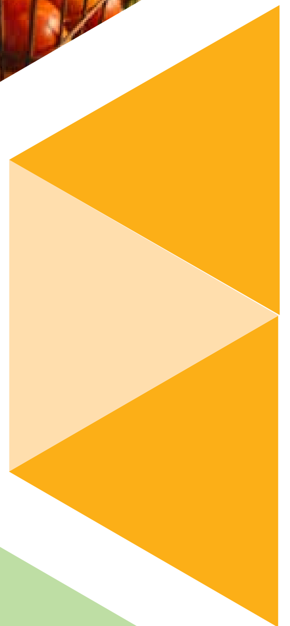
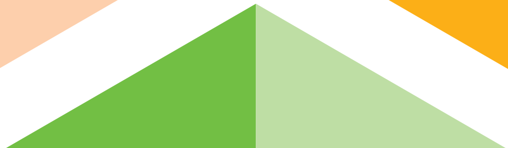
OLIVER WYMAN

FMI
THE VOICE OF FOOD RETAIL
Feeding Families Enriching Lives

BOARDROOM

Strategies for success in food retail





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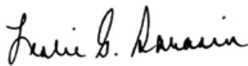
FOREWORD

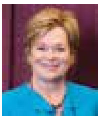
Welcome to the first edition of *Boardroom*, an annual journal from the Food Marketing Institute (FMI) and Oliver Wyman. This collection of articles offers unique and timely insights to help senior food retail executives shape strategies for success and improve performance throughout their organizations.

Every food retail executive faces significant challenges and opportunities in the market today. From consolidation sweeping the industry to hard discount formats entering new markets to the growth of online and omnichannel retail, the food retail landscape is changing rapidly. Companies that adapt the fastest – or, better yet, get ahead of the change curve – will be in the best position for long-term success.

In this inaugural edition of *Boardroom*, leading experts in our field offer original perspectives on a selection of the most critical issues executives must confront in boardrooms across the country and around the world. Many of these issues are on the industry's cutting edge – such as delivering a seamless experience across digital and physical channels, cyber security strategies, and the opportunities and potential risks associated with retail healthcare. Others issues – such as building a culture of food safety, reducing food waste and shaping survival strategies – are evergreen, but they have taken on new urgency and expanded significance, requiring new thinking in today's turbulent retail environment.

FMI and Oliver Wyman created *Boardroom* for the senior executives responsible for guiding their companies in what may be the most challenging period in the industry's history. We think *Boardroom* and the expert insights it provides will be an invaluable tool for senior executives as they work with their management teams to take advantage of the opportunities that accompany every challenge. We trust that you will agree.





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GROWTH STRATEGIES

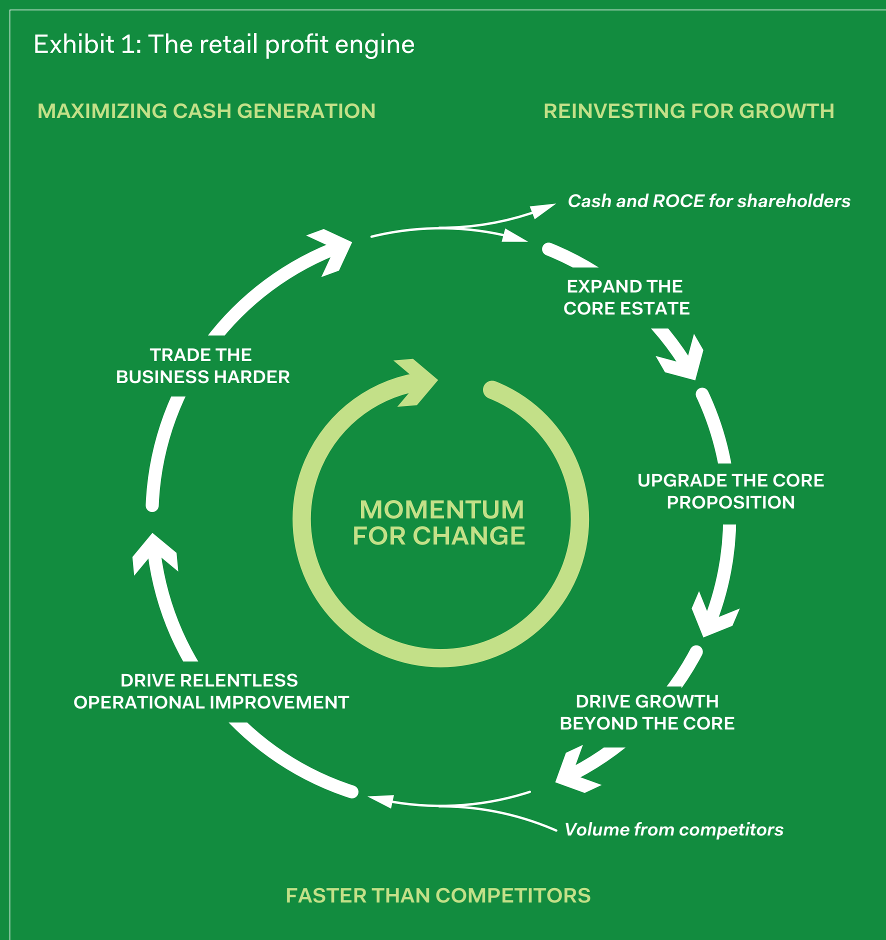
Finding the next source of profitable growth

Jacqueline Martinez
Paul Beswick

Retail is a low-margin business, where success hinges on constantly driving the profit engine. This means retailers are always looking for ways to save cash and to plow that cash into investments that will grow the business and generate more cash, fueling the cycle. The life of a retailer is about making thousands of small, day-to-day decisions to create these sources of cash.

Over long periods of time, retailers face a persistent headwind in their battle to fuel this cycle. This headwind begins with the reality that retailers are only able to raise their prices as much as inflation. However, wages (and often input costs from suppliers) grow at a faster rate. In the U.S., this has produced an annual ~40 bps headwind, which retailers have had to overcome to make a profit. This means retailers need to find a way to not only survive, but grow.

Exhibit 1: The retail profit engine



KEY TAKEAWAYS FROM THE RETAIL LIFESTAGES CONTENT FEATURE

There are two archetypes of successful retailers, "bears" and "sharks," who prey upon a third archetype, "salmon."

Bears are the disruptive entrants to a market with a format new to that market that can steal significant share from incumbent players. They are called bears because defeating them does not require outrunning them – only outrunning other incumbent retailers.

Sharks are retailers who do the outrunning. They are called sharks, because they must constantly swim forward to survive, driving persistent like-for-like sales growth.

Successful retailers start out as bears. To survive, they must transform themselves into either sharks or a new kind of bear. We describe the evolving growth phases of a retailer in terms of life stages, where retailers need to shift their business model in order to continue to grow.

Changing from a bear to a shark in the animal kingdom is impossible. Changing business models for a retailer is difficult. Much of this document focuses on these transitions.

THE TWO WINNING MODELS: BEARS & SHARKS

All retailers must grow to survive. Fundamentally, there are two approaches to that challenge.

Most new retailers in a market grow at first by introducing a new format that is disruptive to that market. Their growth comes from opening new locations that steal share from incumbents. These retailers are like bears. If you are an incumbent, you don't have to outrun the bear; just make sure your competition gets eaten first.

The incumbent retailers who successfully drive growth are like sharks. If they ever stop swimming forward, they die. These retailers grow by driving more sales from their current footprint.

If you are neither shark nor bear, you are salmon, the prey of the successful models. These become clear by looking at a retailer's performance over time.

Exhibit 2 shows examples of sharks, bears, and salmon in 2014. It is worth noting that the sharks and salmon of today were bears at some point.

Walmart, for example, was a bear for the 1980s and 1990s, stealing share from an evolving set of competitors. Walgreens and CVS were bears until about 2008. Lowes and Home Depot were bears until the late 1990s. Kmart was a bear into the 1990s.

The most recent bear onto the scene is Amazon.com. Amazon has driven growth by starting with category dominance in books and expanding to one adjacent category after another, and is now the consideration leader with customers for a very wide range of occasions. They still have room to grow with this model. Food, apparel, and business supplies are among the categories they are targeting.

Exhibit 2: Bears, Sharks, and Salmon as of 2014

	RETAILER	1980	1990		1999		2008		2014	
Salmon	Sears	1	1	↔	3	↓	9	↓	13	↓
	Kmart	3	2	↑	6	↓	X		X	
	JC Penny	4	6	↓	8	↓	17	↓	37	↓
	A&P	7	9	↓	26	↓	49	↓	X	
Sharks	Kroger	5	5	↔	2	↑	2	↔	3	↔
	Walmart	15	3	↑	1	↑	1	↔	1	↔
	Home Depot	X	43	↑	4	↑	4	↔	4	↔
	Costco	X	39	↑	10	↑	3	↑	2	↑
	Walgreen Co.	X	20	↑	15	↑	6	↑	7	↓
	CVS	X	15	↑	16	↓	7	↑	8	↓
	Lowe's	X	46	↑	21	↑	8	↑	9	↓
	Best Buy	X	X		26		10	↑	10	↔
Bears	Amazon.com	X	X		X		25		5	↑

COMPETITIVE THREATS: WHY SMALL IMPACTS MAKE A BIG DIFFERENCE

Retail is a high-fixed-cost business. For almost every retailer, some proportion of stores has negative EBIT contribution. For any format and physical location, there is a minimum amount of sales required to break even. Near that limit, profitability shoots up rapidly. For stores that are just over that threshold, a small decrease in sales has a massive impact on profitability, as illustrated in Exhibit 3. Furthermore, if you lose that share to another competitor, who can slide up the same steep curve, it has a massive impact on your standing in the competitive landscape.

This is why bears can be so disruptive to the market. They steal share rapidly, tipping many stores below the break-even line. Because of these dynamics, even small bears matter. A new innovative independent down the street can cause major pain for an incumbent retailer, even without becoming a major force in the broader retail market.

In the book, **Retail Revolution** (Rajiv Lal, 2014), the authors apply this logic to the financials of a number of retailers. First, they calculate the amount of store sales change that would cause the average store to have a negative contribution margin, likely forcing significant store closures. For one of today's renowned sharks, Costco, a 30% decline in sales would be required to reach this threshold. This number itself is drastic for one year, but amounts to only a 3.5% sales decline over a 10-year period.

Second, the authors calculate the sales change required for stores to fall below the 10% ROIC hurdle generally used to justify investment. Even less of a competitive threat can still reverse the desirability of store investments, which are an essential part of most sharks' growth strategies. Costco would only need to see a 11% decrease – or 2.5% decrease for five years – to reach this threshold. For Walmart, Best Buy and Staples that number is half what it is for Costco. And for retailers like Toys R Us, their current sales trends are already making store investments untenable.

Exhibit 3: A small-scale advantage makes all the difference

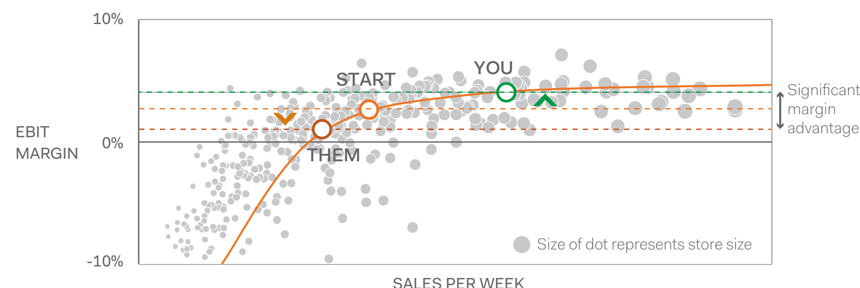
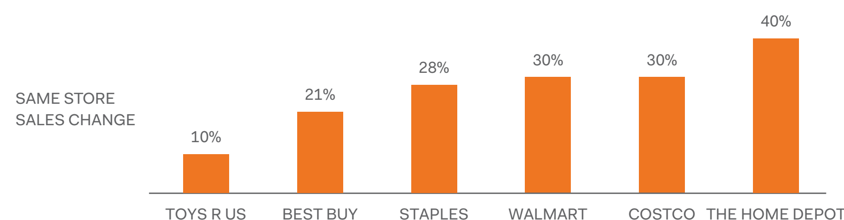


Exhibit 4: Sales pressure required for negative store contribution

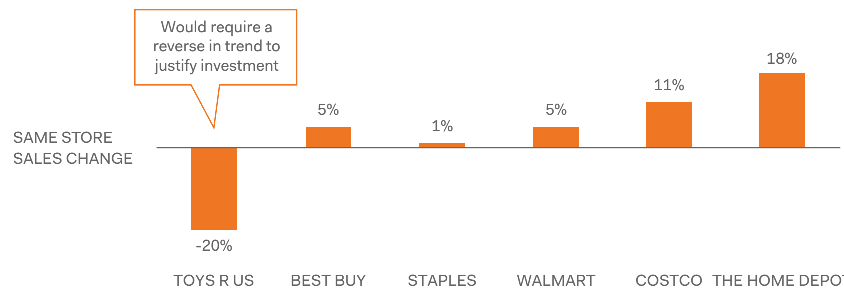


Perhaps most frightening for today's sharks is that e-commerce is enabling bears to grow at a much faster rate than before. Where it took Costco twenty-five years to climb from a top fifty retailer to number two, Amazon's rise took just a fraction of that time. In the face of these competitive threats, it is imperative for today's sharks to constantly be searching for new ways to grow.

CASE STUDY: STAPLES

Outside of food retail, Amazon has already been a disruptive bear to many segments. Office supplies stores provide a good example of how these characters interact. This is a market where macro trends, such as declining printing, have combined with the threat from Amazon to create an extremely challenging set of market conditions. Despite this, Staples has managed to perform well, becoming the shark who has consistently been able to swim faster than competition. By contrast, Office Depot and Office Max have become salmon.

Exhibit 5: Sales pressure required to make store unworthy of investment



By the time market pressures increased, Staples was already starting from an advantaged position. One of their key advantages was a better real estate portfolio, achieved through a top-notch real estate capability. Furthermore, they had a better brand, better price perception, stronger online presence, more efficient operations, and a structurally advantaged portfolio of B2B customers. Given the dynamics of the fixed cost business, this starting position made a major difference in how rapidly Staples' stores faced negative EBIT. Exhibit 6 illustrates this point.

As a result of these dynamics, the brunt of store closures in the office supplies format hit Office Depot and Office Max – not Staples. Exhibit 7 shows a projection we made in 2013 about closures through 2017. We have witnessed these dynamics play out in the lead up to the announcement of the acquisition

The acquisition shows that Staples has successfully won the battle within this format. However, as Best Buy learned when they won the battle for their format, alone this will not guarantee success for long (see Exhibit 8 below). Staples will need to make the most of this acquisition and then continue to look for new sources of growth. What they are doing online around category expansion is an example of the kinds of plays they will need to make to win for the long term.

Exhibit 6: Starting from an advantaged position

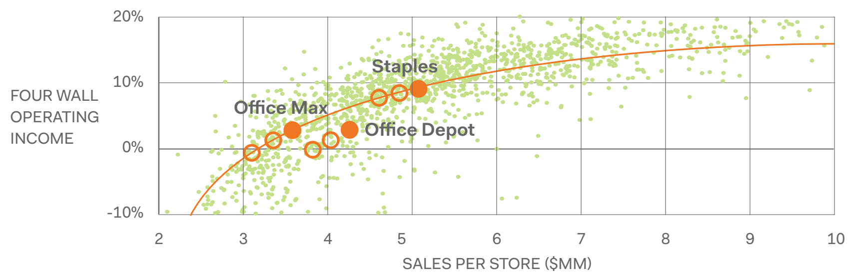


Exhibit 7: Cumulative store closures for Office Supply

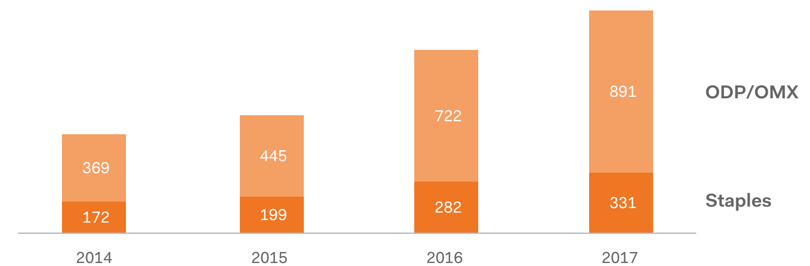


Exhibit 8: Best Buy stock performance, 2006–2013

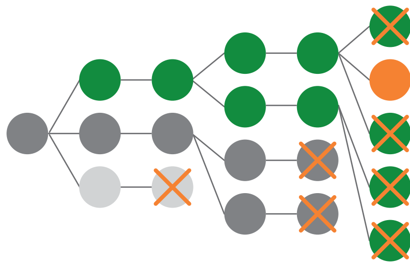
THE LIFECYLE OF A RETAILER

Staples has not always been a shark and Office Depot has not always been a salmon. If you look back in time, both of them pioneered their new formats and were bears stealing share from other parts of the market.

Just as we see bears become sharks or salmon within the office supplies sector, we also see retailers transition roles as they mature across all segments. This is because retail formats evolve through different life stages as they mature. While no retailer has the same path to success, there are common threads to the evolution of every successful retailer. Namely, those retailers who find continued success are those that can successfully make the transition from one stage to the next through the four lifecycle stages.

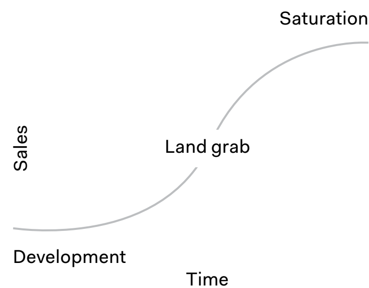
As you can see, these different life stages focus on very different capabilities. Therefore, the hardest part of this process is managing these transitions. We will focus on the challenges faced by retailers reaching maturity and those faced by retailers who have exhausted the growth possible in maturity and need to turn to reinvention.

1. DESIGN AND INNOVATION



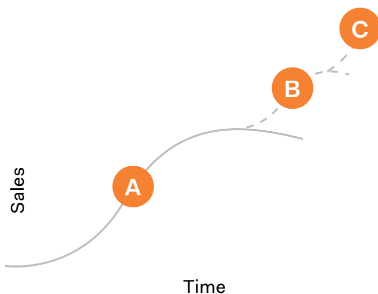
The first is design and innovation. In the beginning, young firms nurture and cultivate a winning, high-productivity format with strong customer appeal and favorable economics. These formats might be physical stores, online properties, or a combination of the two. The aim is to come up with a retail business that is new, different, and profitable.

2. ROLL-OUT GROWTH



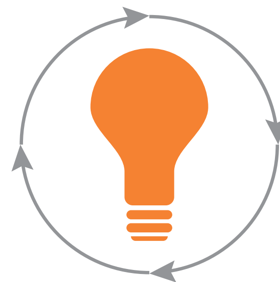
Next comes the stage of roll-out growth, where the goal is to increase in scale as quickly as possible. For bricks-and-mortar and online players alike, economic value is created through ever greater volume, not from tinkering with the proposition. Efficient, rapid expansion is paramount.

3. MATURITY



Third in this progression is maturity, where the primary challenge – usually a difficult one – is to grow sales based upon the same geographic "footprint." The best retailers make massive improvements in both delivering their core proposition and at deriving value from it, reaping large rewards in the process.

