 acquisitions since 2010. These cover areas such as online communities, search and discovery, predictive intelligence, and cloud-based services for e-commerce and operations. Meanwhile, other retailers are re-thinking the role of IT and service operations to bring them from behind the scenes to the front lines (as described in the earlier article *The New IT Horizon*).

CONCLUDING REMARKS

The rapid growth of e-commerce is reshaping the retail ecosystem and the balance of power between consumer product brands, retailers, online players, wholesale distributors, and logistics groups. There is a fundamental shift in the way consumers shop, thereby increasing complexity for retailers. Retailers risk losing customers, cash-flow, and control of key elements of their value chain.

To survive and win in this context, we believe retailers need to shift their operations from cost-centric to customer-centric, focus on the right "plays", and become more agile and innovative to hit a constantly moving target.

BRICKS-AND-MORTAR RETAIL

HOW TO THRIVE IN AN ONLINE WORLD

Today, e-commerce matters in every retail market. In some – such as books, entertainment, and electronics – it has already brought massive upheaval and traditional players have been driven out of business. In others – such as grocery and DIY – its impact has so far been limited but this is set to change.

While e-commerce will affect all retailers, it will not affect them all equally. Modest differences in competitiveness and financial health will be amplified and, as weaker stores are forced to close, those that remain may actually gain volume. This disrupted, dynamic environment does not just present new threats for retailers; it also offers new opportunities.

THE THREAT

ALL SECTORS ARE VULNERABLE AND SOME ARE MORE VULNERABLE THAN THEY SEEM

It's no surprise that e-commerce has grown fastest where products are high value, highly comparable, and easy to send through the post. Although perishable, bulky, or hard-to-deliver products are less well suited to online shopping, the bricks-and-mortar retailers who sell them still face a serious threat. In many cases, their economics are already on a knife edge: earnings and demand growth are low and there is too much selling space in the market. Even a modest loss in volume to online channels will prompt store closures, and some retailers will ultimately go out of business.

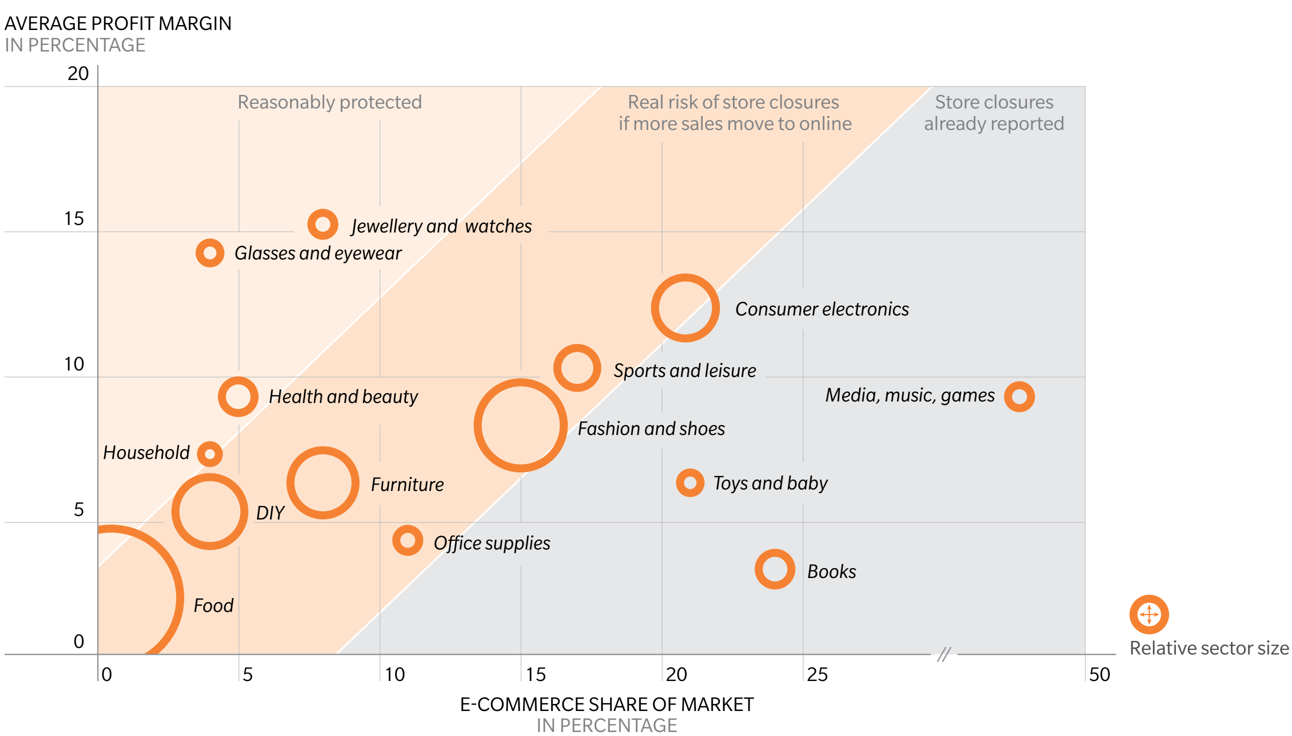
Because retail is characterised by high fixed costs and modest operating profits, small volume losses can quickly wipe out a retailer's profitability, and sectors with thin margins are more sensitive than others. The vulnerability of the US grocery market is examined in our article *Online Grocery: Where Can it Work and What is the Threat?* Compared with a grocer, a typical DIY retailer makes slightly higher operating profits, but since they also have higher contribution margin (in the region of 30–40%) a 10% loss of sales to online retailers would erase all operating profit. So this sector is highly sensitive to online disruption even though many of the products involved are not necessarily well suited to e-commerce.

