OLIVER WYMAN

# THE OLIVER WYMAN RETAIL JOURNAL

VOLUME 5

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THE OLIVER WYMAN

# RETAIL JOURNAL

VOLUME 5

# Editorial

In the retail and consumer businesses, change is a constant. For our intensively competitive arena, adapting to change successfully has always determined who wins, and who falls by the wayside. Nothing new really – but now change is happening at a rate and scale previously unimaginable.  In the old days, perhaps five years ago, adapting to change was an incremental affair, achieved slowly but surely over a decade or more. Things are different now. Disruptive change is setting the agenda, and incremental adaptation appears increasingly inadequate to the task.  Massive change realized over a breathtakingly short time-span is the new reality, even if at times it can be hard to discern.  Each year we choose a cover which aims to convey our theme for the year – this time we have chosen an image of lava flowing into the sea. Lava might look as if it moves slowly, threatening only its immediate surroundings. But consider its impact after a few days: a comprehensively altered landscape. There is a lava flow oozing toward established retail and consumer markets, and its march is inexorable.

The new retail and consumer landscape will throw up threats and opportunities in almost every corner of the business – and much faster than in past upheavals. Accelerated adaptation will determine who survives – but it need not be just about survival. If retailers understand the rules of the new game and make the right investments, they can win: Volume 5 of the Oliver Wyman Retail Journal explores how.

Underlying many of the changes is new technology, the theme of our Strategic Insights section. Retailers already gather vast quantities of data on customer behavior, and are increasingly using analytics to turn this information into knowledge and to generate new business models. Retail's Next Revolution argues that retailers could and should increasingly become purveyors of online, home-delivery services tailored to individual customers.

Technology will also help reach new customers. Home delivery is often not cost-effective for lower-income people, and many don't have bank or credit cards. New payments methods could help them – including smartphone payments that do away with human cashiers – as could models such as click-and-collect.

For grocers and packaged-food manufacturers, a less-obvious but potentially critical source of competitive advantage could be innovation in response to increased government scrutiny of processed foodstuffs and sugar. Alarmed by the rising cost of treating lifestyle-induced conditions and the perceived "complicity" of retailers and manufacturers, governments are considering stepping in. In our view, industry must react constructively. In Fighting Fat, we make the case for being ahead of the curve, and present ideas on how to do so.

Beyond the theme of massive and rapid change, there are still evergreen topics in the retail and consumer industries. In our Business Transformation section, we discuss smart approaches to emerging markets and planning for digital disruption. In Operations Excellence, we present our latest thinking on how to cut costs, waste, and promotions – and how to work better with suppliers.

Change is here, and it's fast and large-scale. The choice for retailers is whether to drive it, or be driven by it. I hope the Retail Journal gives you much food for thought.

Yours,

James Bacos


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Volume 5



## STRATEGIC INSIGHTS









## BUSINESS TRANSFORMATION







## OPERATIONS EXCELLENCE






# RETAIL’S NEXT REVOLUTION

## RETAIL USED TO CONSIST OF THE FLOW OF PHYSICAL GOODS. IN THE FUTURE, THE FLOW OF DATA WILL BE JUST AS IMPORTANT

Traditional retail, after decades of following essentially the same business model, is on the cusp of radical change. As many consumers show signs of having reached “peak stuff,” digital technology is making it easier to go beyond selling more things, and offering instead the access to a broader range of products and services. Retailers will be transformed into information businesses, where the collection, analysis, and use of data underpin competitive advantage.

The change will be revolutionary and have implications for delivery, scale, and operations. Retailers need to get ahead of the trend, or else they will lose out to rivals and new, disruptive competitors. No one knows exactly where this will lead. But here are five predictions that show what the future of retail might look like.

## SELLING PRODUCTS IS OUT; SERVING NEEDS IS IN

Many sectors have already shifted from selling merchandise to serving customers' needs: People used to buy CDs; now they subscribe to music streaming services. Traditional retailers have lagged so far. But food retailers could make a start by customizing online shopping lists and suggestions to meet needs such as a vegetarian, dairy-free, or low-saturated-fat diet. They could use aggregations to set limits, such as treats making up no more than 5 percent of a total basket. And they could factor in customers' diaries, reducing a standard weekly order when someone goes on a trip.

The delivery-box model – which sends complete recipe ingredients to your door – is one example of groceries as a service. The first firms to do this have been smaller and mostly independent. But in future, clever use of data should enable big grocers to go further. Food subscription services could monitor your store cupboards, and then suggest a few additional items to complete a new recipe. In this world, the customer makes broad decisions about diet and budget, and the supermarket deals with what, when and how much. Customers will not shop at a retailer; they will set parameters in their subscriptions with a food-needs provider.

Beyond food, subscription services could manage clothing needs on the same principle. Customers would set their preferences for color, size, and body shape. The retailer would supply a mixture of basics and seasonal purchases – plus rental of designer outfits for special occasions.

## RETAILERS WILL KNOW MORE ABOUT YOU THAN FACEBOOK

Serving needs effectively implies knowing consumers better. In fact, traditional retailers already have a lot information on their customers, as point-of-sales data tracks people's everyday economic lives, sometimes including their use of telecoms, utilities, and financial services in retailers with a broad offering. In one important way retailers are gathering more significant data than social media: Facebook knows what you say; retailers know what you do – as well as where, and at what time.

Retailers will gather even more information as they expand their services. When they discover a customer prefers healthy foods, they might propose health-related services or insurance. Home delivery services will let them know when a customer is in. Much of this information will be very personal, and providers will need to make sure customers are comfortable sharing it. We think that they will be – so long as they get something useful in return. Many people will be grateful for a digital prod such as, "We know you have no dinner in the fridge. Would you like some recipe ingredients delivered at 8.30, assuming you'll be back from work at the usual time?" Over time, the more useful the services are, the more willing customers will be to share information.

## FEWER, SMARTER PEOPLE WILL WORK AT A SHRINKING HEAD OFFICE

The new business model will depend on crunching vast quantities of data to understand consumers and suggest solutions. That means digitizing the corporation in a way that empowers managers to make quick decisions and drive rapid product development. One retailer in London recently formed a new analytics and digital division, to begin looking at deep customer analytics and associated opportunities. The unit also brings entrepreneurship into the organization: It operates and feels like more like a startup than the blue-chip corporation it is part of.

Simultaneously, digital analytics and approaches will replace many traditional tasks – such as product selection, pricing, and forecasting – with algorithms. Only exceptions will be flagged for human intervention. Basic tasks such as invoice processing will be fully digitized, slashing head office costs.

Put together, these two trends will lead to a radically different corporate headquarters. Its function as a digital core will make the head office more powerful – but it will take on a virtual character and employ far fewer people than today. Some online-only retailers are already there, and traditional retailers will follow. At some point, retailers will abolish the physical head office entirely, distributing small agile teams around the business.

## HOME DELIVERY WILL BE UBIQUITOUS

The importance of physical stores will diminish too, as home delivery becomes a core element of the new services, aided by smart transport solutions. With progress towards self-driving cars already well advanced, it won't be long before an unmanned, hybrid delivery van sends you a WhatsApp message to say that it's at your house and you can collect your purchases from the van's delivery box using a password. If you're not in, it will proceed to other nearby deliveries and circle back to try again later.  Or, perhaps a robot will simply put your products in a locker in your driveway.

Given that many retailers will need to deploy the same shipment service, delivery might become a utility like gas and electricity, and be regulated by governments to minimize traffic. One designated delivery supplier for all retailers would be more efficient than many vans from numerous companies – and the reduction in congestion and pollution would be worth the price of blunting competition.

## THERE WILL BE HALF AS MANY LARGE GROCERS IN 10 YEARS' TIME

As these changes loom, international mergers are back on the agenda – witness the recent deal between Delhaize of Belgium and Ahold of the Netherlands. The obvious reason is the efficiency of international sourcing, which is how Aldi keeps its prices so low. Another factor is the potential to use technology at scale. Apps and analytics are expensive, and Amazon is a world-beater because it develops algorithms just once, and then uses them everywhere.

To compete with Aldi on prices and Amazon in subscription services and home delivery, food retail will turn from a national business into an international one through a wave of mergers and acquisitions.

Many traditional grocers who survive will become international behemoths that leverage synergies in sourcing, back-office functions, and technology at the regional or even global level.

Or they'll be nimble local players, which play up their local adaptation to the max and win customers by being precisely what the international players are not. Retailers who don't think hard about their place in the new world might end up in neither of these categories – and instead be swallowed up into someone else's strategy.

STRATEGIC INSIGHTS

# DIGITAL EQUALITY

## THREE STEPS TO BETTER SERVE LOW-INCOME CONSUMERS ONLINE

Digital has been one of the most discussed trends in retail over the past decade. This is not just hype: Many sectors have seen exponential growth of online sales, and almost every product category has been affected to some degree. In our view, though, all of the existing commentary about online retail's growth ignores the challenges and opportunities around low-income consumers. Despite comprising a significant minority in developed markets and a majority in others, this group is not well served by many online propositions. In response, we have written this article to explain why low-income shoppers are important; to explore the difficulties they face when shopping online; and reveal three ways retailers in developed economies can respond to serve these consumers.

Our research suggests that, as the gap between the highest and lowest incomes widens, the opportunities from building any type of proposition for low-income customers become more significant. In many situations, including where the market is not growing fast enough to keep owners and shareholders happy, retailers cannot afford to ignore the importance of low-income shoppers. For example, the bottom 30 percent of earners still represent 20 percent of grocery spend in the US, 19 percent in the UK, and 22 percent in Russia.

Low-income consumers are increasingly tech savvy and possess better technology than ever before. Despite increased online access, growth of online spend in this group has been much slower than that of middle- and higher-income consumers.

To attract more low-income customers to their online propositions, we think there are three main areas for retailers to focus on: develop low-cost fulfillment options; offer flexible payment solutions; and improve the mobile experience.

## DEVELOP LOW-COST FULFILLMENT OPTIONS

The cost structure of an online retailer is very different from that of a bricks-and-mortar business. On the one hand, an online retailer benefits from carrying less inventory, less shrink, less real estate, and fewer front-line staff. On the other hand, they face higher costs on the supply chain side, especially for item handling and return shipping costs.

In certain product categories, costs cancel out in a way that favors online retail. These are the categories where online sales have captured over 50 percent of the market, such as books, music, and movies. In contrast, in categories such as home furnishings, alcohol, and food, handling and supply chain costs significantly outweigh other savings, making it more expensive to serve customers online. (See Exhibit 1.)

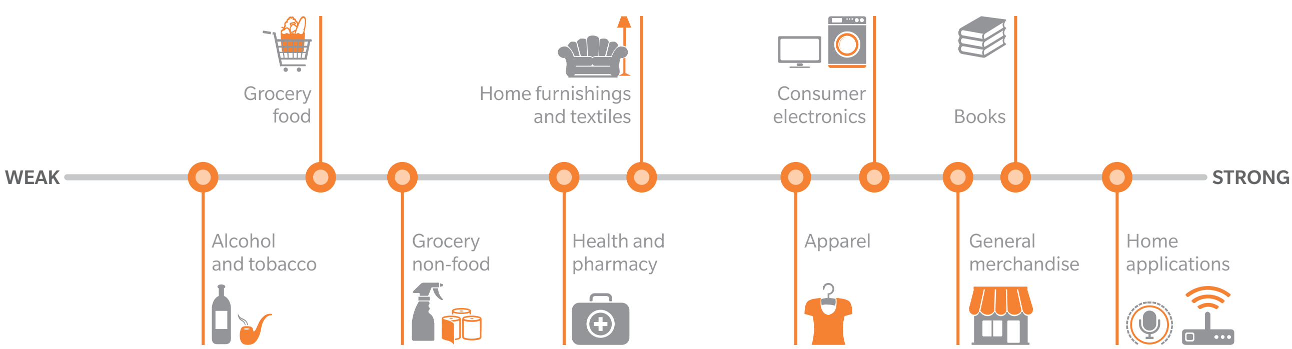
In product categories where shopping online adds cost to the business model, some of these costs are usually passed on to consumers as delivery charges. This can require a larger up-front cash outlay than is feasible for consumers living from one paycheck to the next. Even Amazon only offers free shipping with a paid membership, or with long delivery time, or only for select products or large spends.

The simple fact is that, for low-income consumers, it doesn't make sense to pay someone else to pick your order and deliver to your house when you could do this yourself. To serve these consumers, retailers will have to become more flexible about which elements of the online value chain they do for customers and which they let customers do for themselves to reduce costs and prices.