4. COMPLETE REINVENTION



Finally, retailers reach the stage where complete reinvention is needed. This lifestage shares many of the characteristics of the retailer's early years, in which new formats are spawned, new channels opened, new services offered, new value capture mechanisms engineered, new acquisitions made, and new alliances forged. Success in this life stage requires a higher tolerance for risk than the culture of most mature organizations allows.

TRANSITIONING TO SURVIVE: REACHING MATURITY

The key differentiator between a shark that swims and the salmon it eats is the ability to transition at the key pivot points in the retailer's trajectory. As was clear in Exhibit 2, the successful and innovative retailers of 1980s are often irrelevant today. Those who have managed to transition life stages have thrived.

The reason why this life stage transition is so challenging is that the dynamics of life stage 3 are very different from the dynamics of life stage 2. In life stage 2, retailers succeed by driving economies of scale. This requires standardization. In life stage 3, retailers succeed with economies of skills, using superior insight to tailor the offer to each store or, in some cases, each customer. Making this shift requires that the balance of power within the organization shifts from people who can execute to people who can analyze.

The first sign that a retailer is approaching this transition is that new store openings begin to drive diminishing returns. As a result, sales per store start to flatten or decline. Many retailers falter at this point, sometimes continuing to expand store count beyond what the market will bear. Those who recognize these pressures and react can transition to growth in life stage 3.

CASE STUDY: STARBUCKS

Starbucks faced the end of life stage 2 in 2008. Over-expansion, combined with pressure from the financial crisis, caused same-store sales to decline. They also had gotten away from their core business, losing focus on the service, quality, and value. Many initiatives focused on efficiency, compromising experience at a time when lower priced competitors (e.g. McDonald's) were improving quality.

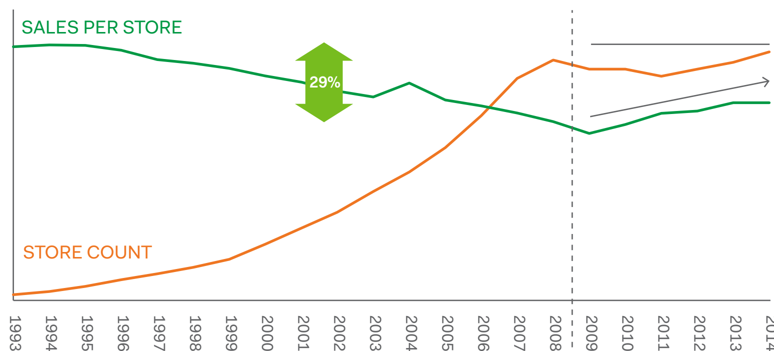
When Howard Schultz returned, he drove a multi-year plan to return Starbucks to life stage 3 growth. They began the turnaround by reversing some of their late-life, stage 2 mistakes – closing 600 stores and taking some distracting food items off the menu.

Next, Schultz laid out an agenda of initiatives to allow Starbucks to grow sales without adding stores. Initiatives focused on service, quality, experience, and customer loyalty.

Many of these initiatives leveraged better data, an ability to test and learn, and a process of harnessing the creativity of the whole organization.

The result was a return to sustainable growth in sales per store and an engine for innovation that has set Starbucks up for future success in life stage 4.

Exhibit 9: Reaching the end of lifestage 2



INNOVATING TO SUCCEED: BEYOND MATURITY

At some point, even the most effective life stage 3 retailers will find continued growth challenging. We discussed Staples earlier as the example of a shark 'eating' its competitors. As we saw with Best Buy, this acquisition will drive enough growth for Staples to stay in life stage 3 for several years. Eventually, however, Staples will need to find another source of growth beyond the core. This need to shift to sources of growth beyond your current core business marks the transition to life stage 4. These sources of growth can be new channels, formats, product lines, or services.

The big challenge of this life stage is that it requires retailers to take a lot of risks outside the core in the same way they did in life stage 1, while still driving the core business forward with the discipline of life stage 3.

CASE STUDY: TESCO

Tesco was a shark in the UK, long viewed as the customer's champion on both brand and value. To deliver on that reputation, they built a highly efficient operation with steady sales growth, while stealing share from the rest of market (an archetype of the successful Stage 3 retailer).

When 'bears,' Aldi and Lidl, entered the marketplace, these hard discounters began to steal share. Rather than respond to these threats aggressively, Tesco's new management was focused on financial performance. This led them to raise prices and increase promotions.

The impact showed first in customer perception, which started to decline in 2007. By 2010, like-for-like sales turned negative. Tesco held on to margin rates until being forced to accept a slight decline in 2012 and a massive decline by 2014.

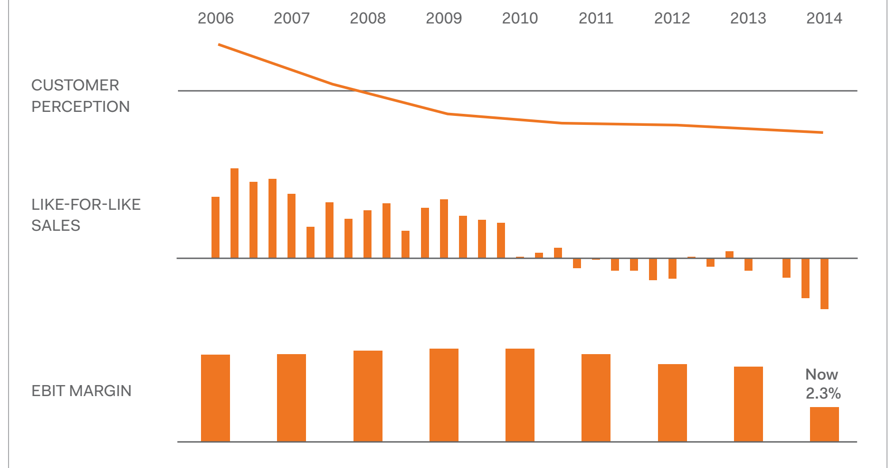
One of Tesco's responses was to develop alternative formats, one of which was the convenience concept, Fresh and Easy.

A successful format needs to balance three elements:

- Customer proposition: The customers and occasions a format will serve
- Operating model: The way the format delivers the proposition at acceptable financials
- Real estate strategy: The type of locations and network densities required for success

These may at times seem contradictory. A high-service customer proposition may cost too much to deliver acceptable financial outcomes at the prices customers will pay. A niche customer proposition may only work at a few locations, making it impossible to reach financial targets. The best locations may also be the most expensive, meaning those locations can't meet ROI goals.

In the case of Fresh & Easy, these three elements were not well aligned. The customer proposition was meant to be fresh, convenient, and value-oriented, but with low service and low choice. They believed this proposition required convenient locations, investing in a dense real estate network from the start. However, the customer proposition was too narrow to be broadly appealing to customers near a store. It was more successful in reaching a subset of customers who were willing to drive reasonably far to reach a Fresh & Easy. Given these dynamics, the dense real estate network meant that the stores were massively cannibalizing each other, driving poor performance.



What Tesco did wrong with Fresh & Easy is characteristic of one of the key challenges facing retailers in this life stage. Tesco bet big, making the cost of failure high and the ability to rapidly correct course low. A real entrepreneur would have avoided the network density mistake, because they would have opened one store at a time, learning when their network density was reaching saturation.

A lack of capital would have forced them to expand in this way. Major retailers trying to innovate can learn from this example by making sure their bets are designed to fail fast and fail quickly, reducing the costs of the inevitable risks of innovation.

CASE STUDY: STARBUCKS ITALIAN SODA AND VIA

Developing a viable growth vector in life stage 4 requires a lot of time and often many rounds of failure. Therefore, starting to place these life stage 4 bets when you are still solidly growing is important. Starbucks, for example, made a number of life stage 4 bets at about the same time that they began their transformation to life stage 3. One of CEO Schultz's passion projects was Italian soda. They bet on it, and it flopped – but they rapidly realized the failure and made the difficult decision to move on to other ideas.

They made many other bets. One that succeeded was an instant coffee product called Via. High-end instant coffee was completely new, especially in the US. Developing this product fully opened up new consumption occasions and customer segments to Starbucks. They invested in patient R&D to make sure the product really could change deep-seated consumer skepticism about instant coffee. When the product was ready, they fully supported the launch with a major in store effort. The result was an extremely successful product and a sustainable new stream of growth that did not cannibalize the core business.

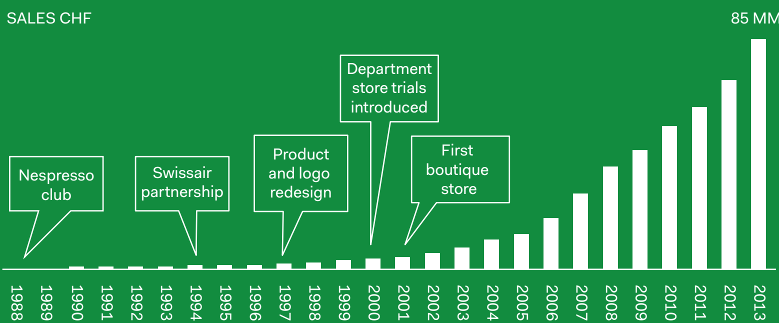
CASE STUDY: NESPRESSO

CPG companies frequently face the same challenge – how to innovate, while still running their large, profitable base business. Nestle is a good example of a large CPG that tackled this challenge in an interesting way.

In the late 1980s, Nestle created Nespresso. In order to foster the spirit of innovation at what was already a well-established shark, they deliberately cordoned off the management and staff from the rest of the company and brought in an outsider manager to run it. They also established a separate headquarters away from Nestle's main facilities.

Then they were patient, waiting through 10 years of unremarkable sales. However, along the way they saw early signs of the success of the business. They kept a spirit of experimentation alive, constantly trying new ways to grow, until they hit on one key idea. Getting consumers to try the product was key to overcoming skepticism about what single serve coffee can be. A partnership with Swissair to serve their coffee in first class was the first sign of the power of this tactic. From that partnership, they expanded to trials in department stores and eventually their own boutique stores. The result was 10+ years of over 30% annual growth.

Exhibit 11: Nespresso growth trajectory, 1988-2013



SO WHAT DO I DO ABOUT IT?

Understand your starting position

There are some stores where you are unlikely to win no matter the investment. For those stores, you want to manage the exit in a way that reduces exit costs – you don't want to waste investment dollars. There are other stores where you already have an advantage. For these stores, you want to invest to maintain the advantage (but not overinvest). The rest of the stores are where the risks and opportunities exist. Those are the stores that merit the most investment dollars. Segmenting your investment in this way will give you an advantage against other incumbent competitors and enhance your position vis-à-vis new entrants.

Know where the bears are

Bears both big and small pose a threat. Even a 10% share loss to new entrants would erase industry profitability. We see at least three 'bears' on the horizon for traditional grocery. Hard discounters like Aldi and Lidl have a profitability advantage to traditional grocery, making up for lower gross margins with significantly better operational efficiencies.

Online grocery, a subject of a previous SME forum, is gaining traction. Today it may be a small bear, but it still threatens existing grocery profitability. Offer specialists from Sprouts to Whole Foods are also growing quickly, especially those with a focus on organic or natural source foods.

Outswim the competition

The difference between a shark and a salmon is about who has the capabilities to drive more out of every store. One of the key levers for doing this is improved efficiency of merchandising decisions. Where a simple pricing strategy may have sufficed in the past, you need different strategies in every store. Where a single assortment flexed by real estate size used to be enough, you now need a different assortment for each mix of customers. Where you used to count on scale to get benefit from suppliers, you need to learn how to drive money from big suppliers, while working with a wider range of smaller suppliers. If done hastily, these capability upgrades can drive massive costs in overhead, labor, supply chain etc., so it is frequently better to plan for 'steps' not 'leaps,' leveraging small upgrades to drive impact in weeks or months rather than years.

Exhibit 12: Aldi's winning operating model

	SUPERMARKET	ALDI	ALDI		
GROSS MARGIN	30.9%	19.1%	(11.8%)	Prices	−
				Supply chain	+
				Shrink	+
				COGS	+
OPERATING COSTS	(25.6%)	(11.2%)			
STORE CONTRIBUTION	5.3%	7.9%	+2.6%	Productivity	+
				Pallets	+
				Service	+
OVERHEAD	(1.7%)	(0.9%)			
EBITDA	3.6%	7.0%	+3.4%	Store size	+
				Overhead	+

Get a bear of your own

Launch your own initiative or become an investor in the next bear. Remember, this is fundamentally a low-odds proposition, so you need to place more than one bet. One way to achieve this is by creating a segmented part of the business, where innovation culture can thrive. In these parts of the business, insist on incremental progress to force concepts to fail fast and help you recognize promising early-stage innovations. You can also invest in other bears, scanning the landscape to turn would-be competitors into your own profit source.

KEY QUESTIONS FOR A RETAILER

What is my current model for success?

Do you have innovative models, channels, offerings to empower growth (i.e., a bear)? Do you have a strong engine for driving operational efficiencies to deliver steady and stable growth within the current footprint (i.e., a shark)?

How long can my current model deliver success?

Are there enough 'salmon' that you could survive disruptive market forces? Are your growth engines beginning to reach the point of diminishing return on investment?

How do I maximize growth in my current model?

Is it better to grow beyond my current geographic footprint? Or drive growth with the stores I have? Or both?

Do I understand my competition?

Who are the other potential sharks in my waters? Who are the bears I see coming? Where is my business most vulnerable?

Strategies to survive

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

David Waller and Nick Harrison

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

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

A NEW BATTLE FOR CUSTOMERS

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

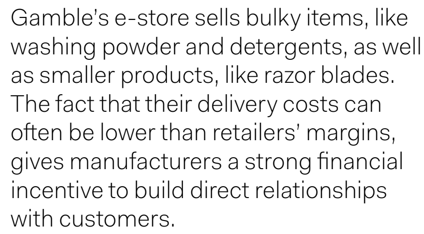
Simultaneous with this growth in competition, is the changing nature of customer relationships. E-commerce is sometimes characterized as being more transaction focused than brick-and-mortar retail, but this isn't always the case and some of the giants, including Amazon, are building customer relationships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

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

Manufacturers can reach consumers directly

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

For example, sports brand, Nike, has been growing its direct-to-consumer business and this now accounts for about 20% of its sales. Procter and



Gamble's e-store sells bulky items, like washing powder and detergents, as well as smaller products, like razor blades. The fact that their delivery costs can often be lower than retailers' margins, gives manufacturers a strong financial incentive to build direct relationships with customers.

Asset-light business models

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

Digital wallets have been launched by some payment providers, who are also making a play to own customers via deeper understanding of their spending habits across sectors. How long will it be before businesses such as PayPal and Google Wallet make recommendations to customers, provide price comparisons, and enable purchasing all from within their own apps?

Price comparison websites already exist in most retail markets, either in the shape of giants like Google Shopping or as sector-specific solutions such as mySupermarket. Today, most of these send customers to the retailer to complete the transaction but how long will it be before this changes?

Visual discovery tools like Pinterest allow users to curate picture boards of products under a theme and share with other users. Such tools also send users to the retailer to complete the transaction but, again, could this change soon?

Apps exist that help customers plan their meals to a budget or plan a weight-loss program, or just to save time. These typically generate shopping lists or feed into grocers' online stores, but will the businesses that operate them soon be looking to cut the retailer out completely?

Growing competition to own the last mile

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

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

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

Google Shopping is perhaps even more interesting, as it is a "retailer agnostic" proposition, and could easily also start carrying products direct from manufacturers.

Future purchasing experiences could entirely circumvent and remove traditional retailers from the value chain. Customers could order branded goods directly through a manufacturer. The order could be delivered by the manufacturer or a specialist fulfillment company without interacting with the retailer. Alternatively, for retailer's own labeled goods, customers could place orders directly through an online aggregator, which either delivers the order directly or uses a specialist fulfillment company. There would be no interaction with the retailer, though the retailer may pick up the order in stores or from the warehouse.

RETAILERS' TRADITIONAL STRENGTHS ARE BEING ERODED

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

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

Physical store assets are no longer enough

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

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

Offering the lowest prices is getting tougher

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

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

Technology is changing service and advice

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

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

HOW CAN RETAILERS FIGHT BACK?

In 10 years' time, what will the world of retail look like? Which of today's successful retailers will still be the key players in their markets? Without wishing to be alarmist, we think everything we've just described suggests that, sooner or later, there will be fundamental changes in every retail sector. Some retailers are better placed than others to cope with these changes, but over the coming decade all are likely to face real challenges.

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

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

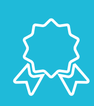
Faced with diffuse or long-term trends and threats such as these, a common reaction is to assume that they're too uncertain or too far in the future to matter. This is understandable, but it's a mistake. Retailers need to act before they start losing large numbers of customers, because once they do their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

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

1. **BOLDLY PLAY THE MOVIE FORWARD FOR YOUR SECTOR**

2. **IDENTIFY NEW WAYS TO WIN CUSTOMERS AND OWN CUSTOMER RELATIONSHIPS**

3. **THINK MORE LIKE AN AGILE START-UP AND START INNOVATING AND EXPERIMENTING RIGHT NOW**



1. Play the movie forward

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

Fundamental questions:

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

Example detailed questions:

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

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

Exhibit 1: Example survival strategies for a large food retailer

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

INFORMATION-BASED SERVICES

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

LAST MILE

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

SUBSCRIPTION

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

PRODUCT DIFFERENTIATION

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

2. Identify new ways to win customers

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

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

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

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

Exactly which combination of strategies makes sense will clearly depend on the characteristics of your business and customer proposition and will be very different for different retailers, as Exhibits 1 and 2 suggest.

3. Think more like an agile start-up

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

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

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

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

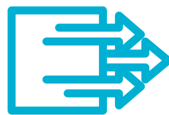
It takes time to develop new skills and capabilities, which makes it essential to figure out how to transform your business as soon as possible. Trial and error is a requirement when it comes to developing, testing, and honing new business models, so if selling through third-party channels will be

Exhibit 2: Example survival strategies for a large food retailer

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

THIRD-PARTY CHANNELS

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



ONLINE

Rapidly develop an excellent in-house online offering.

SUBSCRIPTION

Reduce the size of the store estate, keeping only flagship stores and showrooms.

part of the answer, start trying it now, even if you think demand will be initially low. If sophisticated data-based apps are going to become important, launch beta versions as soon as possible, even if at the beginning not many customers use it. Remember, there is simply no substitute for accumulated experience.

CONCLUDING REMARKS

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

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

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

FOOD WASTE AND FOOD SAFETY

Building a culture of food safety

Chris Baker
Hilary Thesmar

Global food safety in the retail food industry

When a food safety scare breaks, consumer trust erodes, and the entire food industry is affected. Selling safe, quality food has always been and will always be central to the food business. Food safety remains the retail food industry's number one priority. But the landscape is fast changing. New legislation and regulations, new technology, and new consumer demands are just a few of the big shifts facing the industry today.

More than 200 diseases are spread through food, and the CDC estimates that one in six Americans, or a total of 48 million Americans, fall sick each year from foodborne illness. Of these people, 128,000 are hospitalized, and 3,000 die.

A cautionary tale: Could this happen to you?

Two real examples of food safety issues and legal and criminal ramifications underscore the importance of this issue: Peanut Corporation of America and Jensen Farms.