On the other hand, sectors with healthier operating profits are more resilient, for example health and beauty, eyewear, and jewellery. From an individual retailer's point of view, this may be more important than the fact that these markets are easier to serve online.

Exhibit 1 illustrates these points using the example of the German retail market. High margin and easy-to-ship products are an obvious vulnerability, but this also highlights the risk to low margin sectors, such as grocery and DIY, which have the lowest structural profitability and as such are the most sensitive to any volume loss, however small.

Overall, we think that although the growth of e-commerce will be uneven across sectors, it is likely to drive market consolidation almost everywhere.

Exhibit 1: Vulnerability of retail sectors in Germany to e-commerce



Source Industry reports and Oliver Wyman analysis

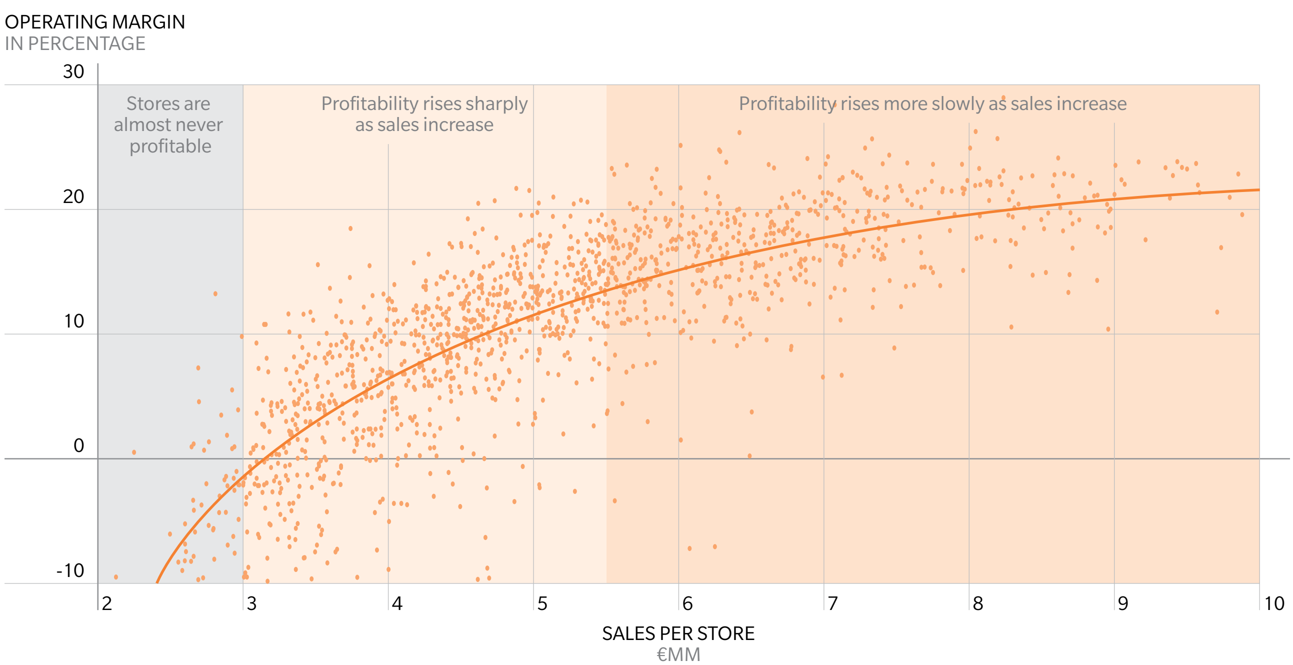
THE OPPORTUNITY
WITHIN EACH SECTOR, DIFFERENT RETAILERS WILL FARE DIFFERENTLY

As well as variability across the retail industry as a whole, within any given retail sector – be it clothing, grocery, or home furnishings – not all retailers are equally vulnerable to e-commerce. Some businesses are better insulated from online competition than others and those with higher operating profits are likely to prove more resilient. It is important to realise that the relationship between financial health and future prospects is much stronger within each sector (for example, grocery versus grocery) than between sectors (for example, grocery versus clothing).

This is because relatively small differences in profitability can mask big differences in the proportion of stores that are barely viable today – which can be very significant in cases where there is an across-the-board drop in sales. High-level comparisons of financial performance therefore tend to understate the differences in the prospects for individual retailers.

In the example shown in Exhibit 2, online retail has already captured 15% of the market and sales losses are being compounded by a move from physical to digital products. We expect average store sales to decline by between 3% and 6% every year over the next three years. Across the industry, this is likely to prompt the closure of around 30% of stores but, as Exhibit 3 shows, this could play out very differently for the competitors in the same sector.