An obvious step is to eliminate last-mile costs by providing pickup points or click-and-collect; this proposition is popular in France for online grocery shopping. (See Case Study.) In the future, other ways to reduce last-mile costs could include incentives for customers in the same area to share deliveries or pick up orders for friends and neighbors.

These approaches could be used not only to neutralize a cost disadvantage in categories such as fresh food, where last-mile expenses are a real issue, but also to fund additional price reductions in categories where selling online is already cheaper than in store.

Exhibit 1: Comparative cost advantage of online retail versus bricks-and-mortar business
Supply-chain costs and handling charges add to the expense of some categories



CASE STUDY

# CREATING AND MAINTAINING SUCCESSFUL CLICK-AND-COLLECT BUSINESS MODEL

Introduced in 2004, the click-and-collect format known as Drive has gone on to win five percent of grocery sales in France. Auchan and Leclerc were the pioneers of the format, which provided a cheap alternative to home delivery for online orders, and they were able to use it as an advantage over the competition.

With click-and-collect sales plateauing, French grocers are now innovating again to stay ahead. Two solutions are currently being played out. The first offers a reduced product range compared to hypermarkets (8,000 SKUs versus 30,000) with 45 percent of products own brand (with higher margins). In the remaining products space, suppliers battle to stay included, giving grocers a better position in negotiations. The result is significantly better online profit levels, some of which can be passed on to consumers with lower charges.

The second solution involves moving from in-store picking for online orders to fulfilling orders from a dark store or central warehouse. This can cut order preparation time by half – on average from 40 minutes to 20 – and thus cut cost from the system.

# OFFER FLEXIBLE PAYMENT METHODS

Many low-income customers are also underserved by banks, and they either prefer to pay in cash or are forced to do so due to lack of other options. Multiple studies reveal that whereas 7 percent of customers in the bottom 40 percent of income in the UK do not have a debit card, in Germany, France, and the US the figure is 13 percent, 24 percent, and 33 percent of customers, respectively. The problem is even more severe in the less advanced economies: In South Africa, 60 percent of customers in the bottom 40 percent of incomes lack access to a debit card, and in Russia, the number is 64 percent.

To address this inequality, retailers need to create ways for online customers to pay in cash. One option is allowing for cash payment at a pickup point, which also, of course, addresses last-mile costs. Walmart's click-and-collect program in the US already enables this type of payment.

Another option, especially for large retailers, would be to help lower-income customers manage their banking needs, for example by issuing prepaid cards that customers can top up with cash. Indeed, such a system could help some consumers save by locking away cash, and could be expanded to include a credit facility to help customers manage between paychecks.

Similarly, it is possible to sell products online that are paid in installments. For example, UK online retailer Very allows customers to pay before delivery, or pay in three interest-free installments over three months, or use their credit service to spread out the cost further. This has provided customers with a unique proposition not available at other low-cost, fast-fashion shopping websites.

Flexible payment methods would also allow lower-income customers to benefit from bulk order discounts, which are often not possible because the initial outlay is just too high. To assist, retailers could find ways to help their lower-income customers plan beyond their current funds. For example, layaway programs, where customers reserve a product and pay in installments, have made a comeback in recent years. Now is the time for retailers to think about offering an equivalent service for big, bulk, online shops that can be dropped off at a local store or convenient pickup point.

# IMPROVE THE MOBILE EXPERIENCE

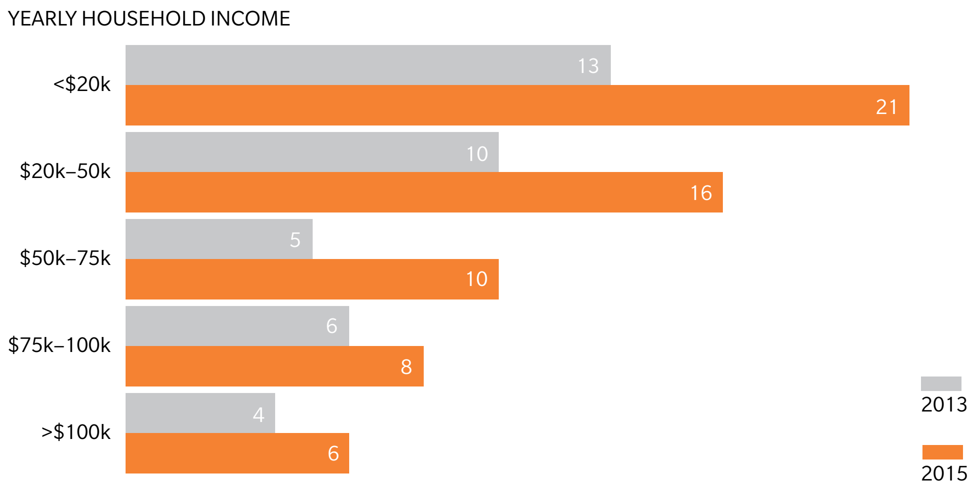
With the rise of smartphones and public Wi-Fi hotspots, many people with lower incomes can get good internet access; they are also more likely to be using their phone as their primary means to going online. (See Exhibit 2.)

This presents a major new area for retailers who wish to support these customers. However, currently too many mobile commerce (or 'm-commerce') sites are simply smaller versions of the full website and completing a complex transaction like purchasing groceries, clothes, or electronics can be tedious and difficult on a small screen. Investing in a version of the website that is custom-formatted for mobile browsing and purchasing is essential to capture the orders and reorders of customers who use their phones for shopping.

Beyond an easy-to-use mobile site, some retailers have tried to simplify online ordering with features that are not budget friendly. For example, both Amazon's automatic reorder buttons for household items and FreshDirect's click-to-buy recipes save time for middle- and high-income customers. However, in their current form, these systems reduce or erase the price transparency that is critical for lower-income consumers.

Retail leaders are investing in their mobile shopping experiences and designing new features that save both time and money. For low-income customers, this could be a grocery app that lets users set a budget and provide some information about dietary preferences to generate a meal plan for the week that fits those requirements and a shopping list. Similarly, a general merchandise retailer who provides parents with a pre-assembled order of school supplies at the lowest possible cost – perhaps allowing the family to start making payments months in advance – might be a very attractive option for many low-income shoppers.

Exhibit 2: Percentage of US adults who access the internet at home by smartphone only
Those in the lowest income group rely heavily on their smartphone for going online




Source: US Digital Users: The eMarketer Forecast for 2016

# CONCLUSION

Online shopping will continue to grow across many product categories, but many retailers are missing the opportunity to reach out to low-income customers who would like to shop online. Serving this group will require creative new solutions as well as reinventing parts of their bricks-and-mortar experience for the digital age. However, significant numbers of low-income consumers are likely to take their business to those retailers who offer a broad range of services to meet their online shopping needs.

# FIGHTING FAT

## A ROLE FOR FOOD RETAILERS

In January 2016, Oliver Wyman led a session at the World Economic Forum in Davos, Switzerland, entitled "Sugar, obesity, and diabetes – the other global food crisis." In the discussion, it was clear that harnessing the positive contribution from the food and retail industries could deliver real change. So, after the session, our retail team decided to study how food retailers can make a difference in their shoppers' weight, build loyalty, and enhance brand position. This report is the end result.

Being obese or overweight creates a global economic burden of trillions of dollars. It increases the likelihood of life-shortening conditions like heart attacks, strokes, diabetes, osteoarthritis, and some cancers. As a result, more members of the workforce have to take time off for sick leave and use healthcare resources.

At its most basic level, the obesity epidemic can be solved if consumers follow a very simple equation. (See Exhibit 1.)

Many stakeholders have proposed initiatives to tackle the obesity challenge. However, these typically focus on a single element of the weight-loss equation. For example, sugar consumption is often in the headlines and is an important part of the problem, but this campaign misses the opportunity to encourage healthier habits like exercise.

Exhibit 1: The weight loss equation
Simplifying the math of caloric intake

**EAT HEALTHIER** + **BE MORE ACTIVE** = **LOSE WEIGHT**

EAT HEALTHIER
- Less sugar
- Fewer saturated fats
- Smaller portion size
- Drink enough water
- Less salt

BE MORE ACTIVE
- More weight bearing exercise
- More cardiovascular exercise
- Less sedentary

LOSE WEIGHT
- Body uses up fat stores instead of creating them
- Larger muscles burn more energy when at rest

# WHY SUPERMARKETS ARE THE ANSWER

In many countries, big supermarket chains are positioned to be able to influence customer health habits in a way that could be very positive for their business while also delivering big health benefits for their customers.

By providing a range of simple services that make weight (and health) management easier, retailers could encourage customers to both eat more healthily and increase their activity levels. The key to this lies in being able to connect changed habits to improved outcomes. Unlike many stakeholders involved in health and wellness, big supermarket chains are in a position to encourage people to eat more healthfully, get them to increase their activity levels, and measure health and wellness outcomes and link them back to shopping habits and activity levels.

We believe supermarkets can provide a range of simple services that make weight (and health) management easier. And in our view, supermarkets that provide these services will create a strong reason for customers to keep shopping with them – and prevent third parties coming between them and their customers. (See our report "The Future of Customer Loyalty.")

## MAKING BETTER FOOD CHOICES TO EAT MORE HEALTHILY

Information on food labels is complicated, even in countries with "traffic light" systems, and customers have to make decisions about different nutrition categories. For example, is a product that's low on fat but high on sugar better or worse than the other way round?

We propose a system where points are calculated for each product, then combined for the basket. This is simpler than traffic-light scoring, as each product label could show only two figures: a Health Score ranging from -2 (unhealthy) to +2 (healthy), based on the overall nutritional value, and the number of portions in the pack.

These scores will help customers make healthier choices by clearly identifying which products are better for them.

At the checkout, the Health Score and the portion count would be combined, giving an overall score for the shopping basket. (See Exhibit 2.) The product scores will help customers make healthier choices by clearly identifying which ones are better for them, while the basket score enables customers to assess the healthiness of all the food they are buying.

Government or World Health Organization (WHO) guidance would be required to set a framework for these Health Scores. This guidance could develop over time to encourage food manufacturers to change their recipes to create healthier products.

Exhibit 2: Creating a basket-level scoring system for healthiness
A healthier approach toward maintaining good eating habits


| | | | | | | |
|---|---|---|---|---|---|---|
| **Sugar per 100g** | 8.5g | 6.5g | 21g | 17.2g | 12g | 10.6g |
| **Calories per 100g** | 59 | 82 | 103 | 366 | 47 | 42 |
| **Calories per serving** | 88 | 123 | 116 | 213 | 70 | 139 |
| **Example Health Score per portion** | +1 | -1 | +1 | -2 | +2 | -1 |
| **Number of portions** | 6 | 6 | +4 | 6 | 8 | 8 |
| **Health Score for whole basket** | 6 | -6 | +4 | -12 | +16 | -8 |