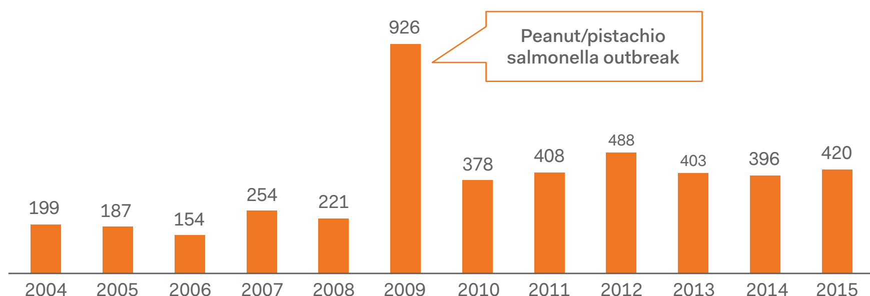
Peanut Corporation of America, (PCA) founded in 1977 and based in Lynchburg, Virginia, manufactured approximately 3% of the nation's processed peanuts. In 2008-2009, the U.S. saw a massive Salmonella outbreak that triggered the most extensive food recall in U.S. history. Nine people died as a result, and more than 800 people in 46 states fell ill. At the conclusion of the federal criminal investigation, the owner, broker, and food safety manager were each found guilty. PCA filed for Chapter 7 bankruptcy and had to close their operations. The former CEO was sentenced to 28 years in prison. The former PCA Quality Assurance Manager received five years. Those are the most severe penalties ever handed down in a U.S. food safety criminal case.

While Peanut Corporation of America may be an extreme example, Jensen Farms' contaminated cantaloupes provide another example from recent history. In 2011, 33 people were killed in a Listeria outbreak, and over 140 became ill. The FDA investigation found that packing and storage facilities were the likely sources of contamination due to unsanitary conditions and the inability to clean properly. The Colorado-based Jensen brothers received five years' probation, and each was ordered to pay $150,000 in fines and perform 100 hours of service. This was a rare move to charge, and it was intended to send a message to the industry about the serious nature of food safety and the consequences of the recent Food Safety Modernization Act (FSMA).

Exhibit 1 shows that total activity in recalls, market withdrawals, and safety alerts has increased over the last 10 years.

Exhibit 1: FDA Recalls

FDA-POSTED RECALLS, MARKET WITHDRAWALS, AND SAFETY ALERTS
NUMBER OF POSTINGS, 2004–2015



Source: FDA. 2015 number includes all recalls reported as of December 14, 2015

In this article, we would like to accomplish three things:

- Provide an overview of the food safety landscape
- Review key components of the Food Safety Modernization Act
- Highlight FMI's portfolio of resources and services that can help

UNDERSTANDING THE FOOD SAFETY ECOSYSTEM AND GFSI

Given the current focus on food safety in the food industry, it is important to understand the Global Food Safety Initiative (GFSI) ecosystem and know who the players are and how they relate to one another.

This ecosystem has been designed "by you and for you," and by extension, the consumer. Retailers and manufacturers ask their suppliers to have a food safety management system in place and to be certified, either through their own auditors or through third-party certification bodies. Most retailers and manufacturers ask their suppliers to comply with the standards and guidance set by the GFSI, founded in 2000 to standardize food safety codes. Underneath GFSI, there are a number of recognized food safety schemes that meet GFSI's standards. Typically, a retailer asks its suppliers to be certified by one of the GFSI-benchmarked schemes. Third-party certification bodies then execute and physically conduct plant and process audits to ensure compliance and certify the suppliers.

GFSI

Following a wave of food safety scares, GFSI was created by retailer members of the Consumer Goods Forum (CGF) in 2000 and serves as the umbrella under which food safety certification schemes fall. Its mission is to develop a set of global standards for food safety certification and provide a universal benchmark for all schemes. GFSI seeks to improve food safety outcomes, while reducing any duplication of effort by manufacturers and retailers that multiple standards would cause. GFSI is currently run independently from the CGF.

Food safety schemes

There are a number of recognized food safety schemes under the GFSI umbrella. A summary of the largest four schemes can be found in Exhibit 2.

Certification bodies

Suppliers pay certification bodies to conduct audits. The certification bodies are licensed by the schemes, but are independent. One certification body might be licensed for multiple schemes, which makes auditor training and competency hugely important.

Exhibit 2: Key recognized food safety certification schemes (as of 2014)

SUMMARY	Largest scheme with European hold	Fast-growing "system driven" scheme	German version of BRC	High quality scheme with limited reach
GEOGRAPHY	UK +114 other countries	US/Japan/ China/India/ Netherlands +135 other countries	Germany/France + 94 other countries	US/Australia/ Japan +43 other countries
SIZE & REACH (annual revenue)	~21,000 certificates	~8,000 certificates	~14,000 certificates	~6,000 certificates
TYPE	Product/process	System	Product/process	Product/process
KEY ELEMENTS	Annual full certification No document review	Full audit every 3 years	Annual full certification No document review No quality review	Annual full certification Document review Mandatory unannounced audits

FOOD SAFETY MODERNIZATION ACT (FSMA) OVERVIEW

What you need to know

Intended to provide important safeguards for consumer, the Food Safety Modernization Act (Public Law 111-353) resulted in the most expansive changes to food safety law since 1938. FSMA is intended to provide important safeguards for consumers, in part, by taking corporate criminal liability to a new level. Implementation of FSMA requires a culture change for retailers that process foods, have distribution centers, and/or import food, as well.

Signed into law in 2011, one key component of FSMA that is already in place is the expansion of FDA's increased records requirements and access to records, including the requirement that food safety records be provided within 24 hours of a request. Other provisions in place now include administrative detention of foods, mandatory recall authority of FDA, and facility registration and withdrawal of registration. FDA is currently finalizing regulations on seven major FSMA requirements including produce safety, preventive controls for human and animal foods, foreign supplier verification, and sanitary transportation.

The FSMA statute can be broken into three primary areas: prevention, detection, and imports. FSMA is intended to improve the capacity to prevent food safety problems via records inspection and other preventive controls; to detect and respond to food safety problems through increased inspection and laboratory accreditation, among other measures; and to ensure the safety of imported foods through foreign supplier verification and import certification.

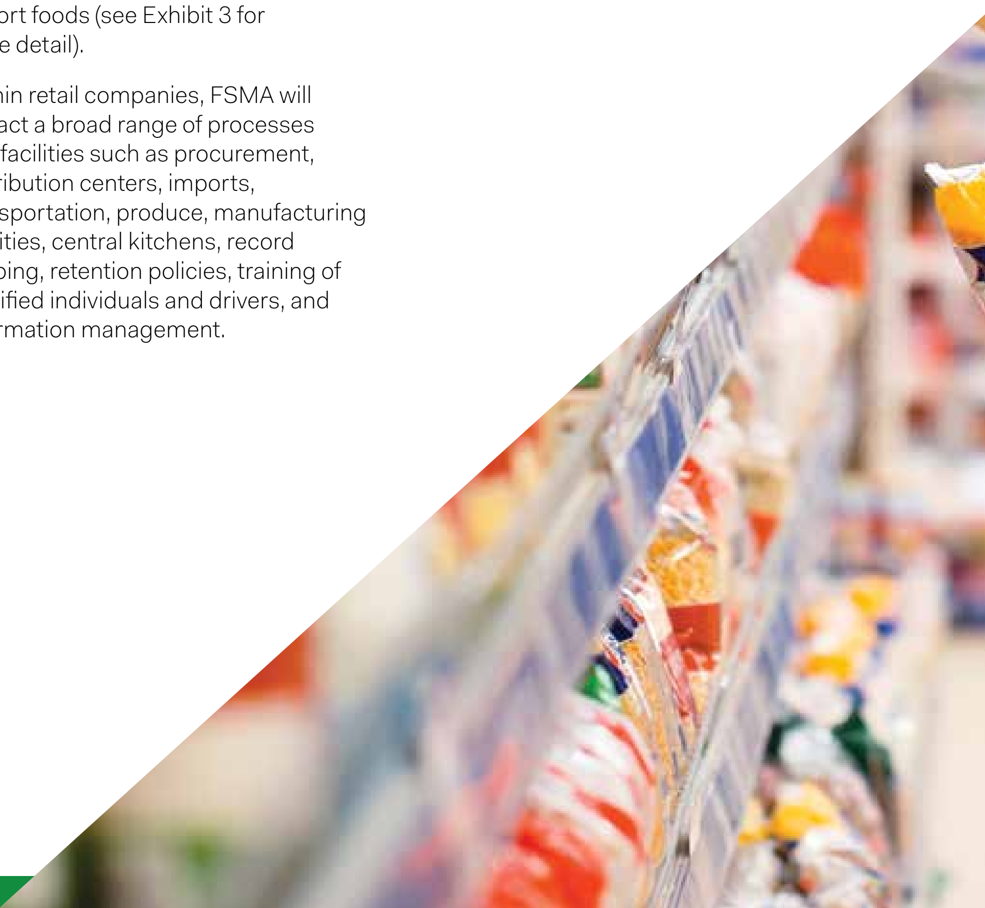
Exhibit 3: FSMA compliance by facility type for retail companies

FSMA Regulations	Retailer	Retailer: central kitchen or off-site production	Retailer/wholesaler: DC, truck fleet
PRODUCE SAFETY	■	■	■
PREVENTIVE CONTROL PLAN		■	■
FOOD DEFENSE PLAN		■	
SANITARY TRANSPORTATION			■
FOREIGN SUPPLIER VERIFICATION		■	■

For retail operations, the scope of FSMA requirements depends on the type of retail facilities. Stores have minimal requirements. FSMA regulations are most relevant to you if you have the following facilities or business operations: processing or central kitchens, warehouses or distribution centers, truck fleets or import foods (see Exhibit 3 for more detail).

Within retail companies, FSMA will impact a broad range of processes and facilities such as procurement, distribution centers, imports, transportation, produce, manufacturing facilities, central kitchens, record keeping, retention policies, training of qualified individuals and drivers, and information management.

Another important implication of FSMA is that the CEO or business owner is personally responsible for ensuring compliance. The majority of the new regulations took effect in 2015 with enforcement beginning in 2016.



7 questions to assess if your company is FSMA compliant

#1	Do you have an FSMA-implementation team led by senior staff across departments?
#2	Are your facilities in order and/or have you talked with your wholesaler?
#3	Do you have an implementation plan?
#4	Is your legal team up to date?
#5	Do your facilities need to change?
#6	Do you have the necessary recordkeeping?
#7	Do you have proper employee training in place?

5 key elements of a successful FSMA-implementation and change-management plan

FMI recommends building an FSMA-implementation team to ensure proper implementation and compliance with FSMA. Here are five steps to creating a successful change-management plan:

#1	Establish a sense of urgency and the case for change.
#2	Think about where your company needs to be to comply with FSMA.
#3	Build a diverse and senior team that can serve as the "FSMA change coalition." This team must have the authority to make decisions and implement key changes across the organization.
#4	Find places where you can kick-start the effort, make rapid progress, and achieve "quick wins" that can be communicated to the organization. Simply providing more transparency and ongoing communication about FSMA to your organization and your customers is a great place to start.
#5	Work over time to make sure that FSMA is not just a "flavor of the month," but rather a new way of working and an integral part of your culture.

Given how interconnected this topic is, the list of potential stakeholders to include is quite extensive. A carefully coordinated effort across functions is critical.

How FMI can help

FMI offers a one-stop shop to custom programs, training, and guidance on food safety to members and is available 24/7 to assist in crisis management.

FMI can help you understand the implications and requirements of FSMA or offer SafeMark® food safety training programs for retail associates. It can also provide template plans and records, best practice guides, factsheets, and summaries in addition to research and education through the FMI Foundation on food safety, nutrition, and health.

FMI-owned SQF Institute is one of the key recognized schemes under GFSI that is perceived to be the most stringent and highest quality. SQF is the only U.S. based GFSI-certified scheme and covers all aspects of the food supply chain and it is the only one with mandatory, unannounced audits and an additional quality audit. It requires a yearly full audit for re-certification and includes food packaging and distribution programs. Facilities already certified to SQF level 2 need only to add a few details to their existing processes and systems to be compliant with FSMA.

Exhibit 4: Summary of FMI's portfolio of services

OUR PROGRAMS

- FMI Center for Retail Food Safety and Defense
- Safemark®
- SQF
- FMI Foundation

OUR SERVICES

- FMI member 24 hour crisis support
- Rapid Recall Exchange
- ReposiTrak®

OUR RESOURCES

- Regulatory and scientific information updates
- Food safety resources, primers, templates, best practices

FINAL THOUGHTS

In closing, we would like to leave you with a practical checklist:

1	Is GFSI certification (e.g., SQF) in place for your suppliers and processing/manufacturing facilities?	☐
2	Is a comprehensive food safety training program in place?	☐
3	Does your organization fully understand the implications of FSMA?	☐
4	Do you understand your corporate liability?	☐
5	Do you have a "Food Safety Board" of key senior stakeholders to own this issue?	☐

Reducing food waste

HOW CAN RETAILERS HELP?

Stefan Winter and Frédéric Thomas-Dupuis

Sustainability is a high priority for most retailers, and food waste is an issue that is attracting significant political and media attention. Many individual retailers have launched programs aimed at addressing it, and some retail leaders have been particularly vocal, for example, in a 2013 article carried in the Telegraph, retail giant Tesco's CEO Philip Clarke declared "war on food waste," even if it meant reduced sales. And the industry as a whole has also responded – associations such as the Food Waste Reduction Alliance (FWRA) in the US, the Waste and Resource Action Program (WRAP) in the UK, and the Retailers' Environmental Action Programme (REAP) in Europe have all been established with waste reduction as their primary goal.

In a debate where emotions can run high, supermarket chains have often been cast as the villains. This characterization is unfair; over the past few decades, large retailers have achieved huge improvements in supply chain efficiency, and the proportion of food thrown away by today's supermarkets is small and getting smaller. Waste generated by retailers today is dramatically lower than it was a decade ago. Even so, there remains room for improvement, and much that can still be done. But waste at the retailer level is only part of the problem – in fact, it is the smallest part of the problem.

Food moves from "farm to fork." Broadly, it makes a journey in two steps: From the farm to the retailer, and then from the retailer to the customer. At the "farm" stage, overproduction, poor supply and demand balancing, and inefficient supply chains all contribute to significant waste. Although these losses can be large in volume terms, the fact that the product is at the beginning of the value chain means economic losses are less pronounced (although still considerable).

Upstream losses are substantial, but by far the greatest waste takes place at the "fork" stage. The fact is that the biggest wasters of food are consumers themselves. Losses in the homes and refrigerators of ordinary consumers have grown relentlessly over time, as disposable incomes have increased and lifestyles have changed. And because consumers are at the end of the value-added chain, the economic cost is enormous.

Exhibit 1: Typical causes of food waste

IMMEDIATELY POST-HARVEST	PROCESSING, PRODUCTION, DISTRIBUTION	RETAILER SUPPLY CHAIN	RETAILER STORES	HOUSEHOLDS
• Improper storage (temperature, humidity, vermin) • Spillage • Grading	• Disposal of product not meeting quality or cosmetic standards • Overproduction • Malfunctions • Spillage • Damaged or improper packaging	• Improper sales/demand forecasts • Overstocking of ultra-fresh products • Improper storage • Improper handling (e.g., temperature)	• Improper sales/ demand forecasts • Improper storage/ presentation • Improper handling • Quality/cosmetic standards of products without best-before date • Nearing of best-before date • Visual stocking criteria (full shelves)	• Overstocking • Not consuming in first-in, first-out order • Improper storage • Misinterpretation of best-before dates • Elevated quality/ cosmetic standards • Misjudged preparation volumes • Preparation mistakes

Of course, food retailers can't dictate customer behavior – but they can still influence how much ends up in the bin. Retailers can reduce not only the food waste they themselves generate, but also help their suppliers and their customers to do the same.

THE FOOD WASTE PROBLEM

Food waste is a significant problem. The United Nations Food and Agriculture Organization estimates that one-third of human food production is lost or wasted globally,[1] around 1.3 billion tons per year. Waste occurs in all parts of the value chain, from post-harvest processing through supply chain to stores and consumers.

It's important to acknowledge that not all food waste is equally costly, since a ton of produce lost immediately after harvest has much lower value added than the same ton of produce thrown away by consumers. The further down the value chain that food is wasted, the more costly it becomes, both in monetary and environmental terms; the economic impact of food loss at the consumer stage is a multiple of losses that occur upstream.

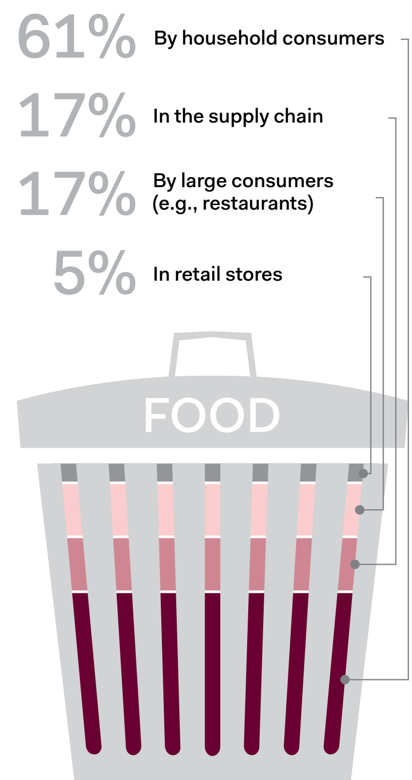
In developed economies, the fact is that the majority of the waste (both in value and volume terms) occurs at this level. In 2012, UK households wasted 19% of all food and drink brought into the home; 60% of this waste was avoidable.[2] Total food waste in Germany is estimated at 11 million tons per year, which amounts to around 286 lbs per capita. As shown in Exhibit 2, 61% of this is accounted for by the end consumer, 17% originates upstream in the supply chain, and only 5% is directly attributable to retailers.[3]

To a large degree, then, food waste is a problem caused by consumers rather than businesses. But although retailers' direct contribution to food waste may be relatively small, they are still clearly in a position to help their customers waste less – a key point we will return to.

DRIVING DOWN TOTAL SYSTEM WASTE

Waste is a problem for retailers, but it is not a retail problem per se: it is a system issue. Each part of the chain from "farm to fork" plays its part, for good or bad. In addition, from an environmental perspective, food waste could quickly become a problem with landfill bans on food products for retailers. Retailers can take a leadership role, not only by addressing their own shortcomings but also by helping other players in the system to improve. Reducing total system waste is the goal, and retailers are in a unique position to contribute towards achieving this goal.

Exhibit 2: The majority of food wastage in Germany is by household consumers



Source: 2012 Study by Stuttgart University, sponsored by German Federal Ministry of Food and Agriculture

[1] Food loss is defined as the mass of edible product meant for human consumption that is redirected from human consumption upstream of retail in the food chain, whereas food waste is the loss occurring at retail level and downstream; for simplicity, we have subsumed both types under "food waste."

[2] Wrap Report: Household Food and Drink Waste in the United Kingdom 2012).

[3] 2012 Study by Stuttgart University, sponsored by German Federal Ministry of Food and Agriculture.

Reducing waste within the retailer

As we mentioned earlier, waste at the retailer – either in the supply chain or in stores – is not the primary contributor to total food waste. One reason is that food retailers have grown to a much larger scale. As Exhibit 3 shows, perishables waste decreases dramatically as a function of sales volume: in our experience, a doubling of store sales reduces the proportion of waste by between 20% and 40% (assuming the assortment stays constant). This implies that today's high-volume grocery stores are much more efficient than their smaller predecessors, and underlines the critical role that volume plays in the fresh food business.