Exhibit 2: The correlation between store sales and profitability in a non-food sector



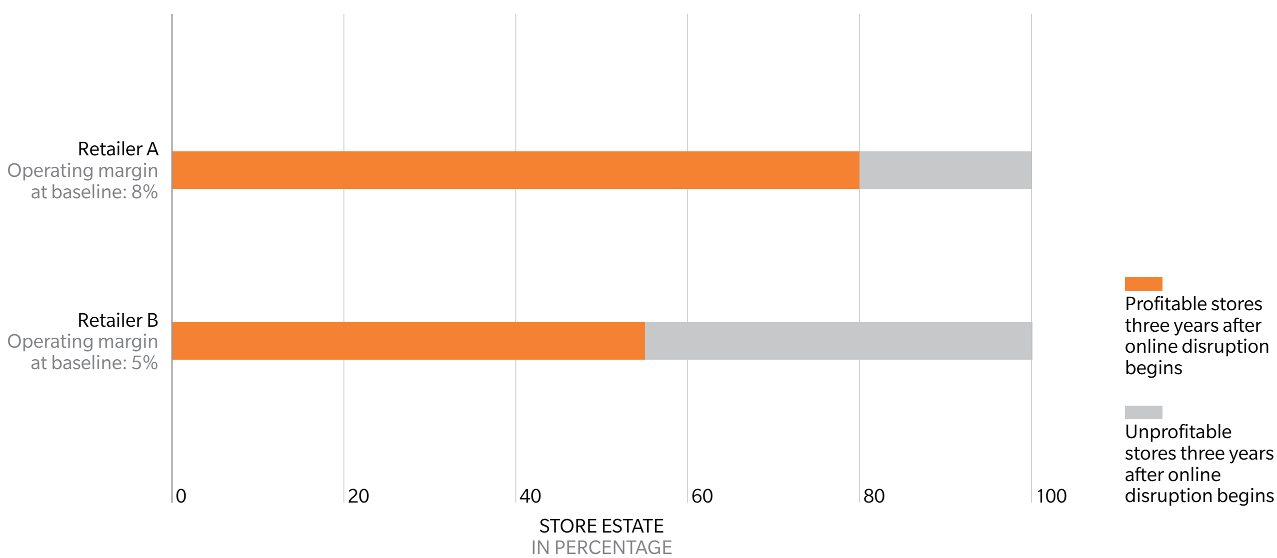
Source Oliver Wyman analysis

Overall, Retailer A is slightly more profitable than Retailer B, but it has significantly fewer stores that are only just above breakeven today. As a result, it is better placed to cope with volume losses: whereas around 20% of its stores are projected to become unprofitable, the figure for Retailer B is 45%. Without a major improvement in performance, many of these unprofitable stores will be forced to close.

In a disrupted market, a slight difference in profitability today translates into a huge difference in prospects for the future. Second order effects will compound Retailer A's advantage: because the two retailers compete head-to-head in many locations, store closures by either one will significantly benefit the other. Over the medium term, closing significant numbers of stores hurts buying power and supply chain efficiency. Depending on the exact nature of a retailer's fixed costs (some are fixed more firmly and over longer time frames than others), there may be a domino effect in which one round of store closures leads to another.

All of this will serve to Retailer A's advantage to the point where, when the dust settles, the overall impact of e-commerce could actually be favourable: in a sector where around 20% of sales end up online, the other 80% become easier for the most successful bricks-and-mortar retailer to capture.

Exhibit 3: Compared to the competition, small profitability advantages can reduce the impact of online disruption



Source Oliver Wyman analysis

SURVIVING AND PROSPERING
STRATEGIES FOR INCUMBENTS

Get ahead now, and it's likely that you will be able to stay ahead.

As discussed, most bricks-and-mortar retailers are highly sensitive to modest losses in volume. E-commerce can therefore have a big impact even without capturing a large share of the market, and the disruption this brings will amplify differences in competitiveness between incumbent retailers. The implications are clear: no retailer can afford to ignore e-commerce, and those who can develop even a small advantage now will be much better placed to cope with the challenge it poses.

In almost all cases, developing a viable online channel of your own will be part of the answer. Even though it may mean cannibalising your own store sales to some degree, consumers will switch to online sooner or later and it would be worse if competitors picked up this online volume. Furthermore, an established bricks-and-mortar retailer has existing advantages that an online-only upstart cannot easily match, for example a comprehensive logistics network. Our article *Changing the Rules: Viable Models for E-Commerce* discusses the strategic challenges of building an online channel in more detail.

As far as the bricks-and-mortar business is concerned, there are three things retailers can do to maximise their chances of emerging as one of the winners.

1. THROW EVERYTHING YOU HAVE AT BUILDING COMPETITIVE ADVANTAGE

The winner-takes-all nature of competition when volumes are declining makes this more important than ever. Higher stakes should provide the impetus to make even tougher decisions on cost or to redouble your efforts to manage retail levers such as supplier negotiations, range, pricing and promotions, and category management more tightly. Small differences will be amplified over time; get ahead now, and it's likely that you will be able to stay ahead.

2. DEVELOP A PROACTIVE “WEAKEST STORES” STRATEGY

Even a modest drop in sales will make it hard for the weakest stores in the estate to survive. This makes it vital to identify these stores in advance and develop a better understanding of their true prospects. Some will be impossible to save in the face of declining volumes, while others will remain viable if you can improve their performance even slightly. If you can develop a thorough understanding of the local markets around each of the weaker stores in the estate, you can make significant gains by focusing marketing efforts and store investment on sites where you compete head-to-head with rivals facing the same struggle for survival.