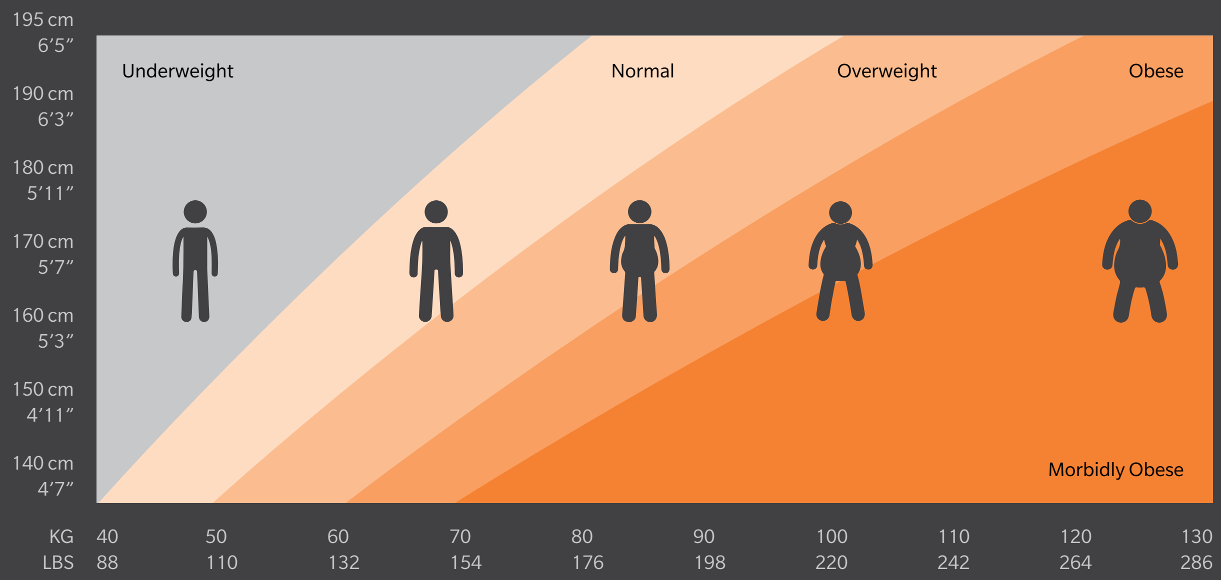
Source: Oliver Wyman analysis

# FIGHTING FAT FACT FILE

## HOW WE ARE PILING ON THE EXTRA POUNDS

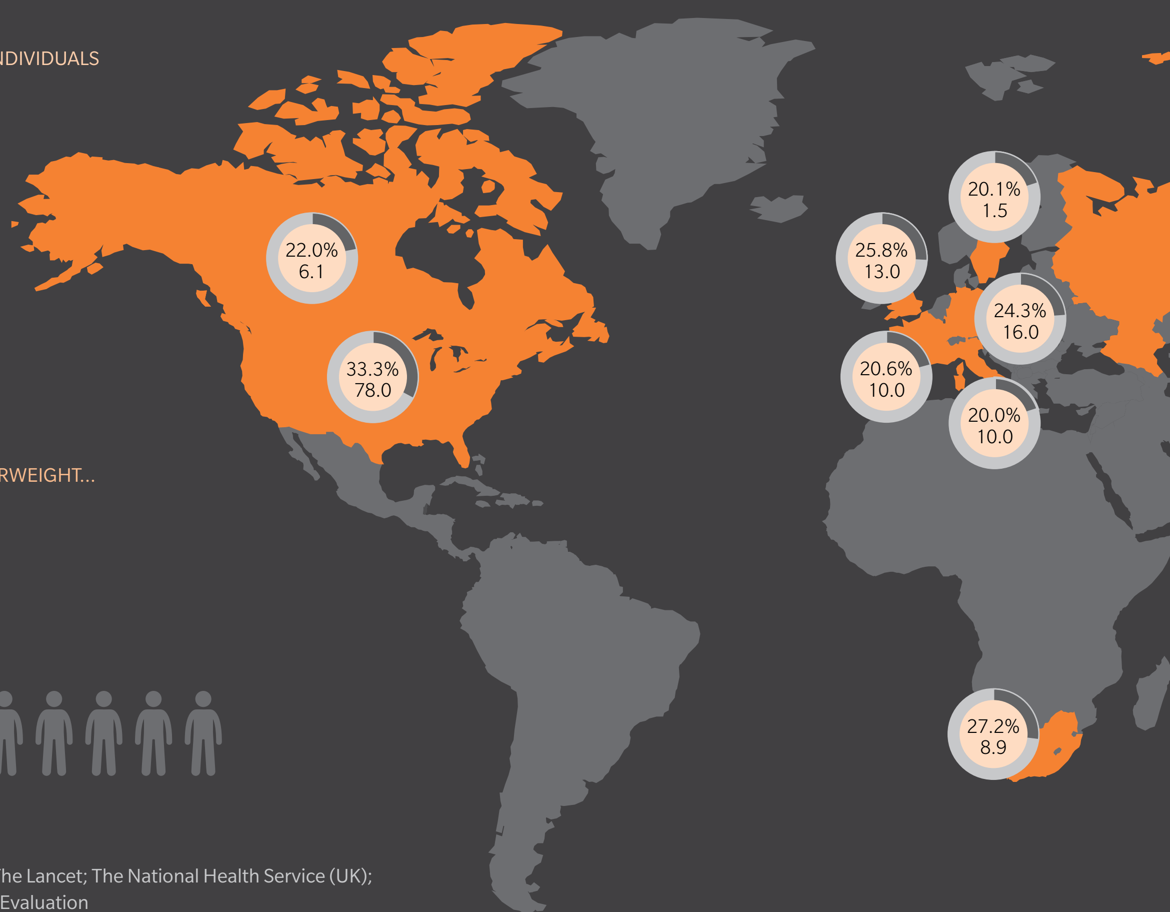
WHAT IS OBESITY?

HEIGHT VS. WEIGHT

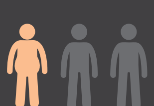



LOCAL OBESITY SNAPSHOTS

% OF POPULATION, MILLION INDIVIDUALS



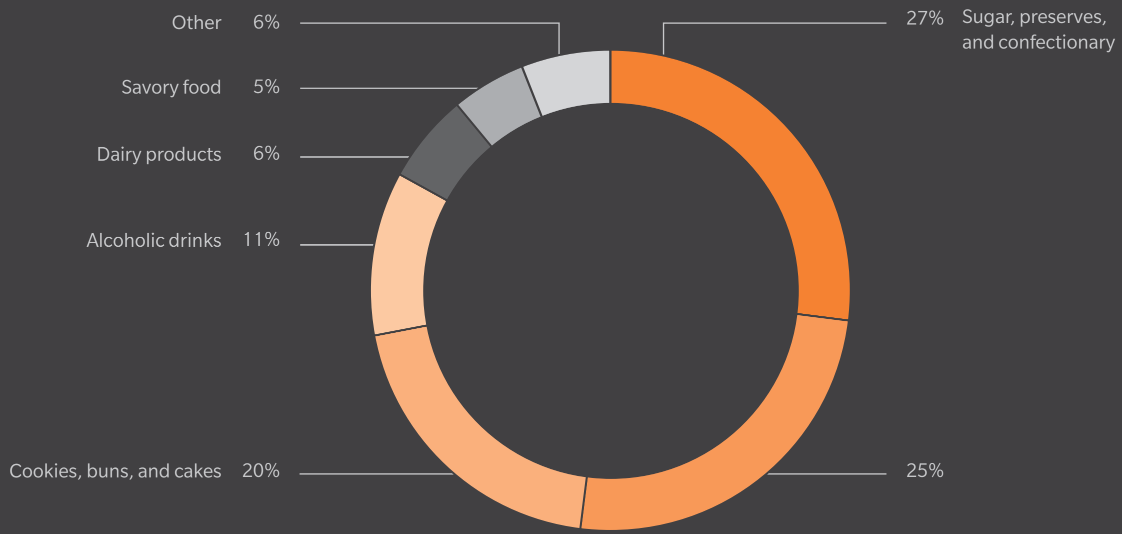

TODAY 1 IN 3 ADULTS ARE OVERWEIGHT…

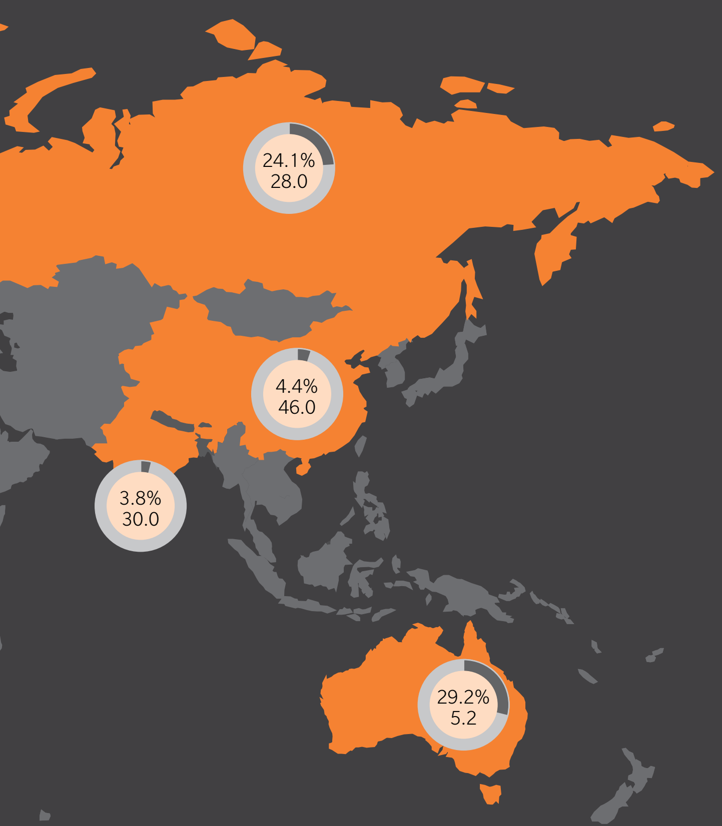


…AND 1 IN 10 ARE OBESE

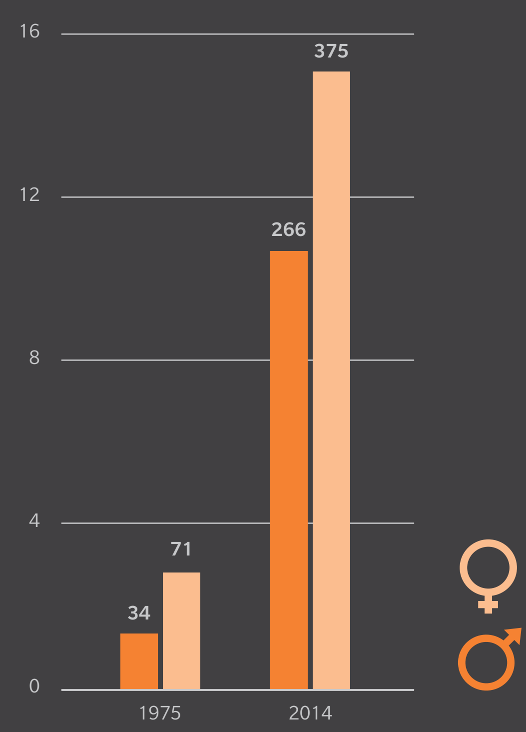
Sources: Diabetes UK; Nature; The Lancet; The National Health Service (UK); Institute for Health Metrics and Evaluation

SOURCES OF EXCESS CALORIES




THE GROWING GLOBAL OBESITY EPIDEMIC
% OBESE, MILLIONS



## ENCOURAGING CUSTOMERS TO INCREASE ACTIVITY LEVELS

While food retailers do not directly control customers' activity levels, we think they can play a role in encouraging people to be more active by helping customers track their activity levels. Many customers have activity monitors, like Jawbone and Fitbit. Retailers could link to this data, or customers could self-report by text, app, or email (with regular reminders from the retailer). For customers without an activity monitor, retailers could provide their own technology that uploads to their database, which may not be as expensive as it first appears. When you consider that many retailers give families a discount of around $50 each year as part of their loyalty programs, offering a health monitor instead begins to look more cost-effective.

Retailers can use their assets in innovative ways to help improve activity levels. For example, stores with excess space could set up gyms, where attendance and fitness classes could be tracked through the swipe of a loyalty card. The activity data could be included in the shopping basket score with, say, every 10,000 steps giving a bonus activity score of +2.

## MEASURE HEALTH AND WELLNESS OUTCOMES AND LINK THEM BACK TO SHOPPING HABITS AND ACTIVITY LEVELS

A powerful part of the proposition will be to show how activity levels and shopping habits contribute to their health outcomes, helping them make informed decisions and trade-offs. Each shopping visit would be an opportunity for the supermarket to monitor customers' key health indicators – weight, body mass index (BMI), blood pressure, and so on – then offer advice and specialist services, such as diabetes monitoring.

In addition to accommodating gyms and fitness classes, supermarkets could use excess space for services such as walk-in clinics, where modern equipment like smart scales can offer health checkups that take only a few minutes, adding another reason for customers to

Exhibit 3: Customer reactions to wellness centers in retail settings in the US
Customers seem open-minded about retail clinics


Source: Oliver Wyman research and analysis visit the stores. (See Exhibit 3.) Customers might be offered personalized advice linked to their shopping and activity habits. And with everything tracked on an easy-to-use app or web platform, they could quickly compare their shopping and activity logs to their checkup results.

Food retailers already collect huge volumes of data, and have an excellent track record of building sophisticated databases and keeping sensitive information private. Government or healthcare systems can use the combined databases in their care models with a focus on prevention. (See our report "Measuring Wellness.")

Moving beyond individuals, information collected could contribute to a digital community. Think of friends using the same supermarket and comparing progress; we can imagine how the competitive element might incentivize higher Health Scores. Building a sense of community makes the service more engaging and, we believe, increases loyalty to the retailer. To help offset retailers' costs, governments or healthcare providers could buy health-monitoring and related services, if they are high quality and favorably priced.

# CONCLUSION

By redefining themselves as health and well-being brands, and building customer loyalty through healthy living programs, supermarkets are poised to create unique customer propositions. Consumers will get the advice they need to improve their health, translating into savings for the economy. (See Exhibit 4.)

This is a solution where everyone can benefit, and which could transform the waistlines of an entire population.