But although they achieve high levels of efficiency, most retailers still operate with significant fresh wastage levels. It is difficult to keep an accurate account of all types of waste in the system – known and unknown – and only a minority of retailers have true transparency over the real volume lost. Depending on the product category and store, waste as a percentage of sales can range from the low single digits up to the high teens. For many retailers, then, there remain significant opportunities to reduce waste, and to generate significant profit increases at the same time.

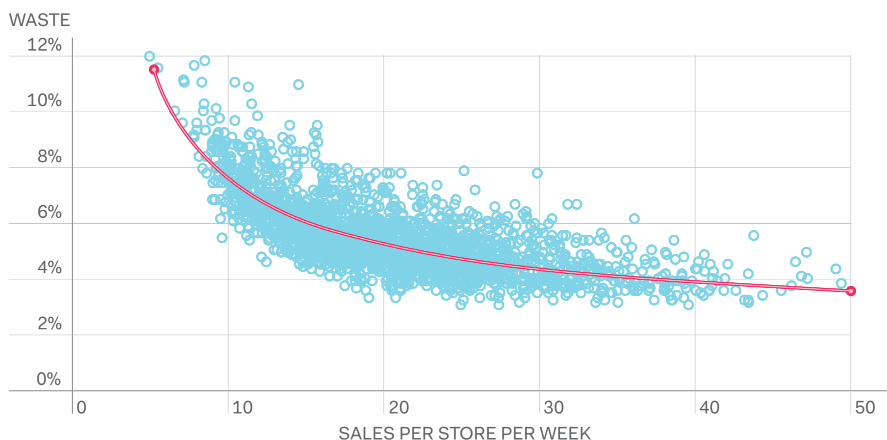
In our experience, there are three changes that can deliver big benefits:

1. Get the right volume into stores at the right time

The closer the match between customer demand and the volume of product in the store, the lower the potential for waste. Clearly, all food retailers take forecasting and ordering seriously – but the difference between being "OK" and being "best in class" is significant. Some retailers still rely upon relatively

Exhibit 3: Higher-volume grocery stores operate at lower waste levels

Examples of waste in fresh categories across one retailer's store estate



basic approaches, such as paper-based order books in the stores. This leaves considerable room for improvement – in some cases translating into reductions in waste of up to 35%, with corresponding benefits to earnings, both in the form of reduced losses and the avoidance of lost sales, and the difficult-to-quantify, but nonetheless real, customer perception benefits.

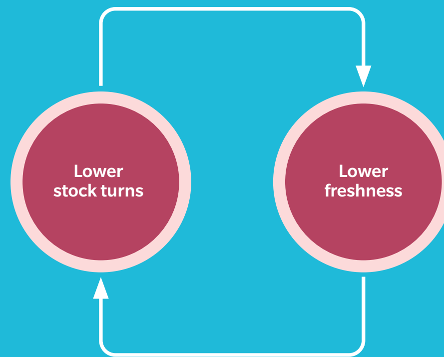
Of course, improving forecasting and ordering aren't easy, and present some real systems challenges. But it is often possible to make material gains without undergoing radical surgery, for example, by giving stores more accurate forecasts, and better information and guidance when placing orders, or by improving operational practices within the store.

2. Consolidate range where this will improve freshness and reduce waste

Retailers always want to offer customers the best choice, but before adding a new stock-keeping unit (SKU), it's vital to consider the freshness and shrink implications for the range as a whole. For a given level of store traffic, there is a limit to the breadth of the perishables range that can be on sale without producing massive increases in waste. The key is to avoid offering so much choice that the rate of sale of slower-selling products drops below a critical level. Getting this wrong initiates a vicious circle, as shown in Exhibit 4, in which lower stock turn translates into worse freshness, and worse freshness translates into even lower stock turn, with disastrous implications both for sales and for the level of waste.

In particular, adding products that are duplicative with existing choice, products that the consumer sees as interchangeable, is a sure-fire way of reducing overall stock turn and increasing waste. In retailers with significant waste problems, then, re-examining the range and deleting slow-moving tail products that are highly substitutable will normally drive a significant improvement as sales are consolidated onto remaining lines, driving increased turn, reduced wastage, and increased freshness for customers.

Exhibit 4: Low rates of sale on fresh items initiate a vicious circle



3. Optimize handling of best-before dates

Another source of retailer waste is allowing multiple "best-before" or "use-by" dates on the shelf, which leads to "date sorting" by consumers and an inevitable trip to the bin for the product with the shortest life. The confusion surrounding "best-before," "use by," and "sell by" dates has serious ramifications on food waste. FMI research suggests that confusion about dates drives 9 out of 10 Americans to throw food out unnecessarily on occasion, costing the average family hundreds of dollars per year. This presents a dilemma when it comes to reducing food waste; some of the strategies available might be profitable for the retailer, but effectively just shift the problem onto the consumer and ultimately generate even more waste downstream.

Dealing with forecasting and assortment is a prerequisite for solving the "best-before" conundrum. Better forecasts and a "right-sized" assortment mean that lower levels of safety stock can be held, which means less product and fewer date codes on the shelf.

Beyond this, better operational discipline is the key – strict stock rotation, and tight replenishment practices, which ensure that the product is only taken from the back room to the shelf when existing stock has almost sold through.

Another option for managing waste can be in-store production. Where the operating model allows, perishables nearing the end of their life can be transformed into a ready-to-eat product in store, for example, through a salad bar or as part of a store-produced convenience range. Of course, in-store production is complex and labor-intensive. It can generate even more waste if poorly implemented but, for some stores, it may offer a significant opportunity.

HELPING SUPPLIERS WASTE LESS

Retailers have only an indirect influence on how much food is wasted by their suppliers, but because the absolute level of waste is usually greater, it can nonetheless be a big opportunity. Since retailers' choices can have a strong effect on many of the drivers of waste, they can make a good claim to a share of the cost savings that can be achieved.

In our experience, two initiatives that do not require significant capital investment, but which often produce significant gains, are collaborating on demand planning and better management of grading requirements and quality control.

1. Collaborate on demand planning

When it comes to demand planning, suppliers and retailers sometimes operate at arm's length. While not always easy to achieve, closer collaboration can help reduce waste by helping suppliers cope with the volatility of and uncertainty in demand for their products.

There are three reasons that fresh food categories present particular challenges for suppliers. Firstly, underlying demand, and sometimes supply, tend to be extremely volatile, for example in produce, where the weather has a strong effect on both harvests (and therefore product supply) and customer demand.

Secondly, promotions generate demand spikes that create a "ripple effect" throughout the supply chain and cause inventory build-ups, overages, and, ultimately, waste.

This affects not only the promoted items themselves, but also other products that are "cannibalized" and suffer an unexpected drop in demand as customers switch to the product on promotion.

Thirdly, trading events such as range changes, or changes in which products are distributed to which stores, occur frequently in fresh categories. These often impact the demand mix of the entire category.

Suppliers therefore face a lot of uncertainty about how much product they will need to provide. To avoid being caught out by changes in volume and to maintain a high service level for the retailer, producers feel the need to keep safety stock on hand, or require long lead times. Both have a detrimental impact on freshness and, ultimately, on food waste.

Reducing this uncertainty can create benefits for suppliers, retailers, and consumers alike. For the supplier, it means lower inventory costs and a better ability to plan production. For the retailer, it means fresher product, less waste, and better in-stock position, resulting in higher margin and more sales. And for the consumer, the product is fresher and keeps longer.

Better collaboration and information sharing is the key to achieving this. Most retailers use forecasting to drive their replenishment; sharing these forecasts in advance with suppliers will take out the guesswork for them. And at the same time, systematically measuring cannibalization during promotions gives both retailers and their suppliers a better idea of which products are likely to be affected, further reducing uncertainty about levels of demand.

2. Manage grading requirements and quality control

Stringent grading requirements are a significant contributor to waste in the supply chain, although they aren't as disastrously wasteful as is popularly believed. Manufacturers of processed foods themselves demand massive quantities of fresh products, so it clearly isn't the case that every apple or potato rejected by a supermarket on cosmetic grounds gets thrown away. Nonetheless, by loosening such rules, retailers can help their agricultural suppliers sell more of their products, and hence reduce waste.

Managing grading rules to allow more variation has been on the agenda for some time, but there are also opportunities to

address genuine quality differences. A tiered range architecture – with entry-range, own-label, branded, and premium products – has long been in place for many product categories. In fact, some retailers already offer different grades of produce, with lower-quality options selling at a considerably lower price point than the premium offer while keeping the overall margin mix of the category attractive.

However, stringent grading requirements are not the only reason that product gets rejected by retailers. Often, product is sent back at the receiving dock because of process failures. Standards are sometimes not sufficiently clearly defined or communicated. Sometimes changes to quality standards are agreed throughout the season between buyers and suppliers but may not filter through the retailer's internal communication channels. And in some cases, stores and depots use different criteria when deciding whether to accept or reject a batch.

A best-practice quality control process is key to ensuring that product is never rejected without good reason, while maintaining the highest standards of quality and food safety. This requires clearly defined and transparent standards, consistently communicated and applied throughout the entire value chain, from producers via distribution channels to stores and, ultimately, consumers.

Exhibit 5: Importance of access to quality fresh food

Proportion of consumers that say access to the best quality fresh products is the most important consideration when choosing where to shop

COUNTRY	PROPORTION
United States	70%
United Kingdom	60%
France	52%
Germany	43%

Source: Oliver Wyman Fresh Survey and Analysis

HELPING CUSTOMERS WASTE LESS

Most food waste happens at the consumer end of the value chain. But it's important to acknowledge that much of it is the result of deliberate choices rather than simple negligence.

Where this is the case, it may be very difficult, inconvenient, or costly to reduce. For example, shopping for groceries every day would reduce waste but would be a lot less convenient than buying food for several days at a time, even though some of it might then spoil.

It's therefore important to distinguish between "structural" waste, where customers' lifestyles and choices make some level of waste inevitable, and "preventable" waste, such as throwing away food after forgetting it was in the fridge and buying something else instead. As retailers look to help their customers reduce waste, it makes sense to focus on the latter and to recognize that, precisely for the reason that most food waste occurs in the home, there are likely to be real constraints on how far it can be reduced.

Grocery chains are sometimes accused of having a strong vested interest in consumers wasting food. We fundamentally disagree with this view, and see reducing waste as more of an opportunity than a threat for retailers. Any risk of lost sales is small and helping customers waste less will always be a slow and gradual process, which will need to be achieved in spite of rising incomes and more diverse lifestyles.

Meanwhile, the demand for fresher, higher-quality food continues to increase, and providing it becomes an ever stronger source of competitive advantage. Exhibit 5 shows how important access to the best-quality fresh products is when customers are choosing where to shop. And although consumers might struggle to waste less food, this doesn't mean they don't acknowledge or appreciate retailers' efforts to help them.

At a simple level, there are two ways in which retailers can help customers reduce waste:

1. Have fresher products with longer life on sale in stores

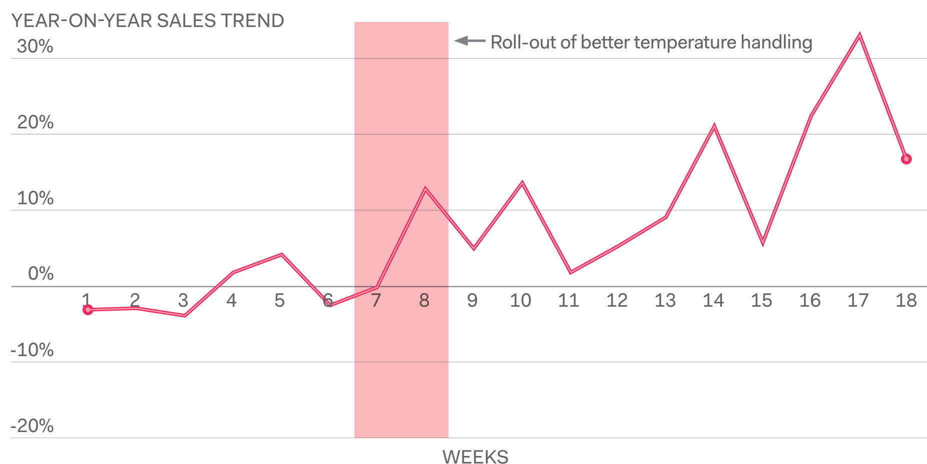
Consumers often plan meals in advance but their plans can change. As a result, a lot of consumer wastage is driven by insufficient freshness upon time of purchase, and not giving customers long enough in which to consume the product and thus building inflexibility into their meal planning.

Improving freshness on the shelf usually requires improving product velocity and handling through the supply chain. In fact, developing a faster, more sensitive supply chain reduces waste not only for customers, but also for retailers and their suppliers. Why? Because there are two fundamental drivers of food waste in the supply chain.

The first driver is the time spent between production and the product getting to the shelf; every hour and every day spent in the chain reduces the life of the product and makes it more likely to end up being thrown away. The second is how the

Exhibit 6: Better temperature handling of bananas can dramatically increase sales

Year-on-year sales trends for bananas at one retailer



product is treated: many fresh products are highly sensitive to poor handling, so quality can suffer as a consequence of improper treatment in the supply chain. These fundamental drivers have a powerful effect on how much food ends up being thrown away by customers, as well as how much is wasted by retailers and their suppliers.

Fresh product can spend too much time in the supply chain for a number of reasons. Too much inventory in the supply chain will mean that product doesn't turn fast enough. The number of distribution tiers in the supply chain also affects its speed; bundling distribution platforms can help consolidate inventory at a single point and reduce it in total. Receiving, picking, and delivery are organized on a recurring schedule, and this can mean time is lost by product sitting and waiting for the next process cycle to start.

Better synchronization can speed things up and improve freshness, for example, optimizing delivery frequency to stores or synchronizing warehouse receiving times with suppliers' operating schedules. In an ideal world, a strawberry can be picked from the field in the early morning hours, arrive at a retailer's depot before midday, be delivered to the store in the afternoon, and be purchased by a customer that same evening.

How product is treated in the supply chain is a second key driver of waste. Fresh product can often be very sensitive and when handled improperly, the quality suffers. This can lead to the product ending up as waste either directly, because it becomes unfit for sale, or indirectly, because its life is reduced. Right treatment starts with the right packaging.

Many fresh products have specific temperature requirements; for certain products, such as meat, maintaining a continuous cold chain is legally mandatory and essential from a health and safety perspective. No retailer would risk any compromises here. For items such as produce, however, there are no legally binding requirements in most countries, and retailers often strike a compromise between quality and cost. Often this trade-off is made giving insufficient consideration to quality implications, for example, bananas sustaining damage while being transported or stored too cold, or bread being exposed to moisture condensation as it moves between two temperature zones.

Retailers who have focused on treating product the right way have often found that increased sales (see Exhibit 6 for an example) and reduced waste have outweighed any investment in supply chain cost, at the same time as conferring a significant competitive advantage. And the product is much less likely to be thrown away once in the possession of the consumer.

2. Help customers buy only what they will eat

Wastage by customers can be reduced if customers buy only the products they will need. Today, this is not always straightforward. Large pack sizes and multi-buy promotions on perishable products can mean customers have little choice but to buy more than they need or, retailers can make it so cheap that customers buy food on the off-chance that it might get eaten.

As well as offering smaller packs and reducing multi-buy promotions, retailers can also offer more in-store food counters and loose (rather than pre-packaged) produce, so that consumers can select the quantity they need. Another approach is to construct a product range that explicitly offers different levels of ripeness, for example both a "ready to eat" SKU and a "ripen at home" SKU.

Beyond this, technology may provide additional opportunities to help customers avoid buying more than they need. Smartphones are one example: their widespread use can offer new ways of helping customers reduce waste. Menu planning and shopping apps are still at a relatively early stage of development but, in the near future, they will be much more widely used, especially by customers keen to waste less food.

Many retailers already offer such apps, but there remains scope to innovate, perhaps by designing sets of recipes that "plan for leftovers" and suggest flexible ways of using them. Apps that can remind customers about food that will soon need using are another possibility – and not as far-fetched as it might sound, considering the role that smartphones can play in self-scanning and online shopping.

CONCLUDING REMARKS

Food waste is already a hot topic, and its importance is only likely to grow. Jürg Peritz, former member of the Executive Committee of Coop in Switzerland and fervent champion of sustainable grocery retailing, said in a recent interview: "Customers care [about sustainability] today, and will care even more tomorrow. The chance for retailers to differentiate themselves and their brand is enormous."

Retailers have made great strides in reducing the amount of food that is wasted in their stores and distribution networks but there is still more that they can do: better forecasting, more careful assortment decisions, and more discipline around best-before dates can deliver significant reductions in waste. At the same time, retailers can help suppliers reduce waste through closer collaboration on demand planning, and tighter management of grading and quality control decisions.

More importantly, retailers are uniquely placed to help customers reduce the amount of food wasted in the home. The key here is to improve freshness and quality by increasing speed through the supply chain and by ensuring that food is properly handled at each stage. Retailers can also help customers avoid buying too much food by offering a more carefully tailored assortment and smaller pack sizes, and cutting back multi-buy promotions on perishable items. And in the future, menu planning and shopping apps are likely to offer further opportunities to help waste-conscious consumers.

The good news for retailers is that reducing waste in stores and the supply chain usually means lower costs, and can often be achieved with very little investment. Meanwhile, helping customers reduce waste by increasing product freshness and shelf life represents a significant improvement in the customer proposition. Ultimately, then, reducing food waste isn't just the right thing to do – it's often the profitable thing to do as well.

CYBER AND CRISIS

Crisis management in food retail

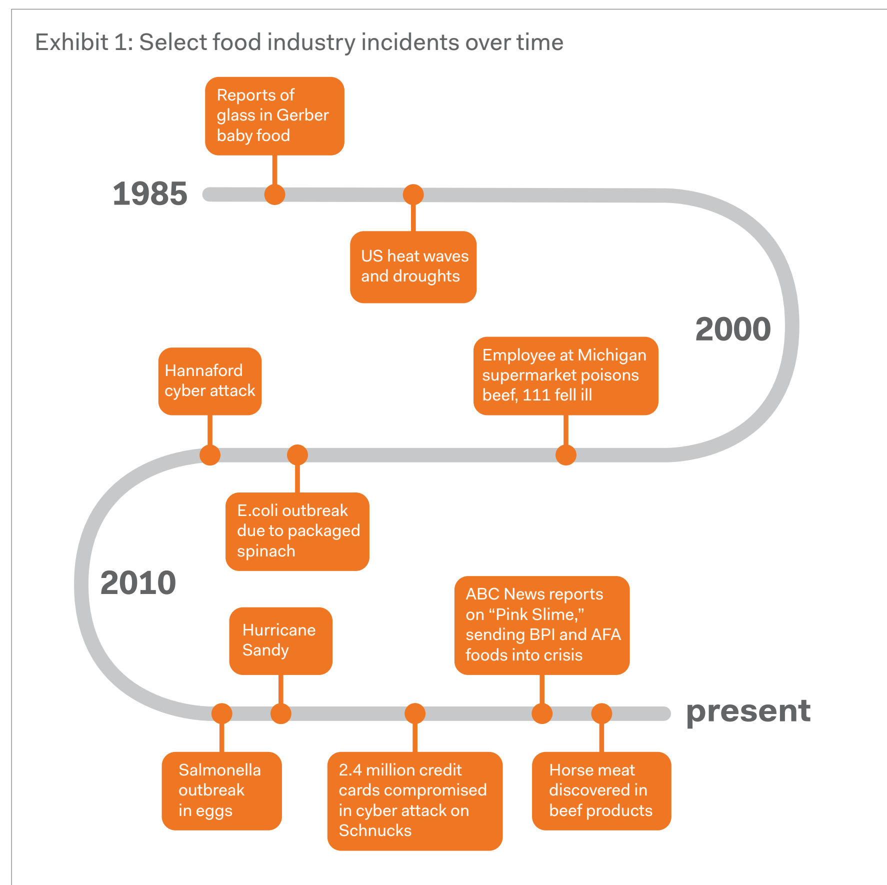
Davia Temin
CEO,
Temin and Company, Inc.