3. GET TO WORK ON TRANSFORMING THE FIXED ASSET BASE

Part of the strategy to defend the business must be to squeeze fixed costs to maximise the proportion of stores that will remain viable in the face of small volume losses. However successful these efforts are, the hard truth is that few retailers will be able to avoid closing at least some of their stores, with all the pain that rationalising the store network brings. Divesting sites, trying to get out of rental contracts, and reorganising the supply chain to preserve efficiency is never going to be easy – but, if left until profits start to decline, it gets even harder.

CONCLUDING REMARKS

Putting these strategies into practice is a real challenge. They require placing the long-term health of the business ahead of short-term financial performance, even though results might already be weak. In addition, organisational change is always difficult for large, long-established retailers. There are significant obstacles to overcome but developing a slight edge over traditional competitors is likely to already make a big difference. Of course, realising ambitious growth plans in the long run may require the business to actively participate in the macro market shift to online.

In a sector where 20% of sales end up online, the other 80% become easier for the most successful bricks-and-mortar retailer to capture.

WINNING CUSTOMERS

LESSONS TO SUCCEED ONLINE

In online retail, winning is everything. Fixed costs may be low but fierce price competition means thin margins which require massive volumes to deliver a profit. With customers able to easily shop around online to find the best deals on the products they want, there's little value in being their second choice.

So who are the winners today and how can you ensure your business is one of the front-runners in the future? How satisfied are customers with what you and your competitors offer? And, in customers' eyes, how do multichannel retailers compare with those who operate purely online?

This article shows how the Oliver Wyman Customer Perception Mapping tool can identify winners and losers and how a Customer Perception Map can be used to inform a winning customer proposition for the online business.

UNDERSTAND WHAT CUSTOMERS REALLY THINK

Simply asking customers how satisfied they are does not tell you why they shop where they do. In addition, because each customer is more familiar with some retailers than others, it does not allow meaningful comparisons between all competitors. To address this, we have developed a methodology called Customer Perception Mapping.

We ask thousands of customers to make direct, detailed comparisons between different retailers across dozens of shopping attributes. The survey is constructed in a way that allows us to match what consumers say about different retailers with their actual choices about where to shop – to generate fair measurements of how well each retailer is doing in customers' eyes.

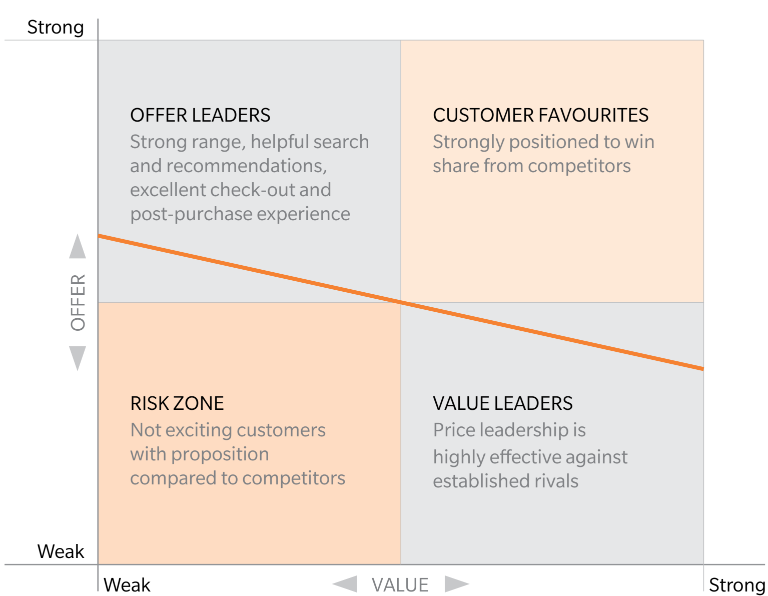
Customer Perception Mapping distils customer satisfaction into two fundamental, independent aspects: offer and value. Effectively, it summarises the retail proposition down to "what customers get" and "what it costs them". For any given retail market, these two measures can be presented in a single Customer Perception Map that shows how customers view each of the players in each market (see Exhibit 1).

Over the past decade, we've applied this approach across many different bricks-and-mortar retail markets in different geographies, and have found the results it generates to be a good leading indicator of financial performance.

USE CUSTOMER PERCEPTION MAPPING TO CREATE A COMPETITIVE ADVANTAGE

The Customer Perception Maps shown in Exhibit 2 paint a high-level picture of online retail in Germany. They identify those who have a winning customer proposition and those who are vulnerable to losing market share. By looking more closely at the detailed customer responses from this dataset, we can suggest three common strategic learnings that apply across geographies.