Exhibit 4: Stakeholder benefits of retail-based health and wellness services
Supermarkets may be the answer to a healthier society

| SUPERMARKETS | CONSUMERS | GOVERNMENT/HEALTHCARE PROVIDERS |
|---|---|---|
| • Increased customer loyalty<br>• Enhanced brand position<br>• Economic benefits<br>– Own-brand healthy options likely to be higher margin[1]<br>– Cheaper than % loyalty scheme<br>– Consumers are more likely to shop at just one store, rather than shop around<br>– Ability to provide customers with better, targeted offers/coupons | • Positive reinforcement to make better choices and sustain them<br>• Helpful, easy-access health support<br>• Improved quality of life<br>• Easy access to own information | • Reduced health inequalities<br>• Improved access to healthcare<br>• Potential to build a robust national wellness database<br>• Saving money<br>• Improving society's relationship with food in the long term |

1. Production and manufacturing costs tend to be lower for fat-free or lower-sugar formulations Stakeholder benefits of retail-based health and wellness services.

Source: Oliver Wyman analysis

# RETAIL HEALTH CLINICS

## PART OF THE "NEW FRONT DOOR" TO HEALTHCARE

Over the past few years, the United States market has seen an explosion in retail health clinics. It is estimated there are now more than 2,000 health clinics operating out of pharmacies, grocery stores, and big-box stores. These around-the-corner sites of care meet people's desire for more convenient health services and present consumers a "new front door" to care. In addition, because retail clinics can provide certain types of care in a more affordable setting than an emergency room or traditional doctor's office, they present an opportunity to reduce health spending.

Right care in the right place at the right time is a compelling value proposition, and one that has the potential to disrupt the entire health marketplace. In fact, Oliver Wyman predicts that consumer use of alternative sites for care – such as retail clinics and telemedicine – will increase. As a result, $200 billion in current US healthcare spending could flow from traditional sites of care to these new options.

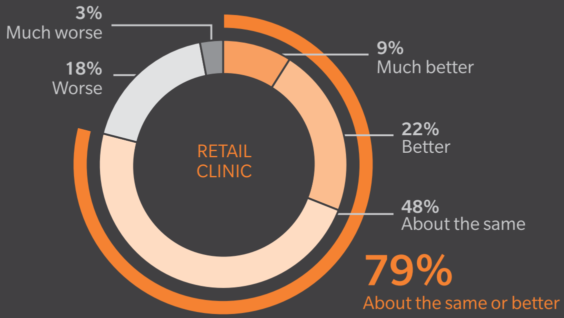
Much is at stake for all industry players, but retailers in particular, will play a significant role in the new health marketplace. With their existing customer base, brand loyalty, physical footprint, and health resources, they have an out-of-the-gate advantage. However, understanding consumers' starting-point familiarity and comfort with retail health clinics is essential.

To gain a clearer view of the new front door landscape and what role retail health clinics may play in it, Oliver Wyman conducted a national online survey of more than 2,000 individuals spanning all demographic and health segments. The findings, which were first published in the 2016 report "The New Front Door to Healthcare is Here," revealed that, consumers' awareness and use of retail health clinics is on the rise. What's more, many actually find the experience there better than a traditional setting. Yet the research also uncovered that not all retailers are created equal (in consumers' eyes). Every retailer must think strategically about pairing its offering with its customer base.

While the US healthcare market is unique, what could be interesting for other markets is the degree consumers are willing to access health in entirely new ways.

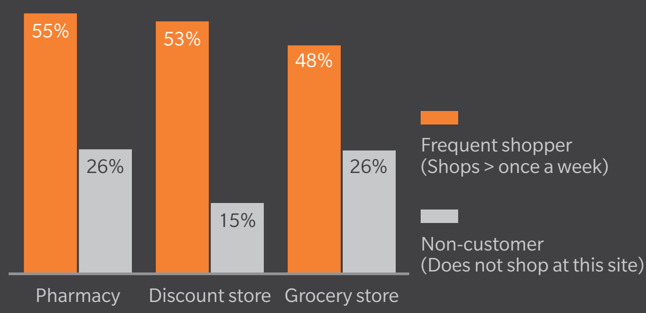
## SATISFIED CUSTOMERS

Most people who have used retail clinic found the experience the same or better than a traditional site of care; 22% said better and 9% said much better.



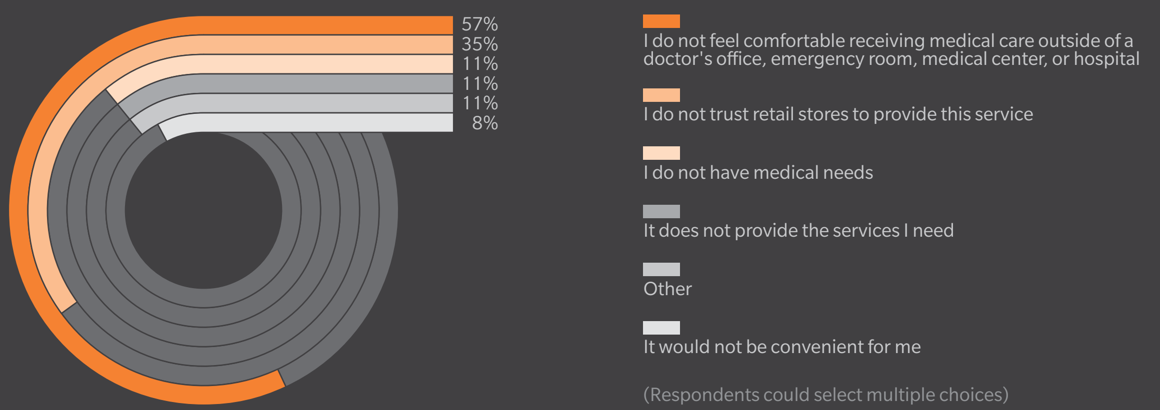

## FREQUENT SHOPPERS

Consumers who regularly shop at a retail store are more willing to receive health services at that retail site. So while the US healthcare market is in its early stages, consumers over the last several years are shifting their thinking and are open to retail as a point of healthcare delivery.




## HURDLES TO OVERCOME

Why would customers not use a health and wellness clinic in a retail store?
The majority said they did not feel comfortable receiving medical care outside of a doctor's office, emergency room, medical center, or hospital.




## NOT ALL RETAIL SITES ARE CREATED EQUAL

Consumers also seem to draw distinctions between the various types of retail settings. For example, people were more willing to receive routine preventive care in a health and wellness clinic in a drug store than in a health and wellness clinic in grocery store.

| | PHYSICAL | ROUTINE PREV CARE | ROUTINE EYE/EAR | ROUTINE DENTAL | MINOR EPISODES | DIET/ NUTRITION | FITNESS/ WELLBEING | CHRONIC MGMT |
|---|---|---|---|---|---|---|---|---|
| **Interested** | 25% | 52% | 21% | 20% | 62% | 50% | 51% | 39% |
| **Grocery store** | 7% | 22% | 12% | 5% | 24% | 20% | 20% | 13% |
| **Discount retail store** | 9% | 23% | 15% | 7% | 23% | 19% | 19% | 14% |
| **Drug store** | 10% | 29% | 15% | 7% | 31% | 24% | 25% | 17% |
| **Walk-in clinic/urgent care** | 13% | 29% | 14% | 9% | 39% | 18% | 19% | 18% |
| **Remotely** | 4% | 5% | 2% | 2% | 15% | 25% | 26% | 19% |
| **Not interested** | 6% | 5% | 5% | 6% | 7% | 20% | 19% | 13% |

Source: "The New Front Door to Healthcare is Here" 2016 report.


SECURE,
FAST,
DIRECT
IT'S TIME TO WAKE UP TO
EVERYDAY BANK-TO-BANK
CONSUMER PAYMENTS



In 2018, Europe will be hit by a new wave of payment regulation, called the Payment Services Directive 2 (PSD2). This little-heard-of acronym has broad implications for retailers operating in Europe because it will pave the way for direct bank transfers as an everyday payment option for consumers. In fact, we estimate it will capture 20 percent of customer spend away from debit and credit cards and circumvent $1.4 billion in card scheme transaction fees.

We believe this time will be different than previous attempts to enable bank-to-bank consumer payments in Europe because the regulation mandates direct, secure, and faster access to current accounts. Consumers will no longer have to log-on to lots of different sites and apps to view their financial information or transact purchase. As well as enabling easier and simpler transactions, if a consumer has a savings account in one bank, a checking account with another, and a loan elsewhere, the consumer will be able to view everything in one place for the first time, and move money around quickly and easily.

Under PSD2, any technology-enabled consumer business, including retailers, will be able act as a Payment Initiation Service Provider (PISP), which essentially will be the new portal between bank accounts and customer information. The hold of banks over consumer relationships will weaken, and retailers acting as PISPs will be able to build stronger relationship with customers.

We think retailers should be encouraging consumers to adopt this new type of payment. From an economic perspective, retailers should prefer payments through a bank-to-bank mechanism, as it eliminates interchange and scheme fees paid for a card transaction. In addition, the ability to initiate a payment directly from a consumer's bank account will reduce any friction in making a transaction, improving the customer experience and building loyalty. More importantly from a strategic standpoint is the data advantage this could give a business, potentially allowing them to see who else customers shop with, allowing bespoke marketing activities.

For larger-value transactions, an incentive to use a direct bank payment could be a one-off discount, funded by the savings the retailer makes by avoiding the traditional card transaction fees. Elsewhere, it could simply be because the retailer has made this type of payment the fastest and easiest way to complete a transaction.

## Exhibit 1: Adoption of bank-to-bank payment will depend on payment channel and transaction type

| | LARGE MERCHANTS/BRANDS | | SMALL MERCHANTS/BRANDS | |
|---|---|---|---|---|
| | High transaction value | Low transaction value | High transaction value | Low transaction value |
| **MOBILE/ONLINE EXAMPLES** | Payment for a holiday with a major travel website | Regular payments to an app store, or online retailer | Payment for a holiday rental property | Mobile payment at a kiosk |
| **OFFLINE POS EXAMPLES** | Purchase of a vehicle at a major dealership | Contactless card payment in a grocery chain | Purchase of a luxury item from a boutique | Contactless card payment in a taxi |

Many positive opportunities to benefit from PSD2

Neutral or mixed opportunities from PSD2

Least likely to benefit or be affected by PSD2

Source: Oliver Wyman analysis

In Exhibit 1, we show the purchase occasions and channels where direct bank transfers are most and least likely to be adopted.

Payments made through online merchants could easily be made through this new method, but it may take longer to introduce in brick-and-mortar stores because of the upgrades required at the point-of-sale. Larger businesses with strong brands will have the most success in driving consumer adoption, due to a high degree of trust and existing loyalty schemes. It will be important for retailers to move first and move fast to offer this service, as the winners will effectively own the customer wallet, gain significant customer insights, and become an essential part of the customer's daily life.

This open-access banking trend is already significantly advanced in other countries. In China, Alibaba created a one-stop-shop app to fulfill many consumer needs on a daily basis, such as shopping, payment, wealth management, and ordering services. Consumers keep all of their financial information in one place, can manage it easily, and can make mobile and online transactions easily.

The approach has proven extremely popular with consumers. In 2015 Alibaba's Alipay and Tencent's TenPay took over 90 percent of the mobile payments in China, worth about $3.4 trillion, up 134 percent from the year before, according to a Bloomberg report. Alipay alone has 300 million users and conducts 80 million transactions every day. Forbes estimates that China's banks lost $22.2 billion in deposits in 2015 to Alibaba and Tencent.

More importantly, Alibaba now has access to a vast and valuable trove of transaction data, which gives them the ability to market different products and services to consumers in a highly relevant and targeted way.

New payment methods are changing the retailing landscape. Retailers must be ready to pivot in order to thrive and succeed in the new environment, To avoid being caught out by an Alipay of Europe, we recommend retail executives consider the following: the effect of PSD2 on the retail payments landscape in the near and midterm; becoming a PISP or partnering with one; capitalizing on emerging new payment methods; and changing their operating model.

# CONCLUSION

Over the coming years, both opportunities and risks will be abundant in European retail as the PSD2 legislation is clarified. Even after Brexit, the UK will not be exempt, as their Open Banking Standard is producing recommendations along similar lines. Innovations are bound to emerge, and competition will intensify, with the potential to make or break a retail business, depending on what actions its leaders take and when. The pressure is on, and the time to ask difficult questions of your retail business model and technology capabilities is now.