Anticipated or not, when a crisis strikes a company, CEOs must be prepared to respond immediately in order to lead their organizations through a potentially catastrophic event. Within the last 5 years alone, the food industry has been at risk for a wide spectrum of crises, including E. coli and norovirus outbreaks in fresh food, cybercrime such as high-tech SQL injection attacks aimed to steal customer data, natural disasters, and traditional and social media public relations disasters. While there are certainly aspects of a crisis response that can be planned in advance, each incident inevitably requires a unique approach.

In many crisis situations, the reputation of a company hangs in the balance and can literally vanish overnight if the crisis is not addressed immediately and correctly. The expansion of social media in recent years has exacerbated this trend, bringing widespread, factually incorrect, and damaging attention to issues such "pink slime" and the presence of horse meat in beef products. These issues have gone viral and, in some cases, pushed companies to the brink of bankruptcy. Interestingly, reputation is rarely the top priority identified by a crisis incident response team. However, given how quickly exaggerations and mistruths spread, reputation does need to remain top-of-mind for every executive in a crisis.

The value of a brand can be maintained or eventually rebuilt, but doing so requires careful management of the crisis itself, and its aftermath. In some cases, if done well, a company can even use a crisis as a pivot point to advance its reputation to a greater level than pre-crisis. Creating a comprehensive crisis preparation plan, correctly managing the event itself, and recovering in the right way can help to protect your brand as well as your organization.

Exhibit 1: Select food industry incidents over time



ACTIONS TO TAKE IN THE MOMENT: LIVE CRISIS MANAGEMENT

When my crisis management firm, Temin and Company, was asked to present one of our ©Crisis Games – live simulations of an unfolding crisis management case – to the Food Marketing Institute, we recruited 12 FMI Board members to participate in the role-play scenario. As I unfolded our several-act case, board members engaged in debate on how to best set strategy and navigate internal and external communications in a constantly worsening situation.

My goal: bring to light in real-time the importance of a series of our crisis management imperatives, especially around strategy, resilience and maintaining public trust. Through the exercise, the executives uncovered the importance of:

- Maintaining a staunch acceptance of reality, as denial is the worst position to take in a crisis situation;
- Embodying a corporate and individual purpose greater than yourself throughout the crisis; and
- Retaining the ability to improvise, and surrounding yourself with a team that can think around obstacles in a non-formulaic way.

In the case, I helped participants think about the appropriate set of executives to comprise the crisis response team – including, usually, CEO, Board, legal counsel – and we concluded that the team should not necessarily follow the organizational chart. A response team must be comprised of members who can think fast and think right, and then can communicate to the public in the right words at the right time.

The dialogue highlighted 13 of Temin and Company's key "©Crisis Management Guidelines":

ONE: Information has become democratized and is generally available to the public and other stakeholders. Given the transparency of the world today, **assume that all will be known**, and design your actions accordingly. This not only applies to social media, but to private communication in boardrooms and by telephone, email, and text. Emails, texts, and even voicemail messages are discoverable in a lawsuit and you must prepare all communication to withstand public scrutiny.

TWO: Control your emotions and always think strategically and intelligently. The mere fact that you can be calm in a crisis will give your employees and customers confidence in your leadership. Take the time to find advisors you can trust – those who have experienced your problem before – and listen to their advice.

THREE: Keep your eyes on the outside. It is easy to go into endless internal meetings and forget that you need to address your problems publicly. It's important to go against your instincts and make sure your eyes are turned outward, as well as inward.

FOUR: Move quickly to assess the situation and damage, and not only strike the right note publicly, but also start to do the right things. As communications travel at the speed of light, you need to respond to brand-threatening crises almost immediately. Remember the Tylenol crisis that everyone quotes as an example of superb crisis management? Well, if a company today took the time that Tylenol did to respond, it would be seen as a failed exercise.

FIVE: Figure out what the right message, tone, words, and delivery mechanism are. Perception trumps reality most of the time, especially in times of crisis. So, addressing the public's perception of your crisis is always a good place to start, but not end.

SIX: Never make a public denial when it's a lie – there is no better way to lose credibility and be hated. Furthermore, when making a denial, never repeat the allegation. Make a positive comment and focus on what you are doing to fix the problem.

SEVEN: Each crisis is different, and the particulars matter. Never copy the responses of others, though you can learn from those who have done it well. If you respond to your crisis in the wrong way, based solely upon someone else's experience, you could be making a tactical mistake that will hamper your efforts in the future.

EIGHT: Limit your liability, but not your humanity, in how you respond to a situation. So many times in crises, leaders will excuse their own bad behavior or their insensitivity to those also affected. However, it is in times of crisis that you must channel your highest self. All eyes are on you as you seek a way to solve the issues and **keep the business going without sacrificing your values and your humanity.**

NINE: Use the opportunity to reset your moral compass. **Morality does matter, and yours will show itself under pressure.** This is where true leaders assert themselves and their sense of right and wrong. Even in complex situations, if you can figure out what the high road is, take it. In the long-run, it will be to your and your organization's benefit.

TEN: If you must, **apologize, make reparations, and then put in lasting, game-changing solutions.** America loves a "comeback kid," and consumers will often cut you a break if you come clean and begin to fix a problem situation. But you can only regain trust once. If you repeat the mistake, the public's trust will be gone for good.

ELEVEN: Become a visible and real part of the solution, no matter what it takes. You have an opportunity to become part of the "cure" after a reputational misstep. Take it, because that can change the game for your organization. This provides a fantastic chance to stand out from your peers in a positive way.

TWELVE: Begin to be identified with best cases so that your own "worst case" is forgotten over time. The public can have a conveniently short memory, especially if you have come back from a reputational crisis with honor. Not only learn from your crisis, but embody the fix. That is what will be remembered. That is what your legacy will be.

THIRTEEN: Never make the same mistake twice.

ENHANCING FOOD RETAILERS' ABILITY TO COMMUNICATE IN A CRISIS: TOPLINE STEPS TO PREPARE FOR AND MANAGE A CRISIS

Part 1: Discovery | Readiness

Crisis management solutions allow the retail food industry to handle unexpected events that could harm people or property, damage reputation or seriously interrupt business. Although crises differ in origin, severity and the factors that are beyond your control, a crisis management plan is the first step to lessening and navigating a challenging situation.

Prior to a crisis, your organization should identify its "preparedness team." Each team should include a spokesperson, an alternative spokesperson, a media monitor, and a social media monitor.

It is also critical to build and maintain relationships with local, state, and federal partners. These relationships can be formed and strengthened through ongoing personal outreach and information exchange. This will be invaluable when a crisis hits, as you will already have a working knowledge of the resources available to your company.

External crisis preparedness has evolved significantly in the past several years, and companies need to utilize various types of communication platforms to remain relevant to a diverse customer base. This includes media training and preparedness for traditional platforms, such as television and radio, along with establishing a meaningful presence on social platforms and configuring messages and statements for release on Twitter, Facebook, and other "new" media outlets. Each company is encouraged to develop a corporate social media policy, and leverage social media to disseminate messages, monitor customer opinions, and engage in action plans.

Furthermore, companies should plan to allocate resources to frequently communicate status in a crisis, for example, by creating a temporary website as an up-to-the-minute online resource center for the community.

Part 2: Action | Responsiveness

The development of employee and customer communication strategies and protocols is key to an action plan. These strategies should focus on how to approach customers during a crisis. Companies must carefully balance proactive and reactive communication strategies.

Within the proactive strategy, timing and consistent messaging are paramount. Real-time updates via Twitter and Facebook must align with media reports, press conferences, and official announcements on Ustream or YouTube.

From a reactive perspective, it is important to identify the key messages your company wants to disseminate during the crisis and remain aware of timing in order to get in front of the story and refocus coverage.

Part 3: Recovery

After a crisis has subsided, the recovery period provides opportunities to reconnect with customers to reestablish trust and further develop your reputation. Reinforce messages and promises with employees and customers, and consider hosting a "lessons learned" debriefing with the press.

Promote your role in the recovery through an editorial follow-up or a case study. Most importantly, however, internally assess your results and performance and adapt plans as necessary to ensure that your company is better prepared moving forward..

FMI'S CRISIS SUPPORT

To best handle a crisis when it happens, the most equipped teams invest time in preparing, planning, testing, and practicing for various scenarios that may one day happen to or involve their food retail location. FMI can help you in this process.

To better help you prepare for a crisis or assist you during one, FMI has been working consistently on:

- Identifying needs, issues, and opportunities related to immediate and potential public concerns regarding the food retail industry;
- Identifying controversial or crisis issues that directly affect the reputation of the food retail industry; and
- Identifying effective, proactive public relations techniques and communications strategies appropriate for the food retail industry.

FMI will continue to support its members in crisis scenarios. More information, including FMI's crisis communication manual and toolkit, can be found through the FMI website.

Temin and Company is a boutique management consultancy focused on crisis and reputation management; marketing through ideas, information, expertise and intellectual capital; and leadership and communications coaching at the highest levels.

Cyber security

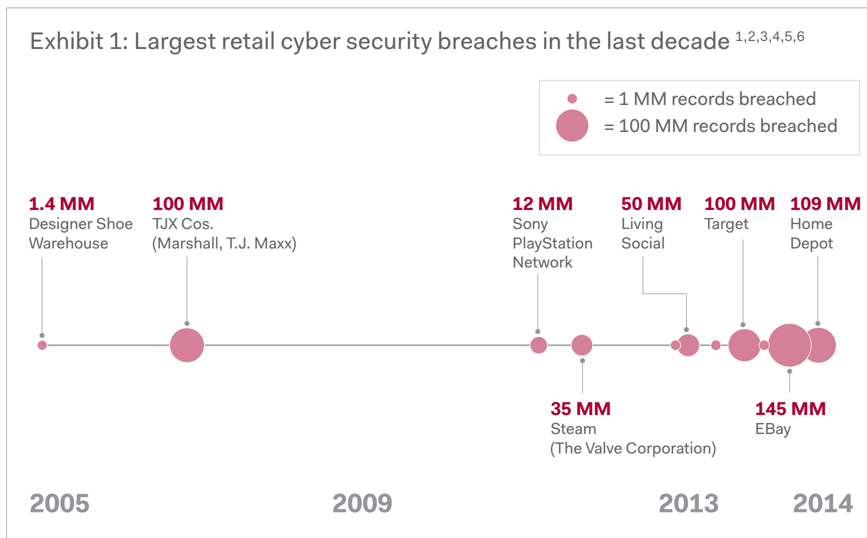
WHAT MITIGATION STRATEGIES SHOULD BE CONSIDERED?

Raj Bector

For many retailers, the question is no longer if they will sustain a cyber attack, but when. The World Economic Forum's 2015 Global Risks Report ranks cyber attacks as one of the top 10 risks most likely to cause a global crisis. Furthermore, it was ranked as the top risk for which North American survey respondents felt their countries were least prepared.

In the past decade, the frequency and magnitude of cyber attacks have steadily increased, as seen in the timeline below. In the retail sector alone, a 1.4 million record attack on Designer Shoe Warehouse in 2005 gave way to 100 million, 109 million and 145 million record attacks on Target, Home Depot, and eBay, respectively in 2013.

Exhibit 1: Largest retail cyber security breaches in the last decade [1,2,3,4,5,6]



As the quantity of data maintained by companies increases, so does the impact of a breach. In 2005, TJ Maxx paid $9.75 million in damages stemming from their failure to protect 100 million customer records.[7] In contrast, Target's 2013 breach, involving roughly the same number of records, has already cost the company some $162 million.[8] An attack may be inevitable, but company-specific mitigation strategies can and should be deployed to reduce the likelihood of a crippling financial blow.

[1] Verisk, The Far-Reaching Effects of a Data Breach, January 20, 2014

[2] Reuters, Sony PlayStation Suffers Massive Data Breach, April 26, 2011

[3] CNET, Livingsocial Hacked; 50 Million Affected, April 26, 2013

[4] USA Today, Target Confirms Massive Credit-Card Data Breach, December 19, 2013

[5] Reuters, Hackers Raid eBay In Historic Breach, Access 145 Million Records, May 22, 2014

[6] CNBC, Year of the Hack? A Billion Records Compromised In 2014, February 12, 2015

[7] LA Times, TJX Agrees to Pay $9.75 Million to 41 States in Data Breach Case, June 24, 2009

[8] TechCrunch, Target Says Credit Card Data Breach Cost It $162M In 2013-14, February 25, 2015

DIMENSIONS OF CYBER RISK MANAGEMENT

As companies increasingly turn to technology to drive growth, whether through eCommerce or loyalty programs, the amount of data being handled by retailers has proportionately increased their liability from an attack. Highly publicized data breaches of superstores like Target and Home Depot have underscored the importance of addressing cyber security. Everyone in the organization now has a role to play in preparing for, preventing, detecting, responding to, and recovering from a breach. It is no longer a matter solely for the IT department. Given the ubiquity of technology across enterprises, the complexity of attacks, and the sophistication of vectors used for an attack, effective cyber risk management requires a holistic, structured approach to the physical and virtual protection of corporate assets.

Cyber risk management lies at the intersection of information security, business continuity planning, disaster recovery, crisis management, and enterprise risk management. Both large and small organizations have some form of these components in place; the challenge is integrating them into a comprehensive cyber risk management approach comprised of the following dimensions:

1. **Strategy and Governance** – determining the company's risk appetite (the amount and type of risk that an organization is willing to assume in order to meet their strategic objectives); how the Board will oversee cyber; Board and C-Suite cyber metrics and reporting requirements; parameters of an enterprise cyber security program; priorities of assets to protect, and risk retention and transfer profile (moving risk to another party, such as through insurance contracts)
2. **Policy** – creating a specific set of enterprise-level policies designed to direct the organization towards the defined cyber risk management strategy
3. **Organization and Workforce Development** – defining and aligning the workforce via structure, decision rights to enable policies, skill requirements, and training
4. **Procedures and technology** – creating the administrative, physical, and technical controls (processes and tools) that empower employees to help protect the enterprise against cyber threat and detect and respond to cyber events

Implementing an effective cyber security strategy requires the flexing of collective muscle across the business. The size of the organization will guide which dimensions are emphasized, but does not eliminate the need for a comprehensive strategy.

THREAT PROFILE TO THE RETAIL INDUSTRY

To understand how retailers can defend against cyber attacks, it is important to understand how these attacks are perpetrated. The majority (83%) of attacks are facilitated by outsiders, most commonly (26%) by a sustained probe or scan. The success of these types of attacks can be significantly diminished through basic computer security hygiene, such as requiring frequent password changes, increasing password complexity (the popular 'dictionary attack' is a sustained use of common words and phrases to try to gain access), locking down firewall ports and platform configurations, and managing software patches.

Mitigation strategies

For retailers, most breaches occur in Point of Sale (POS) systems. There are several technologies used to relieve cyber security pressure points.

Retailers can ensure that they work with payments partners who use these (or similar) technologies to protect customer data. Some retailers have added additional security measures at the POS to strengthen and increase the breadth of encryption. However, this is not a comprehensive solution, as some attacks penetrate the POS and plant malware that intercepts payment information after the chip and PIN stage – exactly what occurred in the Home Depot case. A cross-enterprise strategy, encompassing vigilant and trained employees, coupled with effective detection technology, is essential for safeguarding cyber assets.

Larger organizations are beginning to integrate cyber security into existing risk frameworks. Starting with senior leadership, companies are increasingly establishing the position of Chief Information Security Officer (CISO) separate from the Chief Information Officer (CIO). The CISO is responsible for these issues at the executive level, along with cyber security operations centers to monitor network traffic, manage security sensors, maintain and monitor system logs, and react to real-time alerts of potential security events.

Exhibit 2: Most common types of cyber attackers in retail and their methods[9]

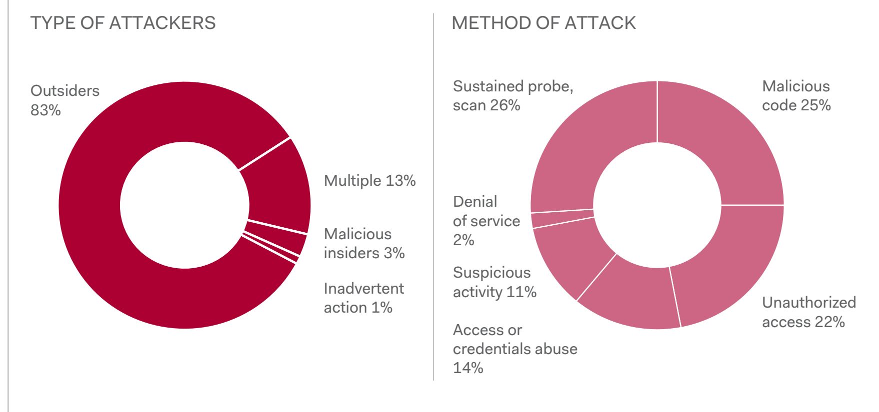
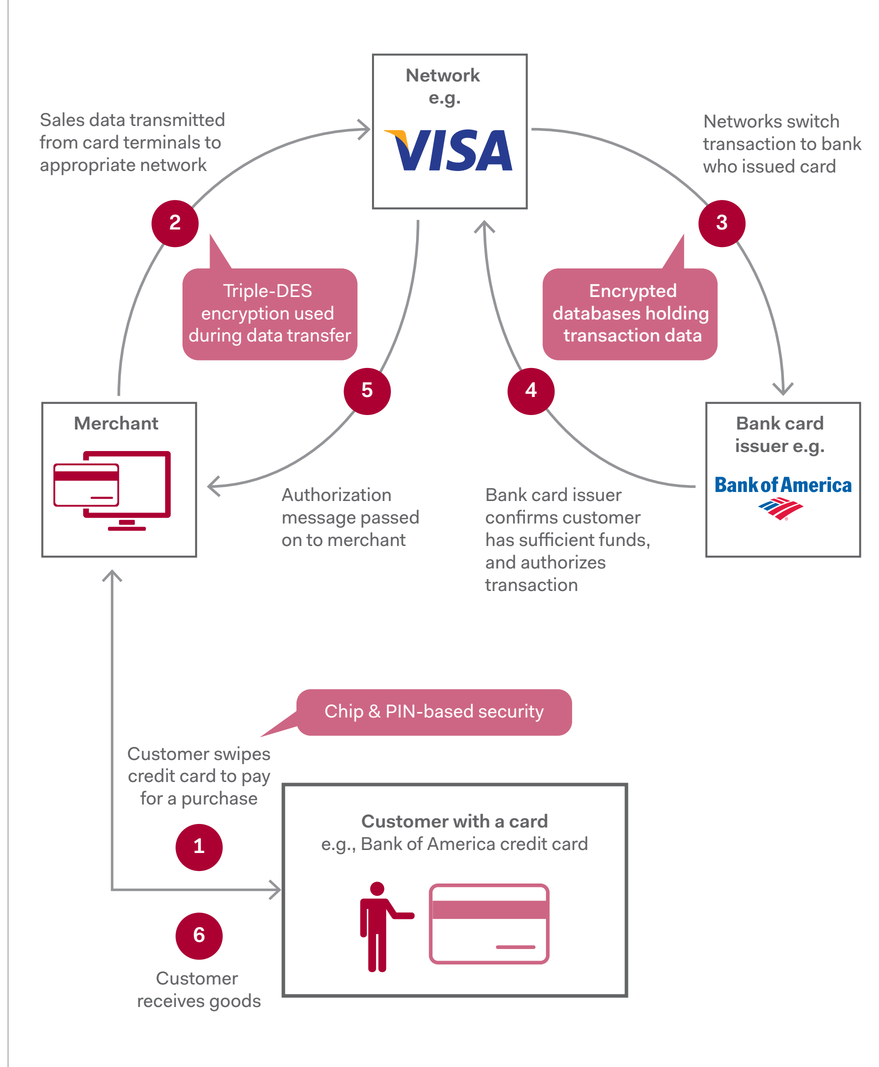
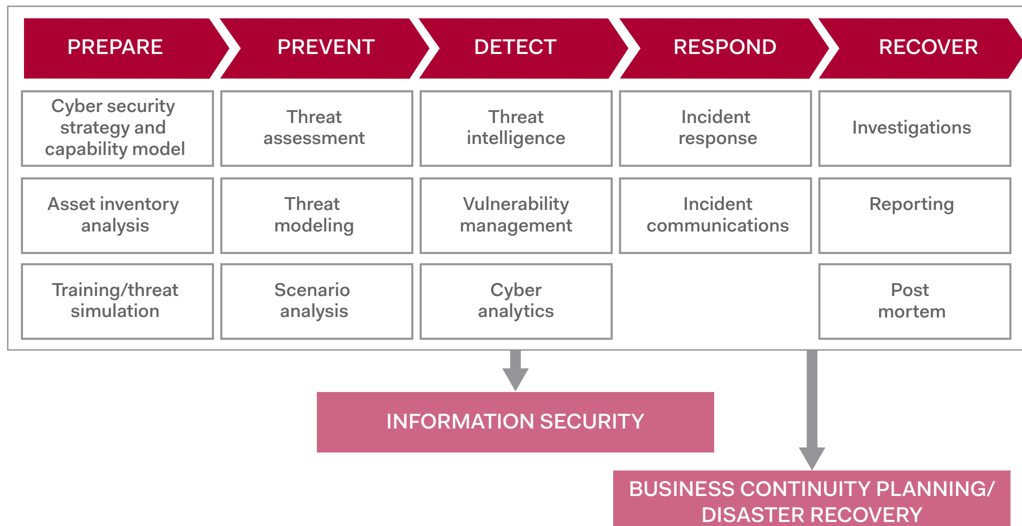