Exhibit 1: Interpreting a Customer Perception Map



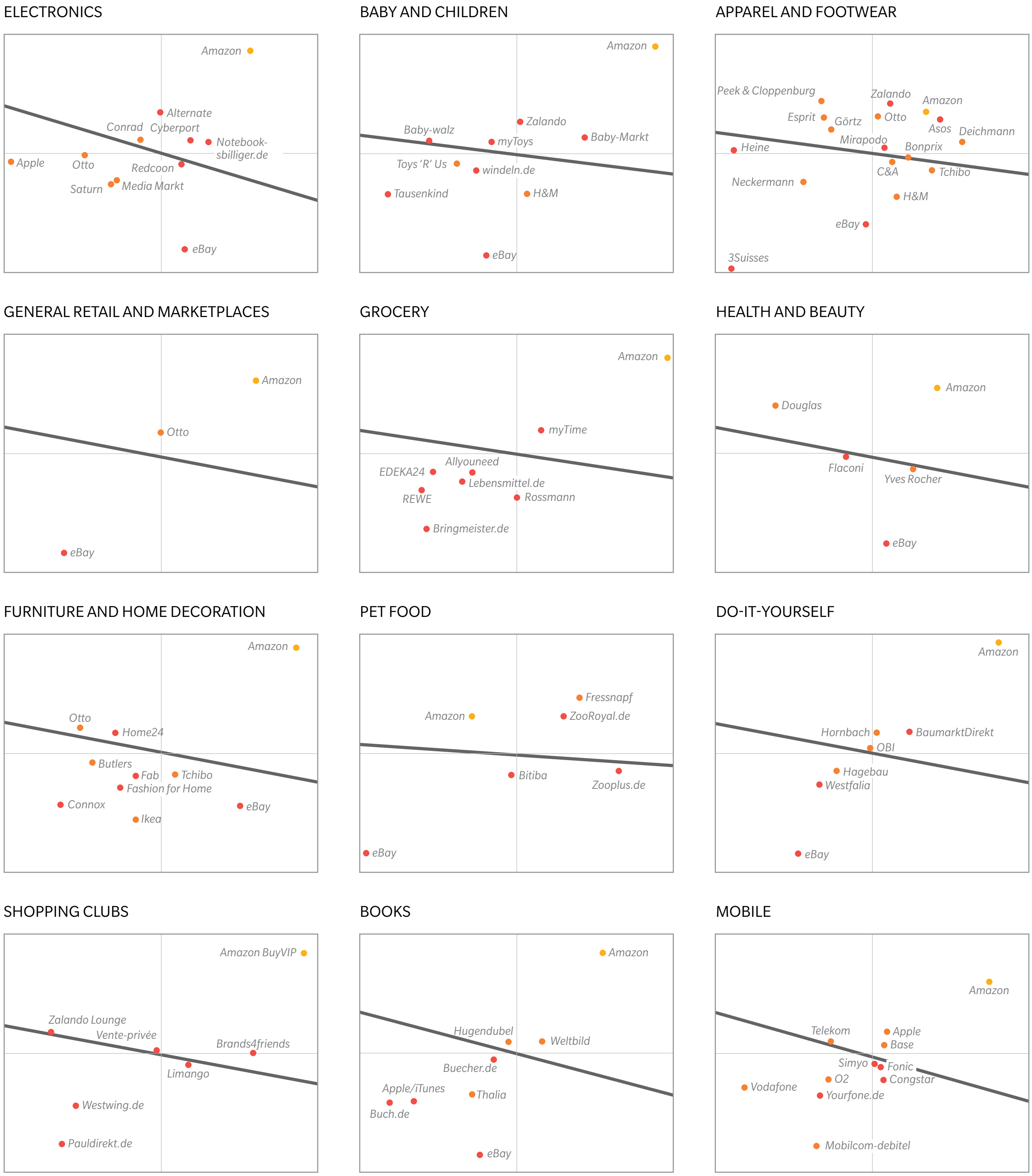
Fair trade line *Indicates the relative importance of offer and value in driving overall customer satisfaction for a given retail sector*

1 Amazon does have areas where other retailers could gain a customer advantage

2 Move the battle to the shopping experience

3 Bricks-and-mortar category leaders must upgrade their online proposition

Exhibit 2: Customer Perception Maps for the different retail sectors in Germany



Online-only retailer

Multichannel retailer

Amazon

Source Oliver Wyman analysis

LESSON 1 | AMAZON DOES HAVE AREAS WHERE OTHER RETAILERS COULD GAIN A CUSTOMER ADVANTAGE

In every sector shown in Exhibit 2, Amazon scores highly out of the 12 sectors investigated and it was the clear customer favourite in ten. Clothing and shoes and pet food are the only exceptions: here, Amazon trails the category leader overall and ranks no higher than third in the market for either value or offer.

In addition, although Amazon's proposition is strong overall, there are four specific areas where it displays some vulnerability, shown in Exhibit 3.

LESSON 2 | MOVE THE BATTLE TO THE SHOPPING EXPERIENCE

Online, location is irrelevant, price transparency is all but perfect, and retailers can offer a broad range of products. Such characteristics of a retail proposition might have been of marginal significance in the bricks-and-mortar world, but they now give the advantage to online players. Similarly, each of the three following areas plays a much stronger role in customer satisfaction with online shopping than with retail:

1. Ease of use
2. Product recommendations
3. Checkout experience

Clicking through an app or web page is not the same as browsing products on a shelf in front of you, and customers are often looking for more guidance. It means that winning in online retail is not all about offering lower prices or a broader product range – you probably will not be able to. Instead, retailers – and particularly multichannel retailers – must leverage these other sources of competitive advantage, as explained in our article *Changing the Rules: Viable Models for E-Commerce*.