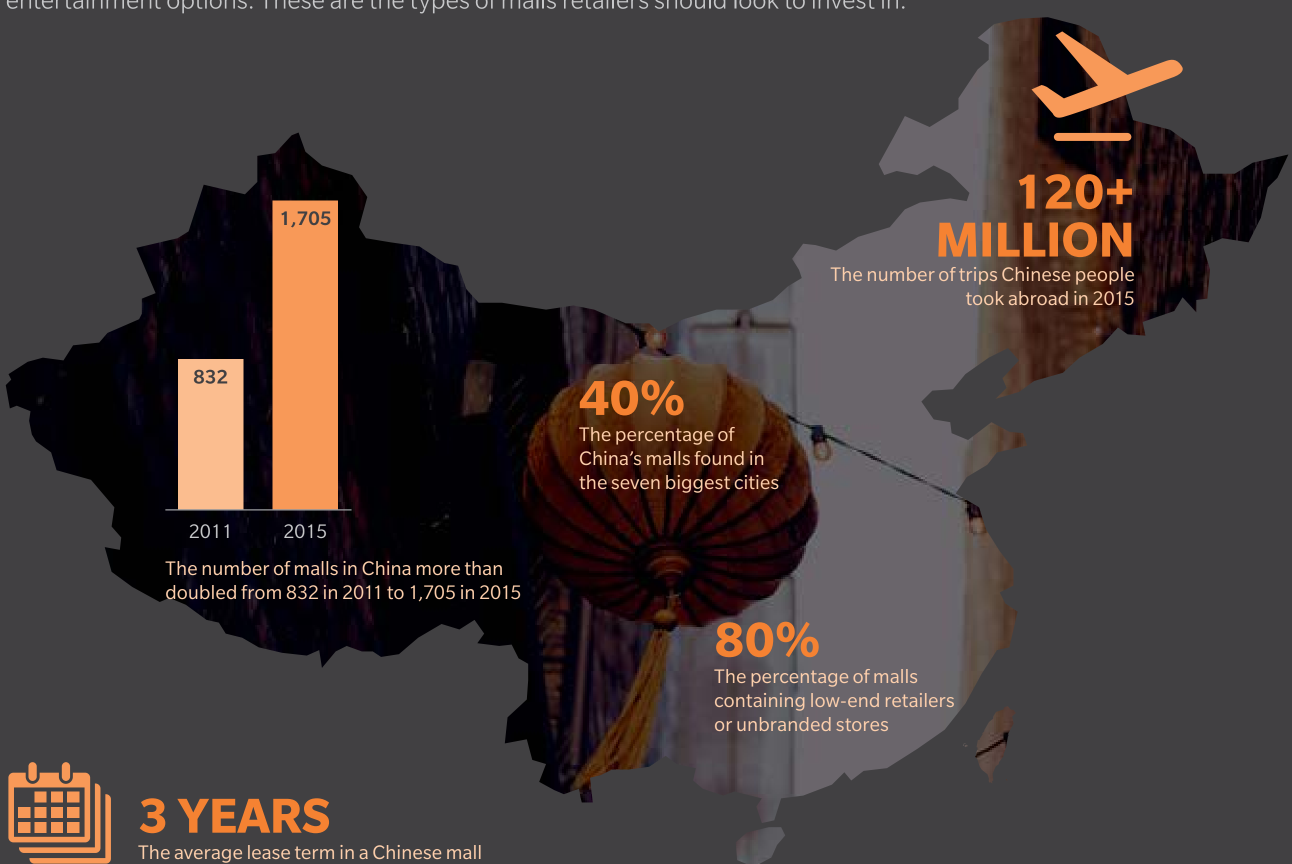
# WHEN THE CHINESE COME OUT TO SHOP

## CAPTURING SPENDING IN MALLS AND ABROAD

The growth in online shopping in China is huge: since 2011 spending online has grown seven-fold from 0.5 trillion yuan in 2010 to 3.8 trillion yuan in 2015, according to iResearch Global. But Oliver Wyman research suggests that there are opportunities for both domestic and international retailers to win a share of the Chinese spend without having to try to compete with online giants. Two ways of doing this are to take advantage of the growth and popularity of malls and to serve the needs of Chinese shoppers travelling overseas.

### SHOPPING AT HOME

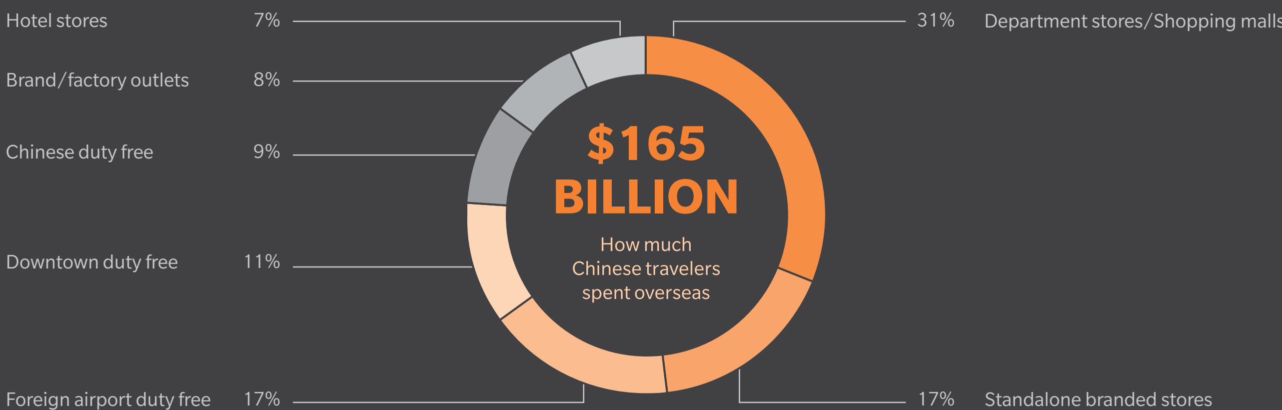
We audited malls in 50 Chinese cities. Our results show that, despite the growing popularity of online shopping, malls are popular where they combine shopping with dining and entertainment options. These are the types of malls retailers should look to invest in.



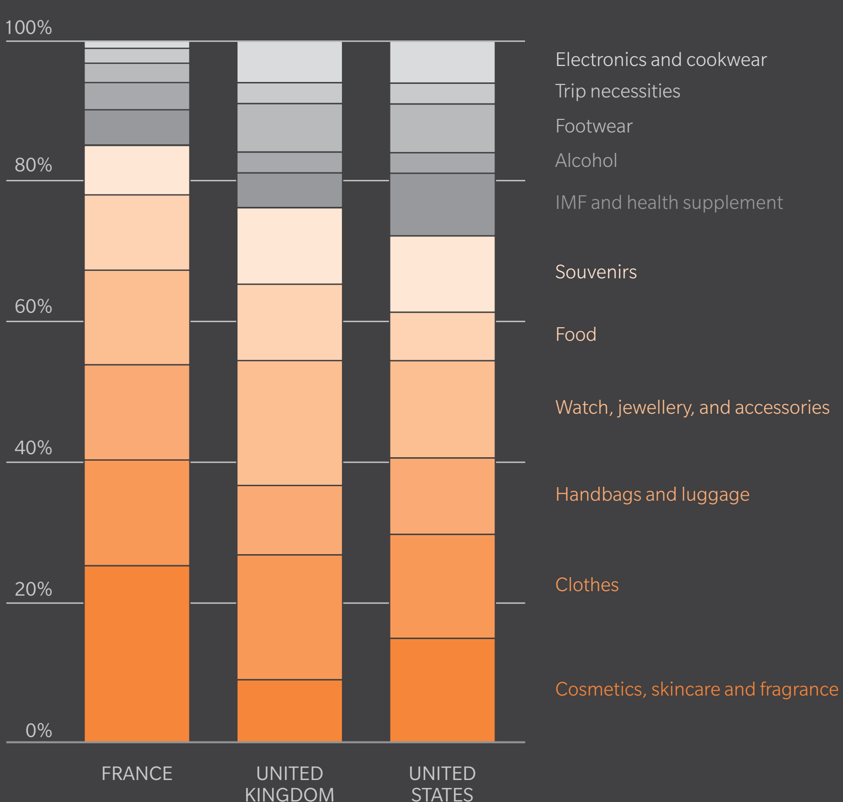
## SHOPPING OVERSEAS

We also surveyed 1,750 Chinese people who had traveled abroad in the past year and found Chinese travelers spend around $1,200 per person on shopping. To capture this spend, it is important retailers engage with potential customers while they are still in China and demonstrate the authenticity, good quality, and a reasonable pricing of their products.

### Here's where the Chinese shop when they travel...




### ...and here's how they spending varies across three destinations





The 2015 increase in spending by Chinese travelers


The percentage of overseas spending that is done for others – either as gifts or to resell back home

BUSINESS TRANSFORMATION

# LESSONS FOR EMERGING MARKETS

## FOUR ACTIONABLE INSIGHTS FOR RETAILERS

In parts of North America and most of Western Europe, the retail sector has reached a saturation point. Opening new stores in these markets does not lead automatically to an increase in bottom line results. Under these conditions, retailers have had to change their approach to maintain year-over-year growth on sales and profitability, for example, by becoming more cost efficient and wringing greater profits out of the same volume of sales, or by investing in commercial capabilities to enhance like-for-like sales. (See our report “The Rise and Rise of Cost Reduction.”)

Meanwhile, in developing economies, some retailers are following in the footsteps of those original retail pioneers, mirroring the same pattern of rapid growth and expanding real estate. Innovation and local customization are thriving in places like China and India, but also in lesser-known markets like Kazakhstan and the Czech Republic.

But the world is not the same place as it was when the likes of Tesco, Carrefour, Walmart, and Edeka made their first billions. With globalization and digitalization, markets are maturing in a very different consumer environment, where they are both hindered and helped by the internet, international competition, and collaborations.

For retailers in emerging markets and those mature retailers looking to expand on the international stage, here is a simple guide to the step you can take.

## BIGGER ISN'T ALWAYS BETTER: SMALLER FORMATS CAN WIN, TOO

In countries like France and the UK, retailers grew rapidly by building huge real estate portfolios of giant out-of-town hypermarkets, and then raced to buy up space on the high street to offer convenience formats in every neighborhood. While there is some demand for super- and hypermarkets in emerging markets, the fastest-growing format is the smaller convenience store size, of under 3,000 square foot.

In Russia, this scenario is being played out by Pyaterochka (owned by X5), Magnit, and Dixy, all of which are pushing out a vast number of discount-style convenience stores that offer low prices and target small but frequent shoppers. The approach has lent itself to rapid expansion, because the stores are small, light on capital expenditure, and easy to open, with a basic product range. Between 2012 and 2016, the three main retailers collectively opened over 13,000 new stores, more than doubling the number of modern retail stores in Russian grocery.

Small formats are also hugely successful in India, where most of the populations' grocery needs are served by small local stores; and in Poland, the discount format Biedronka – a banner of Portuguese retailer Jeronimo Martins – is leading the market. These smaller formats are nimble enough to win share from the international behemoths of hypermarket retailing by tailoring themselves to serve local demand and having adaptive supply chains.

# ONLINE IS A NECESSITY, NOT AN OPTION

In the West, most of the big retailers had a strong physical presence before adding an online channel into the mix. Retailers in emerging markets will likely not have this luxury and will have to adapt themselves accordingly. For example, in China, Alibaba, JD, and Yihaodian built their own logistics networks supporting their online businesses – an expensive choice, but one that gives them full control of the end-to-end customer experience.

Similarly, shoppers in the more remote places outside Kazakhstan's main cities are keen to adopt online shopping opportunities, if the technology and infrastructure can be provided to support it. Retailers in Kazakhstan have proven to the rest of the world that cash-on-delivery is a viable payment solution for online orders. Lack of flexible payment options is often a barrier to people who are not able to access banking services or who prefer to pay in cash, for whatever reason, such as distrust of online payment systems. (For more on this, see "Digital Equality: Three steps to better serve low-income consumers online.")

In developing countries, mobile phones and tablets have leapfrogged desktop computers and laptops in enabling people to get online. Meanwhile in developed countries, use of mobiles and tablets to access the internet is increasing, particularly among people with lower incomes. Successful retailers are investing in excellent mobile shopping sites that are customized to browsing and making purchases on a small screen.

In India, the grocery market alone is worth over $650 billion. But this huge consumer market is regulated by laws aimed at limiting competition from international retailers. However, regulations in India do permit foreign businesses to operate via online marketplaces, allowing consumer goods to go where stores cannot. Businesses taking advantage of this, like UK clothing retailer MISSguided and US brand The North Face, are helping customers become familiar with their brands, so as internet access grows and infrastructure challenges decline, they will be well-positioned to win market share. Those who are watching and waiting for legislation to change are already a step behind.