Exhibit 3: Cyber security defenses in the payments ecosystem



[9] IBM, Cybersecurity Intelligence Index for Retail, 2013

Exhibit 4: Cyber security management capabilities



In addition to detecting threats through traditional information security techniques and strengthening cyber security incident response planning, more companies are holding regular cyber security drills (akin to fire drills) and conducting cyber security audits.

Small and mid-sized operators can still proactively defend against threats without investing in this level of infrastructure. Partnering with managed security providers can help smaller organizations better understand their threat profile and develop an implementable action plan. Another strategy is to leverage existing relationships, by asking business partners what they are doing to protect information and exploring ways to adopt best practices together.

However, not all cyber security risks can be mitigated by security controls. Some residual risk will remain, and it may be possible to transfer some of this risk to insurance providers.

Data breaches are expensive – the average U.S. breach involves over 28,000 records and costs the company $188 per record.[10] This gives insurance a role to play in a comprehensive mitigation strategy. The U.S. cyber insurance market is currently at $1.3 billion and growing, with over $600 million in deployable capacity.[11]

With the largest placements in the $200 million range, however, the industry is still in its infancy.

Insurance covers a diverse set of risks, including:

1. Network security liability (e.g., impact to third parties due to network breach)
2. Privacy liability
3. Regulatory investigation defense (e.g., legal expenses and fines)
4. Event response and crisis management expenses (e.g., forensics, crisis management firms, legal expenses)
5. Cyber extortion (e.g., ransom and/or investigative expenses associated with a threat directed at you)
6. Network business interruption (e.g., loss of income from direct and dependent businesses)
7. Data asset protection (e.g., costs and expenses incurred to restore, recreate, or recollect your data and other intangible assets)

10 Ponemon Institute, Cost of a Data Breach Study, 2013

11 Gardner

Companies can take concrete actions to reduce their cyber security insurance costs. Having comprehensive incident response plans in place saves an average of $42 per record in insurance premiums, and having response consultants can save up to $13 per record. In the U.S., companies with a CISO have reduced premiums by an average of $23 per record.

Regulation around cyber security continues to evolve to keep pace with the complexity of attacks. Regulations are being designed to empower the private sector to engage in collaborative information sharing and provide protection from liability for sharing threat information. Legislation around data breach notification will empower government agencies (e.g., the FTC) to direct security standards requiring businesses with consumers' information to adopt security protocols and boost protective measures.

However, regulation alone is not a silver bullet. Senior management must recognize cyber risk management as a cross-enterprise effort and incorporate all aspects of the organization:

1	SENIOR MANAGEMENT	Ensure awareness, evaluate risk and risk appetite, institute the appropriate control framework, assess compliance and effectiveness through audits
2	RISK & COMPLIANCE	Ensure processes and systems to comply with privacy and data collection laws
3	CISO & CIO	Understand and mitigate risks, communicate lessons learned
4	INTERNAL AUDIT	Act as a line of defense and ensure quality assurance
5	BUSINESS CONTINUITY	Raise degree of resilience, extend disaster recovery to non-physical damages and emerging threats, as a function of the security organization or on an enterprise-wide level
6	FINANCE	Create targeted policies of risk transfer using insurance, implement transfer pricing for businesses that take excessive cyber risk without appropriate controls
7	LEGAL	Understand regulations, contractual obligations, and litigation possibilities, improve ability to provide evidence of proper data protection processes

Although each company's threat profile may differ, we have identified five universal and critical actions for senior management to take to mitigate cyber risk:

1. **Advocate an enterprise-wide approach:** Integrate cyber security into the operational risk program and the broader enterprise risk management strategy.
2. **Know the threat:** Define policies and procedures surrounding cyber security that focus on the behavioral aspects of potential adversaries. Leverage emerging intelligence sources.
3. **Know your assets:** Inventory your assets, quantify the value, and prioritize what to protect and how much to protect it.
4. **Know your vulnerabilities:** Identify major cyber security risks based on your business mix and degree of exposure to your supply chain and service providers.
5. **Know your organization's limitations:** Partner with security vendors and service providers for subject matter expertise, as the threat, mitigation controls, and technology are evolving too rapidly for any one entity to stay on top of these issues.

Over the years, cyber attacks have evolved and advanced considerably. What began as DDOS and spam attacks evolved to sophisticated botnets, which in turn gave way to self-mutating malware used to disrupt critical infrastructure. As the cyber threat evolves, so should your defenses. It is time for cyber risk management to be incorporated into a holistic risk management regimen. Doing so may do more than save your company millions of dollars; it just may save your reputation.

OMNICHANNEL

Fulfilling customer demand: Click & Collect strategies and lessons learned

Chris Baker and Salim Poonawala

Online and omnichannel retail is here to stay and is predicted to dwarf brick and mortar retail over the next five years in terms of growth. U.S. online retail sales are expected to grow to $370 billion by 2017.

Up to this point, omnichannel retail in the U.S. has been defined mostly by online ordering and home delivery. Despite the tremendous past growth and likely future growth of e-commerce, it still accounts for only about 8 percent of U.S. retail sales. This proportion is significantly lower in food retail where it can be tricky to make the economics and operations work due to more complex supply chains and perishable products.

"Click & Collect" – ordering online or on a mobile device and picking up in store or at a dedicated pick up point – represents the next frontier in omnichannel retail in the U.S. Click & collect is appealing to both retailers and consumers. For consumers, it has the potential to remove hassles through easy online or mobile ordering, same-day pick up, no wait time for delivery, and a shorter overall shopping process. For retailers, it is an avenue to offer convenience and value to customers with less investment in e-commerce infrastructure.

To better understand the click & collect opportunity (and threat) in the U.S., we look to France. France has the most mature click & collect – or "Drive" – market in the world. By studying the evolution of click & collect in France, we aim to understand how to this concept might evolve in the U.S. and to learn what U.S. retailers should be thinking about as they consider their omnichannel strategies.

KEY TAKEAWAYS

- Click & collect in the U.S. is relatively nascent. Key players, including Walmart, Kroger and Meijer, have introduced click & collect offers in test markets. Harris Teeter has been rolling out the model and has over 150 Express Lane locations.
- With more than 3,000 click & collect operations, France has the most mature click & collect market. We can leverage learnings from the French experience and consider implications for the U.S. market.
- There are two primary operating models: warehouse picking and in-store picking. While warehouse picking requires a larger initial capital investment, productivity is significantly higher than for in-store picking. Picking productivity in a warehouse is almost three times higher than in-store.
- France's evolution offers two valuable lessons for U.S. retailers looking to enter the click & collect market:
  - Understand cost to serve and price the offer appropriately. Beware the no-fee trap.
  - Build a sustainable business model and plan for each market based on how click & collect will cannibalize store and online sales.

EVOLUTION OF "DRIVE" IN FRANCE

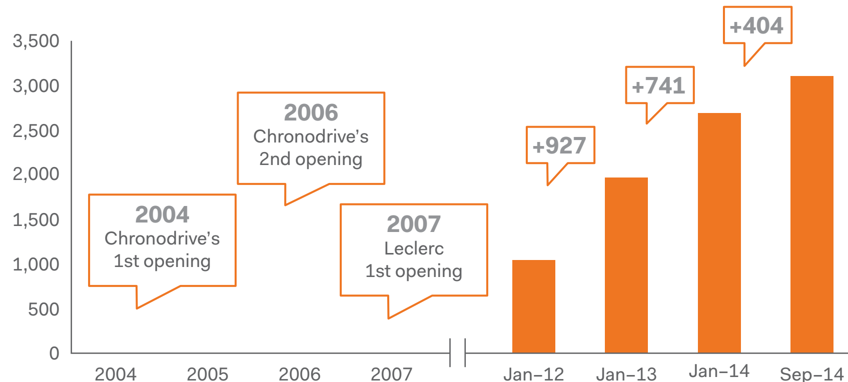
In 2004, Auchan opened its first Chronodrive location in Lille, France, marketing the move as the beginning of a "shopping revolution" in France. Customers place their orders online, the drive employees assemble the customers' order, and two hours later, the customers drive up to the location, identify themselves at a kiosk, and an employee delivers their orders to their cars. The introduction of drive cut down the time to shop for a €75 basket by 40% – from 110 minutes to 65 minutes.

Two years later, in 2006, Auchan opened a second Chronodrive location. Only in 2007 did Auchan's first competitor, Leclerc, open its first drive. By 2012, drive had taken off, and hundreds of locations were added each year. By September of 2014, France had more than 3,125 drive locations (see Exhibit 1).

Today, the vast majority of French food retailers operate drive locations. The average hypermarket and supermarket chain offers drive in 75% of its network of stores, with some retailers, such as Leclerc, offering drive in more than 90% of stores. In fact, French food retailers cannot afford to stay out of the game, for fear of losing customers to competitors offering drive. In western France, there is at least one drive for every 12,000 people.

Overall market penetration in France in 2014, defined as using drive at least once a year, was 25%. Drive's share of the overall FMCG market was 2 percent in 2012 and is estimated to reach 6 to 8 percent by 2015. For certain categories, such as baby care, market share is upwards of 15 percent. Drive's market share is also greater in households with children, reaching 10% in households with toddlers and infants.

Exhibit 1: Number of drive openings in France, 2004 to September 2014



Source: Olivier Dauers September 2014

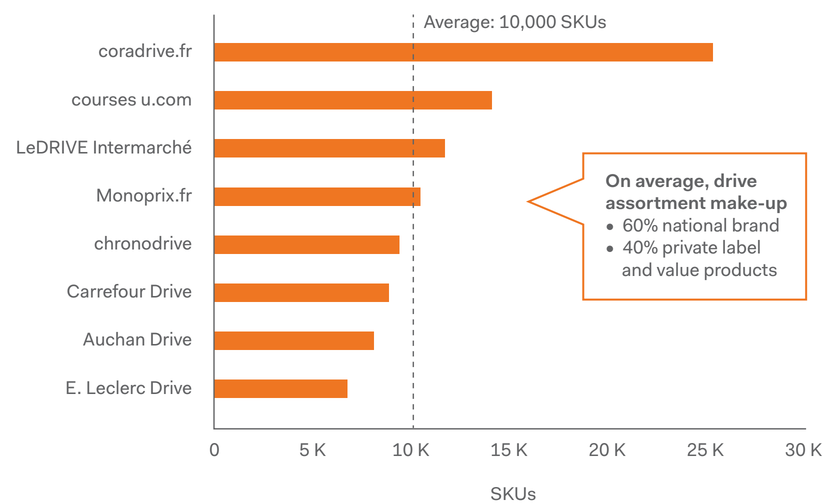
Exhibit 2: Top 5 French food retailers offering drive

FRENCH RETAILER	MARKET SHARE IN FRANCE	2014 GLOBAL SALES	NUMBER OF DRIVES	DRIVE OPENINGS IN 2014	PROPORTION OF STORE COVERED
E.LECLERC DRIVE	19.8%	€47 BN	523	66	91%
CARREFOUR DRIVE	18.8%	€75 BN	413	57	62%
LE DRIVE INTERMARCHÉ	13.3%	€36 BN	887	115	49%
COURSES U.COM	9.8%	€20 BN	610	20	66–92%[1]
AUCHAN DRIVE	8.3%	€48 BN	97	6	75%

Source: Olivier Dauvers September 2014 "Part de marché valeur des enseignes" & Kantar Worldpanel August 2014

1. 66% Super U; 92% Hyper U

Exhibit 3: Average SKUs in a drive by French retailer



Source: Olivier Dauvers September 2014

VALUE PROPOSITION FOR CUSTOMERS

So why were French shoppers so quick to adopt drive?

- No service fees
- Same prices as in-store
- Similar promotions as in-store

The range of assortment offered in drive varies by retailer, with Leclerc offering a limited assortment of 6,800 SKUs and Coradrive.fr offering almost four times as many SKUs, at 25,000. Given that Leclerc has the biggest market share, it is not necessary for a retailer to offer breadth of assortment to win customers.

Spotlight on France

"The popularity of drive in France may also be a result of two factors unique to France's housing market and history. First, less than 40% of French families live in houses, compared to 65% of U.S. families, and home delivery has traditionally been a less convenient and more expensive option. Second, France's postal service workers conducted a massive strike in 1974, and customers were not able to receive shipments from mail-order companies for several weeks. These companies started operating pick-up and delivery services to bypass the French post office and, in effect, conditioned French shoppers to drive to various locations to pick up their orders."

– A former senior retail executive with operational experience building a click & collect service in Western Europe

OPERATING MODELS AND PROFITABILITY

There are two operating models for drive in France: warehouse picking and in-store picking.

Warehouse picking requires on average an investment of €2.5 million to build a stand-alone warehouse of 1,500–2,000 m^2 attached to a click & collect. In-store picking leverages existing stores and requires an investment of only €200 K–€300 K, about one-tenth the investment required for warehouse picking.

The crucial difference between the two models lies in picking productivity, which results in a significant difference in labor costs. Due to the nature and organization of a warehouse, employees can pick ~200 items an hour on average and up to 250 items an hour in some fresh categories. In-store picking productivity is typically only around 70 items an hour. Labor costs for warehouse picking are 3–4% of sales, compared to ~10% for in-store picking. As you can see in Exhibit 4, which shows the typical P&L of a French warehouse drive, the difference in labor costs is significant enough that only the warehouse picking model is truly profitable.

Exhibit 4: Typical P&L of a French warehouse drive

GROSS MARGIN (NET OF LOGISTICS)	**23%**
LABOR (e.g., PICKING, DELIVERY)	9–11%
CAPEX DEPRECIATION	3–4%
UTILITIES, MAINTENANCE, IT, OTHER	2–3%
ADVERTISING	1%
TAXES	1%
RESULTING GAIN	**3–7%**

The CEO of Carrefour, which primarily operates in-store picking drives today, has stated that Carrefour will invest in the infrastructure to build warehouse picking drives. But, in the short term, Carrefour has opted to offer drive in-stores to keep customers.

LESSONS LEARNED FROM FRANCE AND IMPLICATIONS FOR U.S.

There are two primary takeaways from France's experience in the drive market.

- Understand cost to serve and price appropriately to offset higher OPEX and CAPEX. Retailers are providing a service to customers and must make sure to capture its value.
- Build a sustainable business model that is not EBIT-dilutive, taking into account the fact that a big first mover advantage eventually turns into a zero-sum game when all players join the arms race. This includes anticipating how click & collect will cannibalize your store sales as well as the impact you expect to have on your competition.

As U.S. retailers consider entering the click & collect space, it is important to consider the following questions.

1. **Does it make sense for you to offer click & collect?**

   Is your market densely populated enough? Is there consumer demand for click & collect in your markets? Are your competitors offering click & collect?

2. **What type of operating model makes sense for your business?**

   Can you repurpose retail floor space in your current store network for click & collect operations? Do you have distribution centers or warehouses that can support a nearby click & collect location? Should you partner with a third party (e.g., Instacart)?

3. **How will you execute?**

   What changes to your supply chain infrastructure are necessary to implement click & collect? How will you integrate your online and in-store systems (e.g., inventory management, data management, payment, product catalog)?