Exhibit 3: Four areas where other online retailers could win the customer battle against Amazon

VALUE

Amazon's weakest area is the low number of promotions it runs, which reflects their decreased aggression around price and discounting. Amazon scores relatively poorly on this dimension across all sectors, even those where its rating for other aspects of value is high. There seems little doubt that customers have noticed this change, but it remains to be seen whether it will ultimately be enough to cause any significant damage.

PRODUCT DISCOVERY AND SELECTION

Product specialists often seem to beat Amazon on certain dimensions: expert advice, product filters, and the usefulness of pictures and videos provided. This is particularly true in categories where shopping is more emotional or subjective – clothes and shoes, furniture and home decoration, baby and children, and, to a lesser degree, beauty and pet food. This might be an area in which Amazon's broad scope turns out to be a disadvantage, and sectors where searching is complicated may be better served by a specialised online shop.

Range is generally Amazon's greatest strength, but it is sometimes beaten by at least one competitor that offers a better range of premium products. The perceived gap is, admittedly, small – but as with product discovery and selection, a category killer's focused, tailored proposition could create an advantage.

RANGE

This tends to be one of Amazon's strengths, as would be expected given its Prime service and strong focus on logistics excellence. Even so, it shows some weaknesses on ease of collection and returns, as well as on customer service.

PURCHASE AND POST-PURCHASE EXPERIENCE

LESSON 3 | BRICKS-AND-MORTAR CATEGORY LEADERS MUST UPGRADE THEIR ONLINE PROPOSITION

In general, customers see traditional bricks-and-mortar category leaders trail as inferior to their newer online competitors. The specific gaps vary across sectors and across retailers but, in general, poor competitiveness falls into three categories:

1. Lack of scale. Typically affects product range, product reviews, and technology-enabled recommendations
2. Lack of commercial aggressiveness. Exhibited in the delivery charges, returns policy, and pricing
3. Lack of excellence. Where a company is behind the curve in the development of digital products such as product display, shop usability, and filter options

Traditional retailers need to upgrade their offer attractiveness quickly: they risk being squeezed out by sector leaders who have scale advantages that not only reduce costs but also allow them to deliver superior offer quality. Scale advantages in online retail take many forms – compounding the winner-takes-all nature of the market:

- It becomes more economical to invest in a superior digital experience
- Big data plays an essential role in supporting customers in product discovery and selection
- Network effects in product ratings, reviews, and recommendations come into play

CONCLUDING REMARKS

In terms of customers' perceptions, it's clear that, in Germany, Amazon has a big lead over almost all other retailers in almost all markets, and this is likely to be the case in many other countries as well. Their only obvious weakness is in situations where the purchase decision is particularly complex, purchase occasions where a tailored shopping experience and a more comprehensive high-end range can allow a specialist retailer to deliver a more attractive proposition. In fact, the importance of recommendations, ease of use, and service as competitive weapons is likely to drive increasing specialisation in both pure online and multichannel retail over the next few years – perhaps offering some significant growth opportunities.

Beyond this, how customers view different online retailers has strong implications for established bricks-and-mortar players. Today, they are rated poorly compared to newer, pure e-commerce operators; to compete successfully online, they will need to raise their game significantly. And this means more than just competing more aggressively on the "traditional" retail levers of price and range – ease of use and the shopping experience also have an important influence on where online customers choose to shop.

Some of the traditional retailers' weaknesses are the result of deliberate decisions not to invest: to protect margins and live with the competitiveness gap that results. This is understandably tempting from a short-term perspective – and indeed, in some cases it might be unaffordable to do anything else. But in the longer term, it may fatally undermine their ability to compete online.

THE DISCOUNTERS' JOURNEY

FROM BARGAIN BASEMENT TO WORRISOME THREAT

ROLAND NEUWALD

Roland Neuwald is a freelance consultant who helps private equity companies to develop and implement investment and value growth strategies in retailing. He is a renowned expert in food retailing in Germany. Working in various executive functions for Metro AG, he played a significant role in shaping the development of large-scale retailing in Germany for more than two decades. In 2006, he was responsible for the integration of Walmart Germany, and from 2007 to 2013 he held the positions of COO and CEO at Real-Germany. During this period, he put the company back on track to produce like-for-like growth, for example by developing and implementing strategies to fend off the expansion of discounters.

Germany is the home market of discount giants Aldi and Lidl. Over many decades they built the foundation for their international expansion. One format that has really taken a beating from their rise is the hypermarket. Walmart, after a decade of fighting its corner there, eventually pulled the plug on operations in Germany. For the past 20 years, Roland Neuwald has played a significant role in shaping the strategies of German hypermarkets in this challenging environment. We recently discussed with him his perspective on the development of the German discounters and what traditional retailers elsewhere can do to prevent them from making further inroads.

You have been involved in German retailing for more than 30 years. What impact were the discounters having at the time you started out?

Back then – this was the 1980s – the discount business was dominated by Aldi. Unlike today, discounters were not considered serious competition. Aldi meant one thing: low prices. Aldi stores were very plain. Just about every item was sold out of a cardboard box. The product range was very limited and consisted exclusively of private labels. The stores did not have a full range of fresh foods, just a small number of fruits and vegetables, and no fresh meat or fresh baked goods. Essentially, they sold staples. At that time, the stores were designed for customers with limited budgets. Shopping there was not fashionable.