# CONSOLIDATION SHOULD ALWAYS BE ON THE TABLE

Consolidation will always be a feature in retail. Such consolidation may be on a small scale and local, as in the case of the Future Group in India bringing local, family-owned stores (kiranas) – currently serving 98 percent of the country's grocery needs – into their Aadhaar (rural) and KB's Fair Price (urban) franchises. Or it may be national, as we are seeing in Poland, where a highly competitive and fragmented market – the top five leading grocers account for less than 50 percent of the market – is being shaped by those retailers who are actively pursuing a strategy of integrating franchise concepts and local banners.

Merger activity in Poland will continue in the coming years, driving centralization and efficiency. In such retail environments, the winners will likely be those businesses that actively drive consolidation early on and can quickly and efficiently integrate businesses to streamline commercial and operational activities like category management, purchasing, or logistics.

In mature markets, we also expect to see more mergers and acquisitions, as shown in the Netherlands. Two national companies combined when Jumbo bought C1000, and more recently, Albert Heijn merged with Belgian supermarket Delhaize. In addition to national and international consolidation, it is important for retailers to keep an open mind about cross-sector acquisition and merger, such as UK grocer J Sainsburys' purchase of general merchandise retailer Argos. It may prove to be a canny way to future-proof their business in the face of a local market, confronting falling grocery margins, loss of share to hard discounters, rising food inflation, and fickle consumer confidence.

# DON'T FORGET THE BASICS

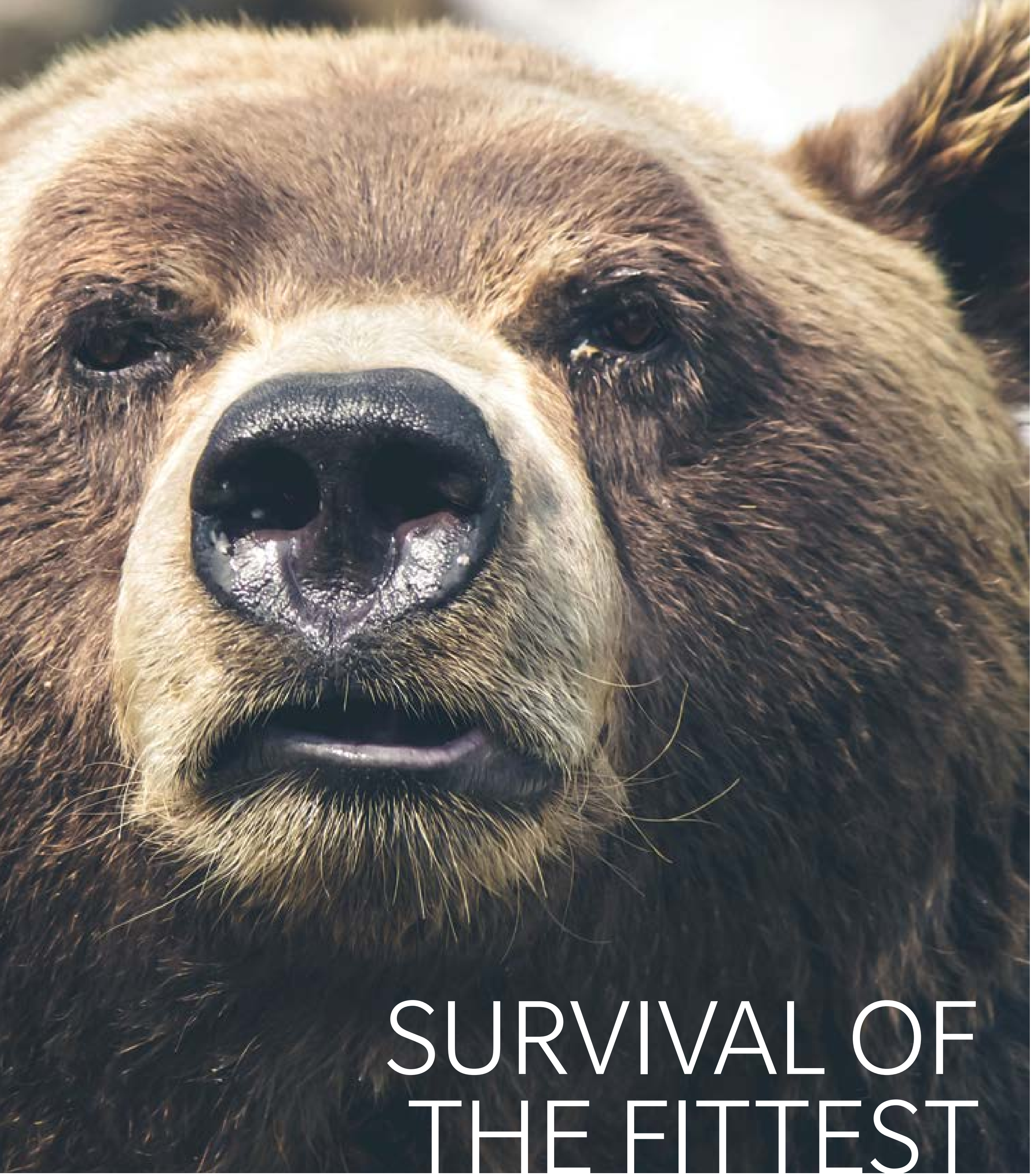
In the end, success in retail comes down to customer satisfaction with prices and product offering. To meet these expectations, a retailer must have strong commercial capabilities. In particular, they should consider reducing complexity and cost in their operations.

For example, promotions are becoming a retail plague in the Czech Republic. Over the past years, the fight for customers and market share has led to a flood of promotional activities by almost all the supermarkets in the country. In the Czech Republic, we see half of the sales made will be products on promotion, rising to 80 percent for some categories – like poultry or beer – during certain times and in certain stores. The grocers may believe they are positioning themselves as the low-cost option, but the result is that customers no longer trust the original shelf prices and will only make purchases on promotion. This is driving a vicious cycle of more and more promotions that damage the business.

Pricing, promotions, and product assortment are among the most powerful levers that a retailer can use to improve financial performance. It is therefore essential to manage them actively, and to ensure senior management retains visibility and control of key decisions. With dozens of buyers making hundreds of decisions every day, the stakes are high, with millions riding on choices made by relatively junior personnel. Ensuring that corporate strategy is cascaded down into individual product categories and that the buying teams have the tools they need to make the right decisions can transform a retailer's financial performance.

## CONCLUSION

The cornerstones of successful grocery retail are the ability to adapt to new and changing environments and developing the right formats and related capabilities in a cost-effective way. To succeed in emerging markets, domestic and international retailers should not only look to customize their businesses to the specific challenges and opportunities of each region, but also be open to learning new ideas from markets and experiences half a world away.



# SURVIVAL OF THE FITTEST

## FOUR STEPS TO PROTECT YOUR RETAIL BUSINESS AGAINST THE DISRUPTIVE FORMATS OF THE FUTURE

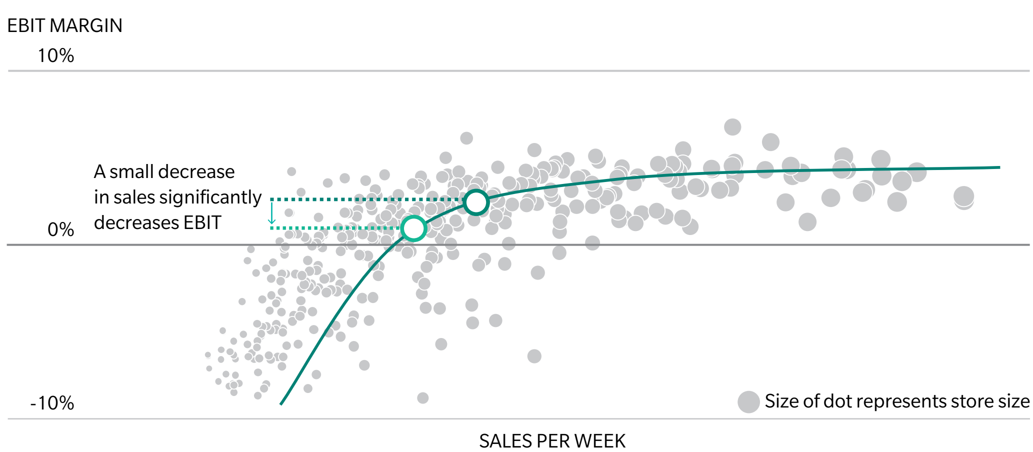
Just as animals compete for food and water, so retailers compete for customers and the money they spend. Retail is a high fixed-cost business, where there's a minimum sales level needed to break even. As you approach that point, profitability becomes very sensitive: For stores that are just over the threshold, a small decrease in sales dramatically reduces profitability. (See Exhibit 1.)

That is why innovators are so disruptive. They take small amounts of share rapidly, tipping many stores below the breakeven point. Most of today's large retailers have many stores on the steep part of the curve. A small decline in sales will push many of their stores into loss-making territory; an even smaller decline will make many stores sink assets, incapable of delivering enough return on capital to justify investment. That is why it is so critical for incumbents to find a way to keep growing; when they do, however, their growth often comes at the expense of a direct competitor who slides down the curve.

## HOW TO SURVIVE

Surviving and thriving in the ever changing retail wilderness comes down to four key themes: anticipating the next competitive threat; understanding the reality of your starting position across your store estate; investing in capabilities to win; and placing bets on reinvention.

Exhibit 1: Profitability is very sensitive to sales disruption




Source: Oliver Wyman Analysis

# ANTICIPATE THE NEXT COMPETITIVE THREAT

Innovators both big and small pose a threat. Depending on the EBIT of your retail sector, it doesn't take much to erode profitability. For example, a typical food retailer would start to lose money with as little as a 10 percent share loss.

We see three types of innovative disruptors on the horizon in retail:

**Online formats.** If an online format hasn't already begun to steal share in your sector or market, you can bet there is one coming. In some retail sectors, an online business model makes these disruptors cheaper from the start. They also have other advantages, such as more customer data, different shareholder expectations, and (in some ways) increased customer convenience.

**Leaders on customer experience and offer.** We see customer experience and offer leaders – such as Apple, Kiehl's, and Wegmans – driving growth in a range of retail sectors. Many of these are niche rather than mass-market businesses. However, they can still damage incumbents by taking enough share to tip them into negative profitability.

**Low-cost operators.** Highly efficient value-focused operators continue to take market share, especially in areas where the economic recovery is weak or non-existent. Examples include the hard discounters in food (particularly Aldi and Lidl) and fast fashion discount retailers in apparel (such as Primark). These formats have a fundamental cost advantage, which incumbents cannot match. (See Exhibit 2.)

Exhibit 2: Cost advantage of grocery hard discounters[1]

| | TRADITIONAL SUPERMARKET | TRADITIONAL HYPERMARKET | LOW-COST HYPERMARKET | DISCOUNTER |
|---|---|---|---|---|
| Sales | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of goods sold and shrink | -69.0% | -73.5% | -76.0% | -81.0% |
| Gross margin | 31.0% | 26.5% | 24.0% | 19.0% |
| Store labor cost | -13.5% | -12.5% | -8.0% | -4.0% |
| Central costs | -14.0% | -12.5% | -10.0% | -8.0% |
| EBITA[1] | 3.5% | 1.5% | 6.0% | 7.0% |

1. EBITA: earnings before interest, taxes, and amortization

# UNDERSTAND YOUR STARTING POSITION ACROSS YOUR STORE ESTATE

If your business is under threat, it is worth being realistic about what you can defend. There are some store locations where you are unlikely to win no matter what you can invest. For those stores, you should manage exits in a way that reduces exit costs. There are other stores where you already have an advantage. For these stores, you want to invest just enough to maintain that advantage but not throw money at them. The rest of the stores are where the risks and opportunities lie; those are the stores that merit the most investment dollars, because they are where investment can make the difference between success and failure. Segmenting your estate in this way will give you an advantage against other incumbent players whose approach may rely more on the average.

# INVEST IN CAPABILITIES TO WIN

The fundamental difference between a successful traditional retailer and one at risk is that the former will have more sophisticated management capabilities. These enable them to drive greater returns from every store and every aspect of the business.

One of the most important tools for success is usually improving the efficiency of merchandizing decisions. Where a simple pricing strategy may have sufficed in the past, you now need a different strategy in every store. Where a single range used to be enough, you now need a different one for each customer segment and store cluster. Where you used to count on increasing scale to drive improved supplier terms, you now need to learn how to drive money from big suppliers while working with a wider range of smaller suppliers.

Similarly, in operations, running stores on gut-feel and instinct is no longer good enough. Store staff need new tools to improve forecasting and ordering, and to drive gains from shrink and availability. Store labor needs to be planned more accurately to match service to customer needs. And, in retail sectors where consultative sales add value, sales assistants need customer intelligence at their fingertips.