Omnichannel operations

TWO STEPS TO SURVIVE AND WIN

Chris Baker and Jacqueline Martinez

While e-commerce sales accounted for just eight percent of retail sales in the US in 2013 and 2014, cross-channel or "web-impacted" retail contribute 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 behavior. Now, 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-center, customer-centric operations. As customers' expectations are evolving, retailers are testing a series of initiatives, including:

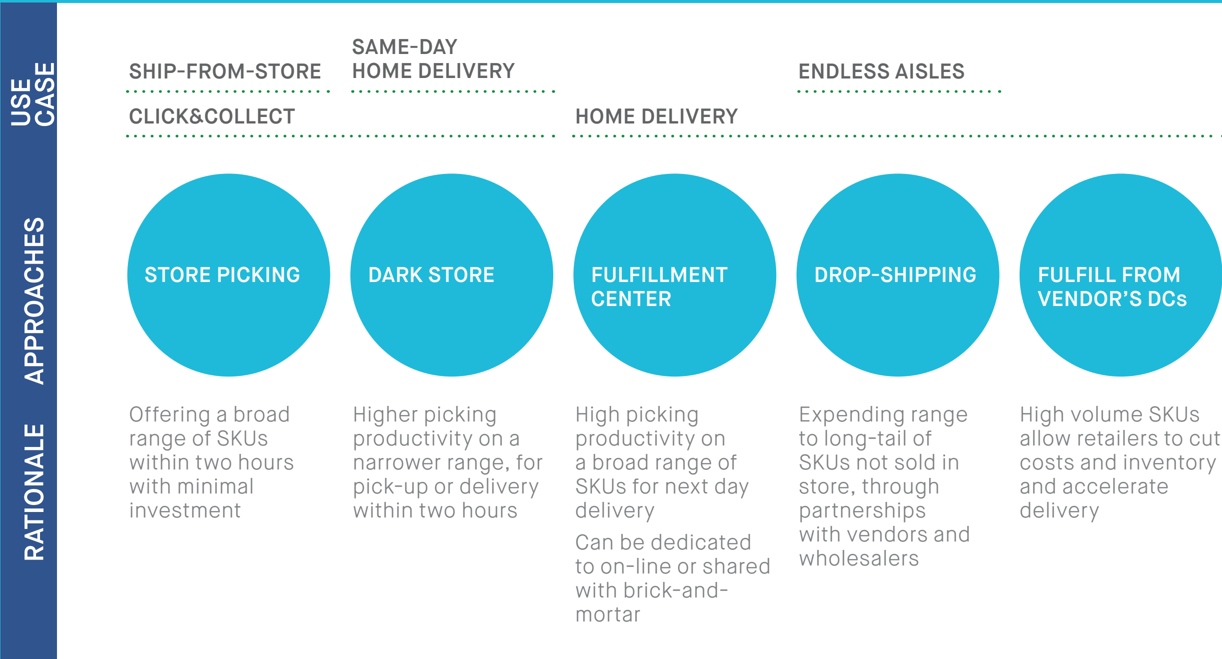
- More access points: online, mobile, stores, drives, lockers, pick-up and drop-off points, parcel shops
- More delivery options: after-hours, week-end delivery, time slots
- Shorter lead times: pick-up within 2 hours, same-day delivery
- Flexible delivery points: e.g., at train station for commuters, work place
- More in-store and "drive" pick-up services: reserve online (e.g., the Gap, Macy's), self-collect, pick-up in drive, endless aisles
- 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:

- Consider four key plays and focus on the "plays"that will drive customer-centric operations
- Think and build with agility in mind. Design your organization and infrastructure to be flexible, innovative, and one that embraces change rather than runs from it

[1] Source: Forrester Research.

Exhibit 1: Dynamic network design and order fulfillment



1. CONSIDER FOUR KEY PLAYS

While virtually 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 fulfillment, existing asset utilization, last mile and delivery, integration with vendors.

Create dynamic network design and order fulfillment

The proliferation of new services will force retailers to develop dynamic network design capabilities, perhaps by leveraging or combining their existing footprint of distribution centers, platforms, and stores with third-party options to fulfill orders faster.

Beyond traditional DCs, retailers are increasingly relying on a more diverse set of models to accommodate different combinations of online versus in-store range, CAPEX requirements, pick-pack-ship volumes, access points, and lead time.

Better utilize existing assets

Physical stores come with high capital and human costs, putting retailers at a disadvantage against their leaner online competitors. However, stores could also become retailers' most critical advantage in the race for offering fast and local services, if they could be leveraged as platforms providing supply chain services, such as order fulfillment, pick-up and drop-off points, returns, ship-from-store, lockers, etc.

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

Exhibit 2: Last mile delivery

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

COLLECTION POINTS
Collect+ | amazon.co.uk | Curbside

LOCKERS
Amazon | ByBox

Build last mile and delivery capabilities

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

Incumbent transportation carriers have for decades built hub-and-spoke infrastructure and fixed delivery waves to offer overnight or next-day delivery services for mid- to long-distance destinations. This model will increasingly become irrelevant for the last mile.

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 impacts 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 radically new solutions offered by start-ups such as Deliv', Collect+, Instacart
- Push their traditional suppliers to innovate more and rethink delivery models.

Integrate with vendors

As part of Amazon's Vendor Flex program, P&G allowed Amazon to set up fulfillment operations within its own warehouses to reduce transportation costs and speed up delivery. While vendor-managed inventory and other collaborative projects have existed for decades, this partnership is among the first in the online space. Target's public reaction to this partnership emphasized the importance and complexity of vendor-retailer partnerships in e-commerce operations.

Vendors 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 vendors' and retailers' interest to better integrate and collaborate to achieve critical mass and 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.

2. THINK AND BUILD AGILE

Traditionally, retailers have grown operations sequentially. Expansion plans are laid out and executed in a series of pre-planned steps over several months or even years. However, given 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 what is essentially an unknowable end state.

Not only will consumer needs continue to evolve, but omnichannel will likely mean different things to consumers in various markets and sectors. Consumption patterns vary across geographies and sectors as it relates to access points and delivery services. For example, in grocery retail, click-and-collect accounts for over 90 percent of orders in France but has only started to take off in the US.

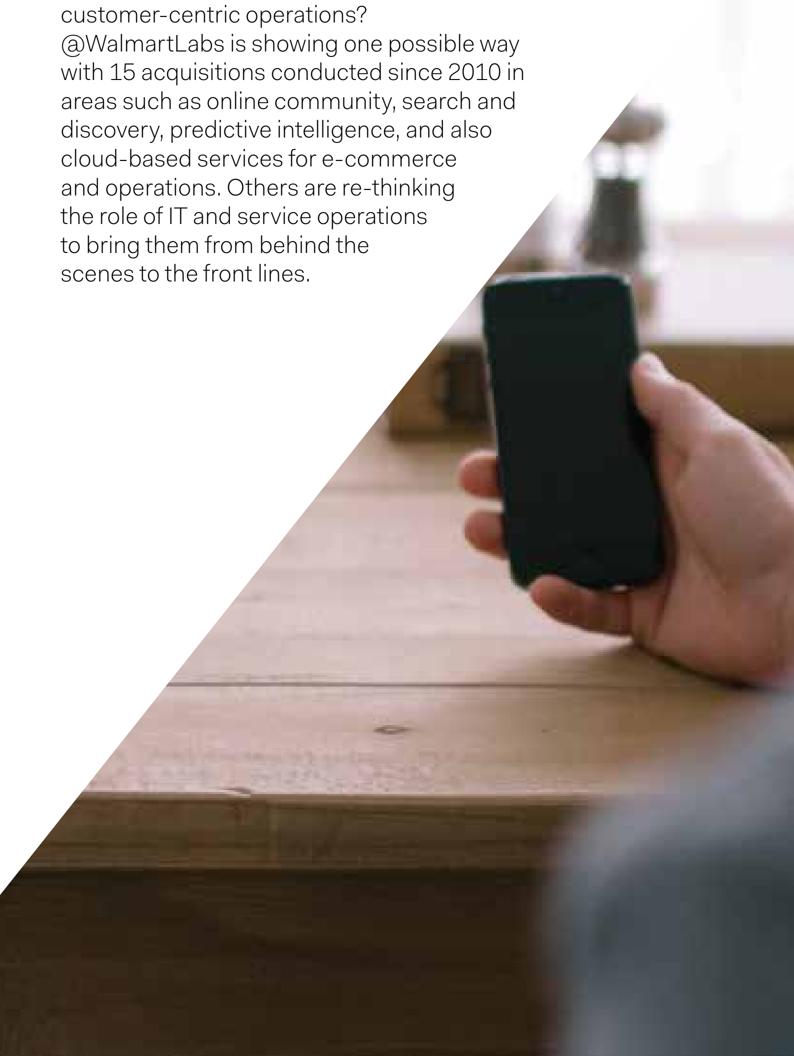
If the only constant is change, then building flexibility and evolution into the organization and infrastructure is paramount. To be agile, retail operations will need to:

- 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 sequential "marathon," where it is better to make progress frequently and tangibly in weeks and months, not years
- Consider working and live proof of concepts that impact the customer 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.

New and innovative approaches to systems and technology are also necessary to underpin the agile organization. Omnichannel brings a radically different set of challenges and requirements that are incompatible with most legacy systems and technologies, such as:

- Visibility and single view of product, inventory, customer, and order data across channels and stakeholders
- Real-time decision making
- Orchestration of multiple stakeholders: vendors, 3PLs, transportation companies, ecommerce platform, ERP, etc.
- Technology-enabled breakthrough in productivity and services: picking technologies and automation, in-store kiosks, etc.

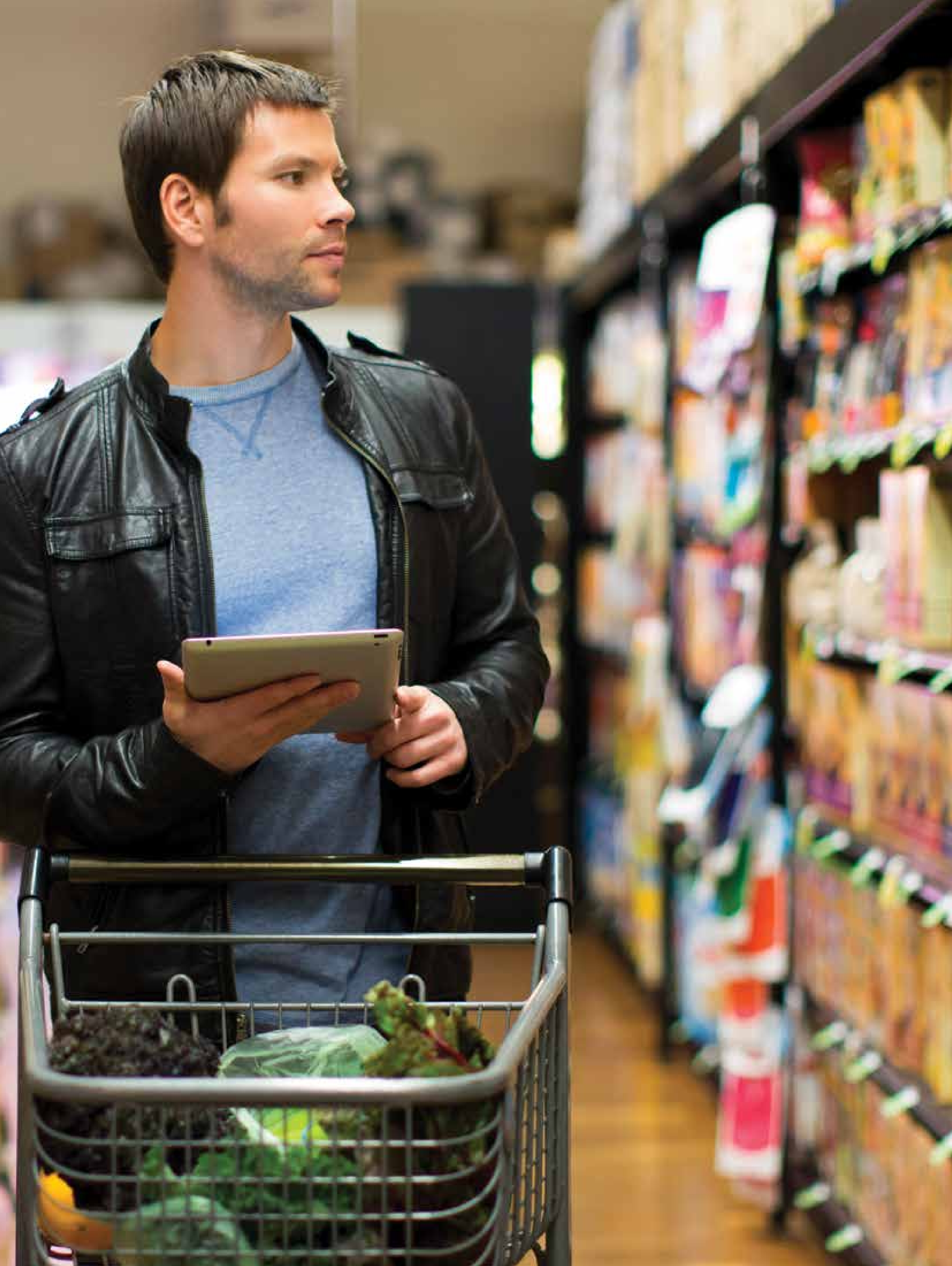
How can retailers evolve their systems to enable customer-centric operations? @WalmartLabs is showing one possible way with 15 acquisitions conducted since 2010 in areas such as online community, search and discovery, predictive intelligence, and also cloud-based services for e-commerce and operations. Others are re-thinking the role of IT and service operations to bring them from behind the scenes to the front lines.



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 a cost-centric to customer-centric focus on the right "plays," and become more agile and innovative to hit a constantly moving target.



Basica
Floradix

HEALTHCARE

Opportunities for retailers in consumer-centric healthcare markets

Graegar Smith
George Faigen

The healthcare industry is undergoing a revolution. Whereas the system had historically followed a largely volume-based, fee-for-service model, the emerging value-based healthcare landscape will be substantially more outcomes- and experience-driven. This shift is expected to rotate over $1 trillion of value out of "traditional" healthcare players, such as insurers and hospitals and create more than a dozen multi-billion dollar, high-growth areas, opening the door for new entrants such as technology companies and retailers.[1]

Stepping back, there are both immediate and longer term consequences and opportunities for retailers of this transformation. In the near term, the tectonic shifts brought about by the Patient Protection and Affordable Care Act – or PPACA – will trigger a wave of activity, as retailers rush to ensure they are fully compliant with the extensive regulations.

Longer-term, the changes underway in the healthcare industry will transcend compliance and cost concerns for food retailers. These changes – some driven by new regulations, others driven by increased consumer choice – create an opportunity for food retailers to participate in a growing industry, build closer relationships with their consumers, and improve profitability.

FMI AND THE PATIENT PROTECTION AND AFFORDABLE CARE ACT

FMI has numerous resources to assist retailers in understanding and complying with the PPACA. A wide array of resources is available on the FMI web portal to help FMI members better understand the new regulations and answer regulatory compliance questions. Furthermore, FMI is at the forefront of regulatory and legislative efforts to minimize the burdens of the PPACA on FMI members, and will continue to work with Congress and the Administration to address member concerns regarding new legislation and regulations swiftly and effectively.

CONTEXT

Over the past two decades, healthcare costs have skyrocketed. Under the defined benefit healthcare model, healthcare providers are paid for the procedures they perform – a model which encourages procedure volume but not necessarily the value or outcome of such activities. Over the same time frame, businesses and insurers have worked hard to hold down costs, often looking to reduce the benefits they provide, or scope of coverage, as a way of doing so. But despite these and other systemic efforts, costs continue to rise. While disagreement still exists around how best to tackle that challenge, there is widespread consensus that the system is broken and that dramatic change is needed.

[1] Oliver Wyman, "The Volume-to-Value Revolution: Rebuilding the DNA of Health from the Patient In," 2012

Into this picture comes the PPACA. Among the raft of changes ushered in by the legislation is a set of requirements and resources that encourages consumers to be more proactive in choosing and managing their own healthcare. One major shift is a move away from defined benefit plans and towards defined contribution plans. Under this model, a sponsor – for instance, an employer, Medicare, etc. – defines a monetary amount it will contribute towards healthcare coverage, and the consumer uses this sum, plus any additional funds he or she wishes to spend, to purchase a plan that best fits his or her needs. And there is a proliferation of choices to suit these needs. In this market, consumers will choose not just an insurer and a delivery system, but also a population-health manager and a services provider, such as a retail clinic. In other words, healthcare will start to resemble a more typical, retail-like market for products and services. Consumers will spend their own money, and the providers best positioned to innovate and offer the highest quality services for that consumer spend will earn consumers' business.

The bottom line: for the first time in generations, millions of consumers are going to be motivated to make better, informed decisions on how to use or direct their healthcare dollars.

The flood of consumers that have already entered the market, plus those still expected to enter, represents a substantial business opportunity for those prepared to act. Before the PPACA there were over 50 million uninsured Americans.

In the time since the PPACA passed, this number has dropped to nearly 30 million. This means nearly 20 million new healthcare consumers entered the market in just a few short years by way of the public exchange, Medicaid expansion, and employer mandates. Adding to this new wave of consumers is an ever increasing portion of the nearly 150 million commercially insured Americans moving into high-deductible plans and/or buying coverage through a private exchange. The market is reaching a tipping point.

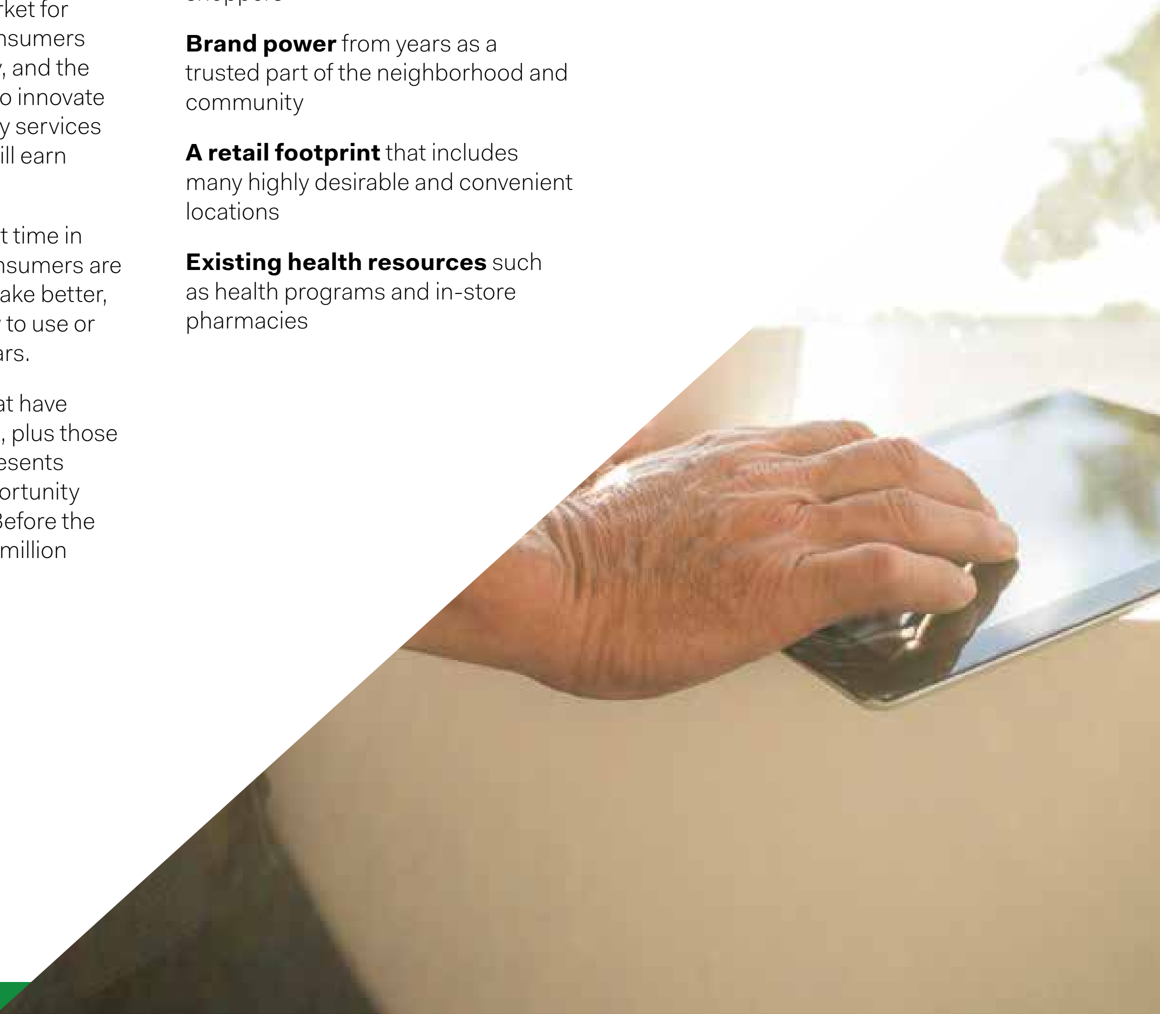
While traditional players such as insurers and providers are attempting to secure a strong footing in this new environment, food retailers have several distinct advantages that can enable them to participate in, and profit from, this space. These advantages include:

A loyal consumer base of regular shoppers

Brand power from years as a trusted part of the neighborhood and community

A retail footprint that includes many highly desirable and convenient locations

Existing health resources such as health programs and in-store pharmacies



INSIGHTS

Tomorrow's healthcare industry will be substantially more consumer-centric than it is today, and its winners will therefore be largely defined by who does the best job understanding and meeting the needs of their newly empowered customers. While there are many consumer pain-points in today's system, there are four broad categories of needs that the food retail industry is well positioned to address.[2]

CONSUMER NEED	ACTIONS TAKEN BY FMI MEMBERS
Convenient access to healthcare services	Provided In-store access to healthcare services (flu shots, clinics, etc.)
Improved health	Built a health and wellness consumer loyalty program
Assistance in making complex health decisions	Provided information and classes on healthy eating and living
Health value, security, and transparency	Built tools for consumers to calculate drug costs prior to purchase

"I want convenient access to healthcare services."