"Aldi generates about €26 BN in sales with private labels in Germany alone."

When did you realise that the discounters posed a real competitive threat to large-scale retailers?

It was a gradual process. As time passed, it became more and more obvious that discounters were something more than bargain-basement operations. At the beginning of the 1990s, people increasingly came to realise that not only was the product price low but also the product quality was also really good. To a large extent, Aldi products were just as good as brand-name products. This was a perception confirmed by renowned and respected independent organisations.

Lidl expanded at an ever faster rate. All at once, brand-name products were increasingly showing up on the shelves of discount stores. By the mid-1990s, the discounters began to launch non-food sales campaigns that struck a chord with many consumers. This served as a breakthrough to the broader middle class. At the same time, the stores offered high-quality items like champagne at low prices.

This represented the dawn of the smart shopper: the quality-conscious consumer who is proud of paying less for good quality. In a nutshell, you can say there is one thing that marks the difference between the 1980s and now: at that time, if you shopped at Aldi or Lidl it was because you had to; now, you choose to shop there and, if you do, you receive a pat on the back from neighbours or colleagues for getting a really good deal.

A further change is that discounters moved into small towns and rural areas during the 1990s. Increasingly, they took over the role of the local suppliers. Initially, this shift hurt the small independent supermarkets. It has also had a growing impact on large-scale retailing. Today, 98% of all customers in Germany are no more than ten minutes away from the nearest discounter.

What do you consider to be the major structural strengths of the business model used by successful discounters?

The product range is straightforward and is enhanced by non-food sales campaigns. This, in turn, is optimally coordinated with all processes, store design, and logistics. A discounter has about 1,000 square metres per store and sells a maximum of two to three products, including sale items, per square metre. Placement and processes are thoroughly standardised. Thanks to the restricted amount of selling space, you can easily expand this model and thus achieve economies of scale and synergies – both in terms of procurement and organisation. The reduced complexity of the product range facilitates a high level of detail regarding customer and product orientation. Furthermore, it is easier to shop at discounters than at larger formats. As a result, they offer a certain amount of convenience.

"Once discounters appear in a new market, the pressure on a company's own business model automatically increases."

How big a business edge does the discounter business model offer?

In terms of personnel costs, discounters have a clear advantage. The difference between them and full-range stores is certainly more than 5% in sales. Not only do they not offer services such as fresh-food counters staffed by store employees but they also have an edge in purchasing price. I know that Aldi generates about €26 BN in sales with private labels in Germany alone. At Edeka, the figure is less than €8 BN. When you consider that Aldi's volume covers fewer items, the purchasing edge will be tremendous. Then there are the benefits produced by the international bundling of product procurement, economies of scale in logistics, store construction, and central functions. As a result, discounters can afford to sell products at margins ten or more percentage points lower than the competition.

How are the discounters' organisational structures special?

Aldi and Lidl have unbelievable cost discipline, and the business model is continuously refined. Every manager knows the discount business model inside out. During orientation programmes that last from six to 12 months, top college graduates are initiated into the ways of the business model while working in stores – even if they intend to work in areas such as procurement or IT in their future careers.

The two discount leaders also have a long tradition of family-led management. In contrast to some of their competitors, this enables them to think long term, without having to deal with pressures exerted by shareholders or the capital market. In food retailing, this can give them a real edge when entering new markets, especially when wrestling with start-up problems. In the UK, it took more than ten years before Aldi became successful.

What defensive strategy would you recommend to established retailers in countries where discounters are just beginning to get their feet on the ground, or just starting to exert real pressure?

The first order of the day is to simply remain level-headed – even when it is really difficult to do so. Once discounters appear in a new market, the pressure on a company's own business model automatically increases. Processes must be optimised and procedures scrutinised. Organisations that suddenly see their sales and market share eroding do not always act logically and correctly.

Here's one example of what I'm talking about: why do companies lower the prices of several thousand food products when Aldi only sells one thousand items?

"Full-range companies must continue to set themselves apart from discounters – and do a better job of it – by increasingly focusing on their own strengths."

Full-range companies should shy away from across-the-board price cuts. Instead, they should focus on creating a base product range of at least 500 discount items made up of food and consumer products then sell these at the same price and – this is very important – of comparable quality to the discounters. Furthermore, these items should be very aggressively promoted at the POS and in advertising to strengthen the price perception.

I have learned over the years that though such steps may sound simple, often they are not fully implemented because full-range companies have a really hard time accepting the resulting margins. Traditional retailers in Germany have at times failed to be uncompromising in carrying out this defensive strategy at an early stage. The approach has failed because of the hang-ups that traditional full-range companies have about aggressively selling fast-moving items at low discount margins.

What sort of conditions must full-range companies put into place to carry out this defensive strategy?

To carry out this defensive strategy requires much stricter cost discipline than many are used to: discounters do not spend one penny more than they have to. As part of a zero-based analysis, full-range companies should systematically examine every cost item and in the process generate real cost transformation. Under certain conditions, it may be enough to simply reduce total costs by one percent, which will then enable all cost savings to be invested in the discount product range.

What can full-range companies do to turn the tables and go on the offensive?