## PLACE BETS ON REINVENTION

To grow long term, innovation is needed. Either launch your own initiatives or become an investor in the next innovator. Remember: the odds of success are low, so you need to place more than one bet, innovating and adapting rapidly. One way to make this happen is by creating a separate part of the business where an innovation culture can thrive. In this new startup unit, insist on incremental progress to force concepts to fail fast and help you recognize promising early stage innovations. You can also invest in other innovations, scanning the landscape to turn would-be competitors into your own future source of profits.

## CONCLUSION

Competition and change in retail are facts of life. Having survived industrywide disruption in the past is no guarantee of enduring the next time around because the threats keep changing. In the past we saw category killers and hypermarkets elbow their way into the retail market, while more recently it has been online pure-play businesses and discount formats with lean operating models. Keeping a watchful eye on emerging formats and innovations is important, but so is taking an honest look at your own business in order to build up defenses and strike first with your own disruptive innovation. In the future, retailers who follow and react rather than innovate and experiment will likely become prey to more successful and agile competitors.

# BREAKING THE ADDICTION

## A SIX-STEP PROGRAM FOR RECOVERING FROM FOOD RETAIL PROMOTIONS

Promotions are the hard drugs of the retail system: They ease the pain in the short term, but as use increases, so does dependency and it becomes harder and harder to quit. After decades of misuse, the side effects are starting to damage the whole retail ecosystem, and we believe more and more retailers will need to break free from their addiction to promotions.

In this article, we talk about how promotions became the short-term fix for a suite of issues, and present the case for the detrimental effect their overuse is having on retailers, manufacturers, consumers, and the environment.

We then provide a six-step program for successfully addressing the addiction.

## PROMOTIONS ARE FAST AND EASY

Promotions can be an automatic response to tough times, used to help retailers meet targets in a difficult quarter, compensate for declining customer numbers, or increase sales over an important holiday period. In many mature markets, promotions are increasingly used to drive sales once room for additional store growth runs out and participation is rising inexorably: In Europe, promotion participation rose from 20 percent in 2003 to 35 percent in 2015.

The dynamics of funding negotiations also drive promotion participation upwards. As retailers push suppliers for better terms, the suppliers want something in return: an increase in promotional funding and intensity.

So if promotions do drive sales, bring in customers, and are funded by manufacturers, what is the problem?

It could be argued that this situation is no different from five or 10 years ago, and it is true that promotions have always been a source of internal complexity and tough debates.

However, we believe that this time it is different. Pressure from multiple sides – including regulators and government – is forcing retailers to look at this topic again, and the call for action is becoming urgent.

As a result, we think it's time for retailers and manufacturers to reduce their promotions programs, and in the next section we explain how this can be done.

# GOING INTO REHAB

For retailers who recognize the damage promotions are causing their business, there are six steps to break the cycle of dependency. Taking these steps will create a competitive advantage of improved value perception, which may prevent sales volume decline and remove costs and complexity from their business.

## STEP 1: SEEK CLARITY ON THE ROLE OF PROMOTIONS

As a first step, be clear about the purpose of promotions. What role do they play in the business proposition? Which customer segments buy into them? How do they link with other levers? How do they work in a world that's shifting to one-to-one customer communication?

This should enable a desired level of promotions to be defined – one which is probably significantly lower than today's activities.

## STEP 2: UNDERSTAND THE REAL IMPACT OF PROMOTIONS

At both retailers and manufacturers, managing promotions takes a lot of time and energy but only a fraction of this usually goes into measuring the actual business benefit of the offers.

For example, often promotions are assessed by looking only at sales increases on promoted items. This means that side effects such as cannibalization and pull-forwards are ignored.

More fundamentally, the traffic-driving power of the program is not monitored, making it difficult to take a critical look at performance week-by-week.

One of the reasons why it is hard to measure the real impact of promotions is that there are so many factors to be considered. (See Exhibit 1.) The criteria for measuring the impact of any promotion include: direct sales increase; cost of the discount being given away; supplier funding; sales changes in related products and brands (cannibalization); sales changes after promotion versus pre-promotion sales (pull-forward); cost of marketing the promotion; additional store labor and supply-chain costs of processing extra volumes; change in basket size (halo); and change in number of customers (halo).

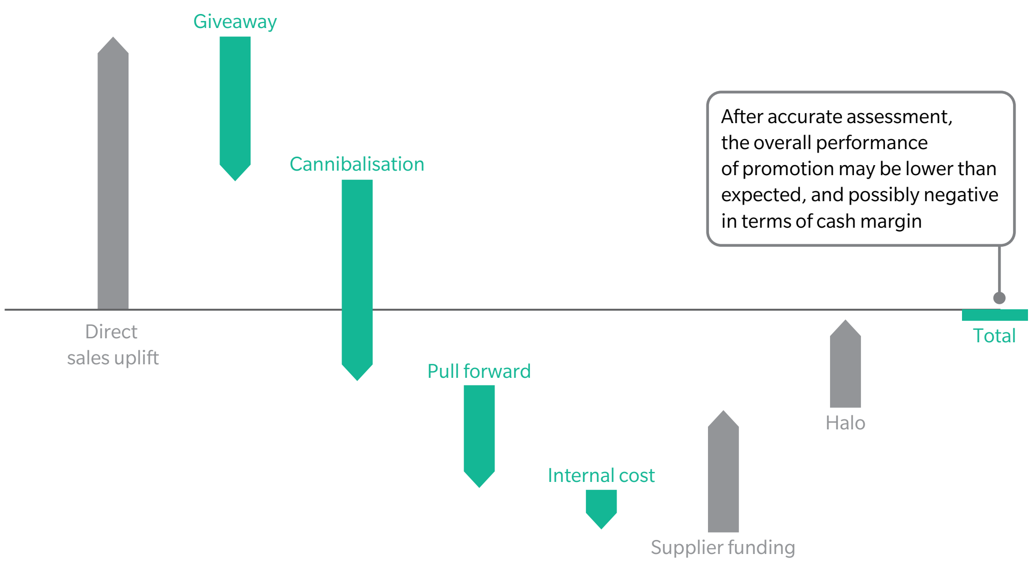
## STEP 3: ACT ON THE KNOWLEDGE YOUR DATA GIVES YOU

Once these effects have been measured, it is possible to work out why some promotions do not work economically.

If there is not much uplift, retailers need to ask themselves: Are customers uninterested? Is the product placement optimized? Is enough stock available on the shelves at all times?

Exhibit 1: Measuring the real effect of a promotion on cash margin
Multiple factors play a role in measuring the impact of promotions

CHANGE IN CASH MARGIN




Source: Oliver Wyman analysis

Even if there is uplift, challenge whether the effect is from the promotion or an external factor, such as good weather driving ice cream sales or a competitor receiving some bad press.

Improved understanding of the true performance of each promotion will lead to better decisions regarding the promotions companies choose to run. Armed with this information, it is possible to decide what to keep promoting, what to stop promoting, and how to manage each of the factors affecting a promotion's profitability, in order to drive additional sales and margins.

## STEP 4: MOVE AWAY FROM PROMOTIONS WHERE POSSIBLE

Once the true benefits of promotions are identified and unprofitable promotions are removed, a more thorough analysis of the remaining program will highlight products and categories where it would be better to shift away from promotions towards an every day low price (EDLP) approach. These will typically be categories where promotions participation is high (40+ percent), where uplift has been decreasing (any money spent on promo yields lower returns), and where the amount of supplier funding is massive (typically covering 80+ percent of the discount).

It is likely that some suppliers within these categories are suffering from the same vicious cycles as the retailer – high cannibalization, low or no volume growth, and degradation of their brand position – making them receptive to partnerships to help correct the promotional strategy.

# REVEALING THE TRUE COST OF PROMOTIONS

Promotions are detrimental not just to retailers, but also to manufacturers destroying value in the long term for both parties. Indeed, they can be bad for customers' health and finances, as well as the environment.

**MYTH**

**FACT**

MANUFACTURERS

Promotions help build brand and popularity.

Promotions degrade long-term brand equity. Customers start seeing the regular price as poor value.

Promotions are the best option when market growth is low and product innovation and differentiation are not generating enough sales.

Reducing promotions programs allows manufacturers to invest more in innovation and development, rather than spending so much time on trade tactics with their retailer customers.

Promotions bring customers through the door and capture their whole baskets.

Price-comparison websites and apps show where the best offers are, allowing consumers to "cherry pick" promotions at different retailers for different parts of their shop.

Promotions get customers to spend more.

As more and more promotions are run, the sales-driving efficiency of the deals diminishes mostly due to lower promotional elasticity and higher cannibalization.

CUSTOMERS

Promotions offer customers value for money.

Some promotions are confusing, and simpler pricing and ranges would meet customers' true needs more easily.

Promotions keep sales volumes up.

Volume uplift is short-lived and customers will switch to only buying the product when it is on special offer.

Promotions are a cost-effective way to increase factory utilization.

Promotions add cost to the value chain because of the increased volatility and complexity they introduce.

RETAILERS

Promotions are an easy option.

Promotions trigger additional costs at each step of the process, from printing coupons to supply chain volatility, waste, and availability issues in store.

Promotions make retailers look cheaper to customers.

Promotions have a lower impact on value perception than everyday low prices (EDLP). Too many promotions can even damage value perception by confusing customers.

Promotions are always a good thing for customers.

Promotions can contribute to unhealthy eating patterns when targeted at categories such as sugary drinks and snacks where buying more means consuming more.

ENVIRONMENT

There is little to no environmental impact of running a promotion.

Because volumes are more difficult to predict on promotional items, they are typically a big cause of in-store shrink. Promotions also cause consumers to overbuy, leading to waste at home.

## A PROMOTIONS ADDICTION IN NUMBERS

# ONE

The number of points of profit erosion to expect from each 10 points of promotions participation

**x2**

Average uplift ratio from each unit of giveaway – significantly lower than most retailers realize

**1/3**

Proportion of promotions that do not really drive sales and actually reduce profit before funding from suppliers, destroying value for both the retailer and the manufacturer

**20%**

Amount by which cannibalization has increased in Europe over the past 10 years

**18%**

Decrease in sales uplift from promotions over the past five years

**20%**

Proportion of promotions in fresh categories, despite the strategic importance of these areas

## PROMOTIONS DRIVE SUGAR CONSUMPTION

Reducing the consumption of sugar, salt, and fat is an increasing concern for consumers, governments, and health care systems in developed countries. When the role of promotions in diet-related ill health was discussed at our World Economic Forum panel on managing obesity, we decided it was time to take a look at a typical promotions programme and see if sugary products really were on promotion more often, and what the increase in consumption patterns really was.

**x2**

Products and categories with above average sugar content are twice as likely to end up in the promotions program

**60%**

Rise in consumption of high-sugar products due to promotions; primarily driven by the participation of lower socio-economic groups

**70%**

Proportion of supplier funding linked to promotions on sweets, confectionery, sodas, and spirits

The reputational risk to retailers is real, providing an additional reason to reduce promotional participation in these categories.

### STEP 5: WORK WITH SUPPLIERS TO TRANSITION FUNDING STRUCTURES TO EVERYDAY LOW PRICES

As mentioned earlier, one of the main issues contributing to promotions proliferation are the terms and conditions negotiated over time between retailers and manufacturers.

This reliance (on both sides) on promotional funding needs to be addressed. While such discussions are hard work, a change is ultimately good for both parties, breaking the cycle of promotions addiction.

Moving to an EDLP structure ultimately makes funding flows less fixed – increasing the degrees of freedom for the retailer to find better ways to win customers and drive share, and helping suppliers to put their money into the places where growth lies.

In Europe, we are seeing renewed interest from both sides to address this issue.

### STEP 6: CONTINUE TO INVEST IN TECHNOLOGY AND CAPABILITIES

Understanding and managing promotions requires analytical horsepower as well as excellent operational workflows. Many retailers and manufacturers have invested heavily in new technology but are joining an arms race: only those on the leading edge will win customers and drive financial returns.

Technology has a tangible impact on the business when it comes to the power of promotional forecasting. In the past two years, there has been a shift from more traditional linear forecasts towards sophisticated machine learning approaches, which can cut error rates by more than 50 percent.

## CONCLUSION

Promotions can be a quick fix, but long term they cause issues for retailers, manufacturers, and customers. The promotions addiction has been going on for a long time, but we do now see a shift, with retailers wanting to change and manufacturers being willing to participate in programs to reduce promotional intensity. Doing this is not easy but it can be done, by following a systematic data-driven approach to reducing dependency.