Access to healthcare today is mostly inconvenient. For consumers accustomed to around-the- clock customer service, the inability to find healthcare on nights or weekends, get medical advice online, or schedule an appointment within a reasonable time frame is frustrating.

Retail clinics are already becoming major players in providing more convenient access; There are now over 1,900 clinics, with CVS and Walgreens leading the way. Food retailers are well positioned to provide consumers similarly convenient access to healthcare services. With a substantial geographic footprint and extended hours already in place, they can capitalize on strong brands, customer loyalty, and their unique ability to occupy an authoritative place in advising on matters of healthy eating and lifestyles.

In addition to clinics, many solutions aimed at addressing the dearth of convenient access have sprung up in the marketplace, such as:

Communication tools: peer-to-peer communication tools, virtual physician access, appointment schedulers, 24/7 nurse call lines.

Enhanced accessibility: mobile clinics, house calls, concierge/on demand services, extended-hours care.

While the issue of healthcare access grabs headlines, it is ultimately responsible for only about 10% of an individual's overall health status.

Behavior is the largest determinant of health status, and unsurprisingly, most consumers have great difficulties in breaking unhealthy habits.

"I want to improve my health."

Food retailers are particularly well positioned to provide consumers with resources that will encourage and reward positive, health-conscious behavioral changes. Many FMI members have already introduced programs to help shoppers who are seeking healthier lifestyles with their food, nutrition, and medical decisions. 86% of food retailers now offer in-store wellness classes, and 65% offer weight-management classes.[3] Recently, many retailers have moved to more targeted programs that address the specific needs of a given population, such as parents, children, or those with dietary restrictions.

Further examples of consumer health solutions that provide convenient methods of improving health and changing consumer behavior include:

Reward-based programs: health and wellness discounts, health rewards programs

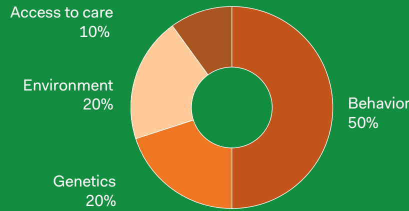
Social improvement programs: "Biggest Loser" competitions, social media-based group health initiatives, such as shapeup, support groups and community activities

Convenient tools: mobile applications, preventive screening trackers

[2] Oliver Wyman analysis of consumer insights and industry trends

[3] FMI study, "Survey Report: Retailer Contributions to Health and Wellness," 2014.

Exhibit 1: Drivers of Health Status[4]



"I want help making complex health decisions."

The current healthcare system is difficult to navigate, and consumers are calling for more support and assistance in making decisions about their health. Food retailers already provide resources to aid consumers in planning meals and managing their pharmaceutical needs. They could choose to go even further and provide resources, for example, easy-to-use, informational tools to help their customers make informed choices from an expanding list of healthcare options.

A range of consumer health access tools has surfaced to help the consumer better navigate the healthcare system and to provide clear guidance as they make complex decisions. These include:

Access to physicians: physician directories, health advocates and concierges, second opinion services, government services navigator

Access to information: interactive patient tools, informational webcasts, caregiver information and tools

Access to the experiences of others: physician rating sites, peer-to-peer advice and user groups

"I want health value, security, and transparency."

Fully half of consumers say that healthcare / insurance access or costs are the most pressing health problems in America today. And yet few understand the ramifications that their health plan selection and treatment option decisions have on their total out-of-pocket costs.

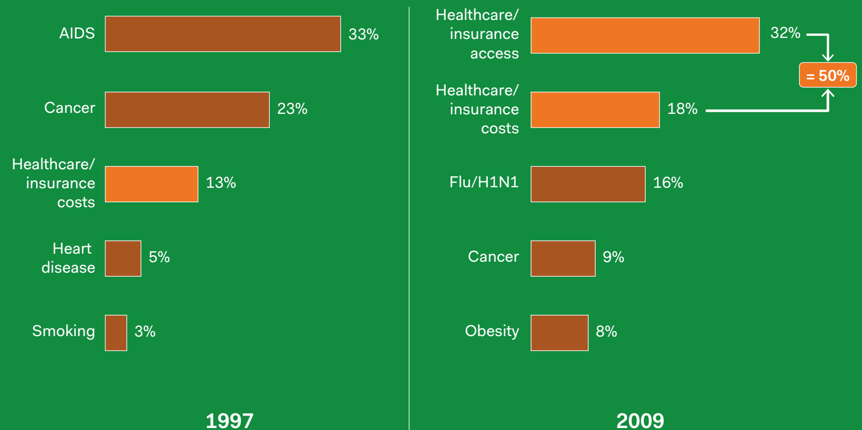
Food retailers could help increase the transparency of consumer healthcare costs by providing tools, such as drug-cost calculators, to their consumers. If used in conjunction with the food retailers' own healthy living programs, those calculators could make the cost versus benefit of a healthier diet more immediately apparent to shoppers.

A number of solutions have emerged to make the cost of care less opaque and to cater more broadly to consumers' desires for financial value and security. Some of the more prominent examples include:

Consumer cost calculators: long-term health cost calculators, healthcare value/cost websites

Financial solutions: medical loans, medical cost credit cards, healthcare annuities

Exhibit 2: "What is the most pressing health problem in America today?"[5]



[4] IFTF, Centers for Disease Control and Prevention, Health and Healthcare, 2010, The Forecast, The Challenge.

[5] Sources: Harris (1999); Gallup (2009)

HOW FOOD RETAILERS CAN WIN

Food retailers have several substantial advantages in the emerging competition to provide fast, accessible healthcare to the cohort of newly empowered consumers. With loyal customer bases, trusted brands, and centrally-located stores, food retailers could become major players in the healthcare revolution, particularly as healthy living and eating begin to play an increasingly central role in this pursuit. As the chart below demonstrates, different retailers will surely pursue this opportunity to varying degrees.

At a basic level, food retailers might choose to upgrade the overall health of their workplaces. They can offer healthy meal options to employees or act as health information repositories for workers and customers alike, both of which provide low-risk and low-investment means for taking a more proactive role in managing consumer health. A food retailer could also seek to become a healthcare advisor, integrator, and provider with the right investment and a shift to health and wellness focus.

Example Approaches Food Retailers Can Take

APPROACH	INVESTMENT	RETAILER ACTIONS
A healthy workplace	Low	• Offer comprehensive health insurance coverage to qualifying employees. • Educate employees about how the PPACA will affect them. • Provide resources to help employees navigate health coverage options.
An information destination	Medium	• Display and disseminate health and wellness pamphlets • Host consumer-oriented health and wellness courses (e.g., healthy cooking, nutrition, insurance purchasing) • Create a healthy foods/products rewards and discounts program.
A one-stop-shop health products shop	Medium – High	• Offer health insurance products/purchasing portals in-store. • Offer pharmacy and medical device products in-store. • Offer exercise products in-store. • Create a healthy products rewards and discounts program.
A holistic provider	High	• Build an in-store medical clinic to provide basic services to customers. • Provide access to remote health monitoring/ exam kiosks. • Provide customers with flu shots and vaccinations. • Provide education and monitoring for customers with chronic diseases.

Most retailers do not have specific healthcare expertise, and may consider themselves ill-suited to enter a new industry. But with expansive local networks, existing customer relationships, and high levels of brand trust, food retailers could be ideal partners for companies possessing healthcare expertise and profit from consumer-centric healthcare. Interested retailers should begin planning to enter the healthcare marketplace as soon as possible. Although these moves may seem foreign to retail businesses today, they will inevitably become more common, as the ‘retailization of healthcare’ sweeps through America. The competition is bound to be fierce, but for an industry characterized by low margins and slow growth, this opportunity is too large and too lucrative to ignore.

PHARMACY

Are consumers ready for retail healthcare?

Graegar Smith
Chris Bernene

An Oliver Wyman survey finds strong interest, little familiarity, and complex preferences from consumers. The verdict for retailers, healthcare providers, and payers: It's time to move, but carefully, and together.

The line between healthcare and retail is blurring. More than 1,600 retail locations are now home to healthcare clinics, and an increasing number of pharmacies, supermarkets, and mass chains have entered the healthcare space, some in innovative ways. Employers and insurers are not only adding retail clinics, wellness providers, and telehealth to their benefit design and networks, but looking to these alternative sites of care as a way to satisfy consumer preferences and reduce costs. Healthcare providers, too, are entering the fray, hoping to offer their patients a wider range of services, greater access, and more convenience. Some are doing this independently by opening walk-in clinics or urgent care centers. Others are partnering with retailers.

It is already clear that healthcare's future will include both traditional healthcare providers and new players from technology, retail, and other realms. There is great opportunity on all sides. But how should a retail company or a healthcare payer or provider play? What kinds of services should it offer to what sorts of customers? What is a winning business design or profit model?

Before answering any of these questions, we first need to ask a more basic one: What do consumers want, and what are they willing to try?

To find out, Oliver Wyman conducted a national online survey of 2,019 individuals spanning all demographic and health segments. We found significant interest in new, retail-oriented forms of care. But we also heard strong views on what services should be offered and how they should be delivered—views that don't always match with today's dominant models.

THE CONSUMER SAYS "I'LL TRY IT. WHAT IS IT?"

Though retail clinics and other alternative sites of care have grown dramatically, their market share remains low. Only 15% of consumers say they have used a health or wellness clinic in a retail establishment, and only 8% have used care delivered by phone or online. Interestingly, one-third of consumers say they are not even familiar with retail clinics, and 57% say they are unfamiliar with remote or virtual care (see Exhibit 1).

But they are willing to try. More than three-quarters say they are interested in receiving care for minor episodes at an alternative location. Two-thirds are interested in getting advice on diet, nutrition, fitness, and well-being. Half are interested in getting advice on managing a chronic condition. Interestingly, today's retail healthcare industry focuses almost exclusively on providing routine and minor episode care in clinics. The other opportunities, despite substantial consumer interest, are largely untapped.

But this strong consumer interest comes with some strings attached. For example, 57% of respondents said they would like to receive medical care in a retail clinic. But only 29% gave an unqualified yes (see Exhibit 2). The other 28% were interested only if the clinic was run in partnership with a local hospital or healthcare provider. An additional 16% would be willing to use a clinic for some health-related services, but not for medical care. And of the 48% who said they would use remote services, more than half said they would use them only if care was cheaper to compensate for its not being in person.

Exhibit 1: Consumer familiarity with retail-based health and wellness clinics

15%	of respondents say they have used retail-based clinics
52%	haven't used retail clinics but are familiar with the concept
34%	say they are not familiar with retail clinics

Exhibit 2: Willingness to receive services from a familiar retailer at competitive cost

29%	"I would like the convenience of it and would use the service."
32%	"I would trust the service only if it were in partnership with a local hospital or healthcare provider."
16%	"I would use it for some things related to health, such as nutritional advice, but not for any medical needs."
23%	"I would not be comfortable. I prefer going someplace else such as a doctor's office."

Source: 2013 Oliver Wyman Consumer survey

We note three general points. There is both strong interest in receiving at least some traditional services in new locations, but also strong interest in new services. Retailers and providers alike should consider what mix is the most appropriate for them. For retailers in particular these new services present greater synergies with what is already in the store today.

Secondly, most alternative care sites currently market themselves on the basis of convenience and access. Cost and convenience are extremely important to some consumers, but in our survey group as a whole they rank lower than other factors (see Exhibit 3).

Lastly, trust and perceived quality are key concerns. As we expected, doctors and nurses were the most trusted health information sources in our survey, with pharmacists coming in third. But (1) we note that consumers are significantly more likely to want to use a retail clinic run in partnership with a local healthcare provider and (2) we did not specifically ask what level of trust consumers would need to use non-medical services.

Exhibit 3: Consumer rating of the importance of factors in choosing a site for care

Source: 2013 Oliver Wyman Consumer survey

DIFFERENT SITES FOR DIFFERENT SERVICES

There is strong, broad interest in receiving care at alternative sites, but consumers, at least today, do not see all sites as equal. Exhibit 4 shows the range of preferences. For example, 79% of respondents said they were interested in receiving care for a minor episode in at least one alternative location. Unsurprisingly, 61% of respondents would be willing to go to a walk-in clinic or urgent care center. 36 % of respondents were interested in a pharmacy-based clinic, 24% in a clinic located in a discount retailer, and only 20% in a clinic located in a supermarket.

The chart below highlights a few "hot spots" where consumers are already well aligned with alternative care:

- Consumers are willing to receive a wide array of services at walk-in clinics or urgent care centers.
- Pharmacies come next, possibly because of their dual advantages of convenience and the presence of a trusted advisor in the form of a pharmacist, but possibly because their in-store healthcare offerings are familiar, thanks to the marketing and existing offerings of chains like Walgreen's and CVS.
- In general, consumers currently see less value in traditional healthcare services delivered at retailer locations—an attitude that could change in the next few years, especially if payers push for wider use. But even now consumers are interested in receiving advice and recommendations on diet, nutrition, fitness, and well-being from a wide variety of retail locations.

One would expect choice preferences like these to correlate with age, income, insurance status, and overall health. We might expect, for instance, that younger consumers would be open to new ways of receiving care, especially via the internet, or that older consumers would disproportionately favor the traditional doctor's office. But in this case, they do not. Interest was spread fairly randomly across traditional demographic categories.

Digging deeper, we identified 11 consumer segments in the broadly defined health and wellness market. While the segments do not correlate with the factors typically used to predict consumer behavior, there are some interesting patterns of buying preferences. For example, consumers in the segment we call Remote Lifestyle Advocates (who make up about 10% of the population) are interested in receiving new "lifestyle" services like nutrition, well-being, and condition management remotely, but traditional services like routine care and minor episode treatment at urgent care clinics. They are not very interested in any other alternative care locations. Convenience Care Shoppers (about 5% of the population) are interested in receiving traditional services at most physical locations, but not remotely, and they are not very interested in new lifestyle services at any physical location (see Exhibit 5). The challenge will be to find ways to predictively group consumers to these segments and tailor business models to them.

Exhibit 4: Percentage of consumers who would consider receiving specific forms of care, by location

	PHYSICAL EXAMINATION	ROUTINE CARE	MINOR EPISODES	DIET/ NUTRITION	FITNESS/ WELLBEING	CHRONIC MANAGEMENT
Interested in receiving care in at least one alternative location	44%	64%	79%	66%	64%	50%
Grocery store (such as Kroger, Publix, Safeway)	10%	17%	20%	22%	21%	11%
Discount retail store (such as Walmart, Target)	11%	20%	24%	25%	25%	13%
Pharmacy (such as Walgreen's, CVS, Rite Aid)	15%	30%	36%	35%	33%	19%
Walk-in clinic or urgent care center	35%	46%	61%	30%	30%	33%
Remotely via phone, voice chat, or video chat	4%	11%	13%	32%	33%	19%

Source: 2013 Oliver Wyman Consumer survey

<10% 10-24% 25-49% 50%+

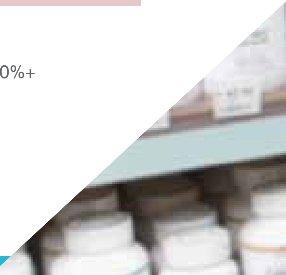


Exhibit 5: Two consumer segments compared by percent willing to receive services at a specific location

REMOTE LIFESTYLE ADVOCATES

	PHYSICAL EXAMINATION	ROUTINE CARE	MINOR EPISODES	DIET/ NUTRITION	FITNESS/ WELLBEING	CHRONIC MANAGEMENT
Grocery	1%	5%	2%	2%	2%	2%
Discount	2%	6%	6%	3%	4%	2%
Pharmacies	9%	24%	24%	12%	12%	10%
Urgent Care	28%	40%	62%	1%	2%	16%
Remote	7%	19%	21%	94%	91%	43%

CONVENIENCE CARE SHOPPERS

	PHYSICAL EXAMINATION	ROUTINE CARE	MINOR EPISODES	DIET/ NUTRITION	FITNESS/ WELLBEING	CHRONIC MANAGEMENT
Grocery	34%	72%	78%	10%	3%	22%
Discount	40%	85%	84%	12%	3%	30%
Pharmacies	44%	87%	87%	15%	6%	42%
Urgent Care	56%	78%	84%	11%	9%	19%
Remote	8%	17%	20%	34%	31%	24%

Source: 2013 Oliver Wyman Consumer survey

<10% 10-24% 25-49% 50%+

DESIGNING FOR THE FUTURE: 1 + 1 = 3

In looking for new healthcare opportunities, the temptation is to think too narrowly—to look only for new ways to deliver traditional healthcare services. But this thinking leads to a conundrum, because consumers want a combination of quality, convenience, and cost that is impossible to deliver in the old payer/provider/retail models. What we see in our data is that consumers want a solution that combines the best aspects of traditional retail (convenience, access, cost transparency) with the best aspects of traditional care models (quality of care, high trust in the provider). A new model is required.

As retailers start to enter healthcare in a big way, new approaches for solving the conundrum are emerging. By working in partnership to build new service and delivery models, providers, payers, and retailers can meet consumers' needs. Rite Aid, for instance, has recently announced a plan to offer chronic-care services to patients who have been referred by their doctors. By extending the care of providers into a retail setting, Rite Aid can collaborate with providers to provide pharmacy services and lifestyle coaching aligned with the physician's care plan. This can lead to lower costs, healthier and more satisfied patients, and loyal customers.

We are starting to see many other models of payer-provider-retail partnerships springing up around the country. Experiments are taking place in many different locations, including supermarkets, stand-alone clinics, and drugstores, and they use digital as well as brick-and-mortar channels. As we see these models and hear the voice of customers, the question is less "Should I play in retail-healthcare?" and more "How should I play?" and "Who should I partner with?"

Our survey suggests to us that we are near a tipping point of consumer acceptance, one that will open great opportunities and enable far-reaching change in healthcare. The future, we think, belongs to those who can truly understand what consumers want and need and build a portfolio of business designs complete with the partnerships needed to bring them to life.

January 2016: Oliver Wyman is in the process of conducting a new survey on this topic. The results of that survey will be available in Q1 2016 at health.oliverwyman.com. Or interested readers can contact graegar.smith@oliverwyman.com.

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