Full-range companies must continue to set themselves apart from discounters – and do a better job of it – by increasingly focusing on their own strengths. These strengths range from product variety and excellent fresh-food departments, ones that offer service and special items, to store design. In regard to service, in particular, full-range retailers must take steps to ensure that customers can buy many items that are not sold by discounters. Full-range retailers must also ensure that this standard applies to in-house logistics and the checkout process. You have to remember that discounters are real pros when it comes to product availability and checkout processes.

"In their drive to gain market share, I think discounters will primarily focus on the developed markets of Europe and North America – and perhaps on Asia later."

Should full-range retailers consider the option of opening their own discount format?

If discounting were viewed as an additional channel like e-commerce, and not as a retail format, things would have already changed by now. As online retailing has grown rapidly, every retailer has begun to think about multichannel, omni-channel or cross-channel strategies and, correspondingly, to develop ways to realise these approaches. The fact of the matter is this: when discounters enter a new market and begin to generate growth, all other market players will lose market share. For this reason, it makes sense for market leaders, the ones with the necessary financial strength at least, to think seriously about the option of creating their own discount format – and they should do so as early as possible. But you can't pull this off while employing the business philosophy, organisational structure, and culture of a full-range retailer. The two models are simply too different. This means that the discount format must be independent. It must be managed separately from the full-range operation.

In countries where discounters are currently playing a minor role, the longer that the market leaders wait, the less chance they will have of retaining their market share once the discounters begin to grow. In the UK, Aldi and Lidl have a market share of just 10% right now. If this figure rises to 20% over the next ten years, the brunt of this growth will be borne by leading companies like Tesco. The time to act is now.

Discounters have gained a very substantial market share in Germany. Will this happen in other countries?

It depends on the economic conditions. For one thing, discounters' cost strengths are much more pronounced in developed markets: this is where the advantage they have in personnel costs has the greatest impact. This is why Aldi primarily does business in countries with comparable gross domestic products. In addition, discounters always profit when economic conditions or consumer confidence worsens because this makes the middle class less reluctant to shop in their stores. In their drive to gain market share, I think discounters will primarily focus on the developed markets of Europe and North America – and perhaps on Asia later.

One last question. If you could start your retailing career over again, which business model would you choose?

I am really satisfied with my decision to work in full-range retailing. Every business model has its own special features. And each must be constantly refined and modified to address new market developments. Young people should select the retail business model with which they can identify, and then make the best of it.

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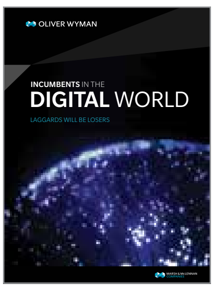

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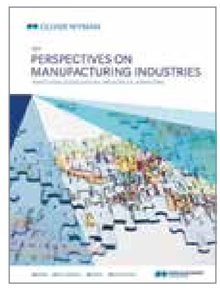

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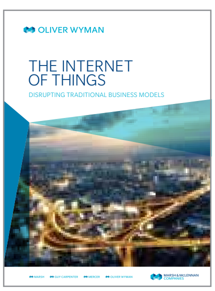

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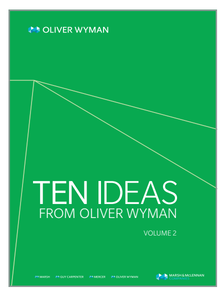

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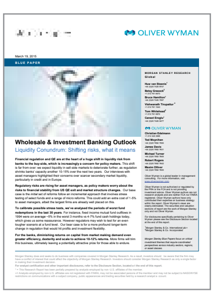

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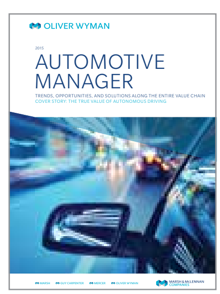

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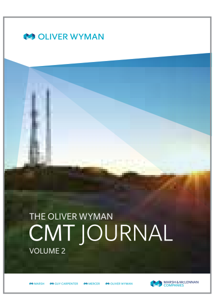

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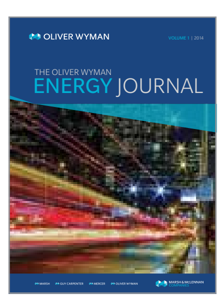

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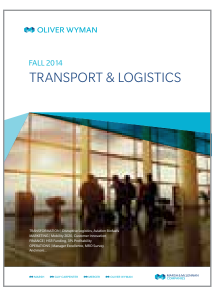

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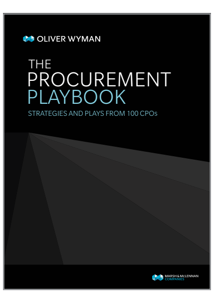

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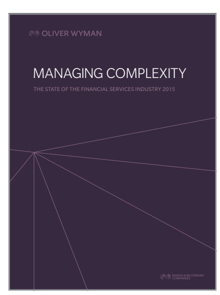

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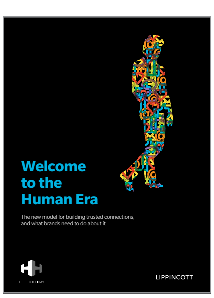

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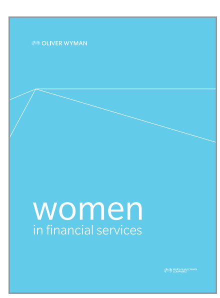

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