OPERATIONS EXCELLENCE

# THE RISE AND RISE OF COST REDUCTION

## HOW TO CUT BETWEEN 20 TO 40 PERCENT OF COSTS FROM A RETAIL OPERATING MODEL

Cost is always on any good retailer's agenda. Cost inflation is usually higher than price inflation, so the business must continuously generate efficiencies to maintain the same level of profitability. However, this treadmill can generate an incremental approach toward cost: squeezing out a little more each year, salami slicing labor budgets, pushing suppliers a bit harder, challenging expense budgets.

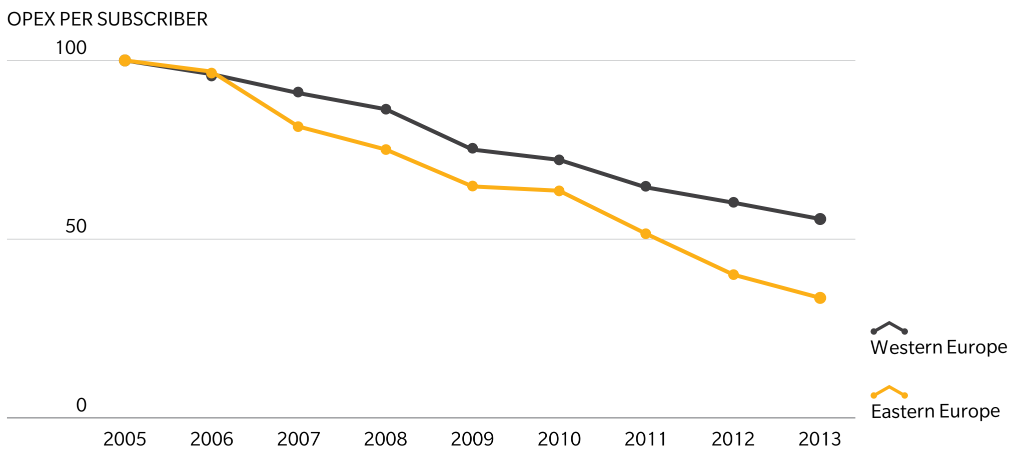
Such programs are part of the day-to-day for most retail executives. But in today's market, such incremental efforts are no longer good enough.

Faced with flat demand, excess space, and competition from lower-cost business models, what many retailers really need to do is dramatically change their cost structure by stepping up cost savings by an order of magnitude – we're talking 20 percent instead of 2 percent. Other industries have already lived through this: over the past decade, to remain profitable as the average revenue brought in by each user has declined, mobile telco operators across Europe have had to cut business costs per subscriber by up to 30 percent. (See Exhibit 1.)

Similarly, retail banks are cutting costs dramatically as their products become digital and physical branches are needed less and less.

For the first time, we're seeing many retailers getting ready to look at cost step-change programs. A few years ago, step-change conversations on cost were rare among retailers; today, they are common.

### Exhibit 1: Telco operators successfully reduced OPEX per subscriber by over 30 percent in less than a decade



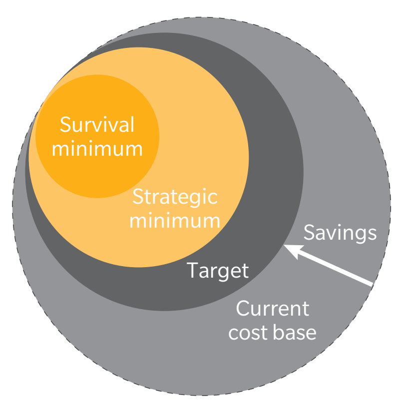

Source: UBS; Wireless Matrix (BoA, Merrill Lynch); Informa Telecoms & Media; CISCO; IEEE; Oliver Wyman Research

### Exhibit 2: Three steps to a zero-based approach to cost

Step 1: Identify survival minimum
- Base services, such as regulatory reporting
- Justified internal demands, such as health and safety
- But no frills, no comfort, no breakouts

Step 2: Identify strategic minimum
- Short-, medium-, and long-term targets are all considered
- No frills, with only a few people creating impact, but targeted investments are delivered

Step 3: Agree a realistic optimization target
- Limited amount of extra activities included
- No unnecessary internal demand
- Few activities that do not create extra value



So how can a retailer step-change its cost position? One way is for the retailer to switch from ongoing incremental reductions in head office staff to a zero-based approach toward each function. (See Exhibit 2.), Here, the focus is on tasks that are truly business critical or ones with a real business case – eliminating "nice to have" activities.

Across the business, it's also important to examine radical process simplification and automation – for both internal and customer-facing activities – learning lessons from the new breed of digital retailers. There are now online-only retailers turning over in excess of $1 billion that operate with as few as 200 full-time equivalent staff in the head office. Of course, incumbents are not the same as digital businesses, but the approaches these new entrants take, particularly around using analytics and algorithms to lower staff costs, are instructive. We describe one case of transforming an insurance business through digitization in Case Study 1.

In retail, taking out significant amounts of "tail" range in categories where customers do not value a broad choice enables the customer proposition to be simplified. In Case Study 2, we explain how one discounter reduced its average store product range by 20 percent. While removing products needs to be done carefully, if the cuts are focused on duplicative products and/or categories that are not "choice elastic," then the sales hit can be minimized and sometimes reduced to zero. Simplifying the range in this way enables efficiencies in supply chain and store operating models and a consequent reduction in cost.

The final activity that can bring about a cost step-change is simplifying and rationalizing the supplier base to collaborate much more closely with a smaller number of suppliers and as a result, get significantly better terms (see our report "MoreTrust Wins More Value"). Among some retailers, there is also an opportunity to remove middlemen from the supply chain, as well as shift share to higher-margin, white-label products.

# CONCLUSION

As other industry sectors have made vast improvements in their cost position, retailers may take heart from their success – but they also need the vision to think big. Substantial increases in cost savings have not been achieved through small-scale incremental change to existing business models. Instead, retailers need to go back to the drawing board – leaving behind the "this is how we've always done it" mindset and following a zero-based approach to cost that focuses on what customers really want and need. By redesigning products and services against a low-cost model – for example by using new technology to help customers help themselves or by reducing complexity – retailers can follow those other industries into a profitable future. This kind of change doesn't happen overnight, but we expect to see more retailers in more markets attempting similar programs over the next few years.

CASE STUDY 1

# COST REDUCTION THROUGH DIGITIZATION

## BACKGROUND

A traditional personal insurance company in Europe was losing customers to new digital rivals. It had identified that digitization was the key to survival, and wanted to use it to become more agile with pricing and to streamline the operating model.

## WHAT WE DID

We benchmarked the company against insurance competitors and other successful digital disruptors, which challenged the management team to think differently about how to get things done. We showed the team that one competitor was able to update its prices every 15 minutes, while another needed only 30 customer service staff on 750,000 policies.

With these benchmarks in mind, we helped the company reinvent its key processes in the mold of a digital disruptor. One way was to allow customers to log and track claims online; another was creating a one-stop-shop for its claims suppliers. We also took over a terabyte of data and created a custom analytics engine, which looked at 8,000 risk factor combinations, 750,000 data points, and over 200 million individual quotes, to deliver weekly risk assessments of its clients.

## RESULTS

The benefits to the company were significant:

- Over £100 million of quick wins delivered within 18 months, by rapidly moving the business towards the agreed target cost levels.
- More than 5 points of margin improvement, achieved through dynamic pricing, risk reduction, and add-on penetration.
- Improved agility to react to price changes from competitors.

CASE STUDY 2

# COST REDUCTION THROUGH REDUCED COMPLEXITY

## BACKGROUND

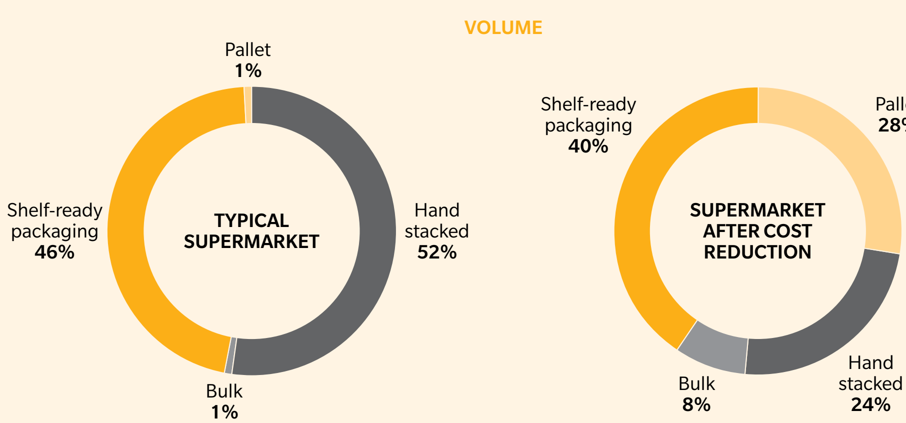
A struggling US discounter identified that it had a vast product range that was contributing extra complexity to the business model, resulting in higher costs across the business.

## WHAT WE DID

Working with suppliers, the retailer switched to only stocking fresh products ready to sell, without any cutting or wrapping in store. When rationalizing the fresh range, we removed high-waste items and focused on stocking products sourced nearby the retailer's distribution center, reducing supply-chain costs. We reduced the number of hand-stacked products by introducing cases ready-to-go direct onto the shelves and, in some instances, by shifting from cases to mini pallets. (See Exhibit 3.)

For faster checkouts, the placement of bar codes on items was optimized to ensure the products scanned the first time, and we increased the height of the checkout counter so items could be slid directly through the bar code scanner and into the shopping cart.

Exhibit 3: Fast and efficient replenishment solutions can deliver 1–1.5 percent operating efficiencies in store




## RESULTS

The retailer achieved a 25 percent reduction in the number of different products sold in a typical store, which supported further reductions of:

- 20 percent in supply chain costs
- Over 5 percent in other store costs such as utilities, maintenance, and cleaning
- Over 30 percent of store labor costs

# MORE TRUST WINS MORE VALUE

## CREATING JOINT VALUE WITH SUPPLIERS CAN UNLOCK BILLIONS

Retail business models are under pressure as they adapt to cost inflation, online and discount competitors, and rapidly changing customer needs. Every part of the business is under increased scrutiny, including the retailer's relationship with suppliers. As a result, some retailers have taken to squeezing their suppliers harder. While this can yield short-term benefit, we are increasingly seeing a trend for retailers to work with suppliers to create new sources of value and deliver higher, more sustained savings. This report describes the steps to move supplier relationships away from a "them and us" mindset, unlocking bigger savings by focusing on improving the efficiency of the supplier-retailer system and redesigning it for mutual benefit.

Around the world, we are supporting retailers who are conducting detailed reviews of their processes with a few key suppliers and tapping into savings of millions of euros. Scaled up to market level, the benefits could be very significant indeed. (See Exhibit 1.)

Exhibit 1: Scope of savings available from supplier collaborations in fresh categories
Joint value creation encourages engagement with partners

| COUNTRY | POTENTIAL SAVINGS AVAILABLE | |
|---|---|---|
| | **Dollars (billions)** | **Local currency (billions)** |
| China | 0.9–1.3 | ¥5.9–8.9 |
| France | 1.5–2.3 | €1.4–2.1 |
| Germany | 1.3–2.0 | €1.2–1.8 |
| UK | 1.7–2.5 | £1.4–2.1 |
| USA | 6.8–10.2 | $6.8–10.2 |

Source: Planet Retail and Oliver Wyman analysis


PAY
HERE
EACH
$5.00

In these new models, the interactions between retailer and supplier change fundamentally, from two people on either side meeting face-to-face just twice a year, to a structure that incorporates dozens of departments and encourages regular engagement and innovation across common strategic objectives – all based on respect, trust, and joint innovation. We call this approach "joint value creation." Making this transition involves three key steps: select the right suppliers to innovate with; build a respectful, productive relationship based on trust; and innovate together on new and improved processes.

## SELECT THE RIGHT SUPPLIERS TO INNOVATE WITH

It's important to point out that not all suppliers are right for the joint value creation approach and, for the majority of medium and smaller suppliers, it is right to continue with the status quo of tough negotiations and limited interactions. To identify those suppliers who could be innovation partners, leading companies use a framework to review the relationship. (See Exhibit 2.)

Exhibit 2: A framework for identifying the right suppliers for joint value creation
Picking the right supplier is a critical step in the process

| DIMENSION | SCORE | RATIONALE |
|---|---|---|
| **Priorities:**<br>To what degree does the supplier see joint value creation as a priority? | LOW – HIGH<br>1 2 3 4 5 | Without a strong business incentive behind the program with high stakes, the right resources may not be allocated on both sides. |
| **Strategic potential:**<br>How important will this supplier be in this market in the future? | LOW – HIGH<br>1 2 3 4 5 | Markets will evolve so it is important to recognize and invest in relationships that could yield advantages like exclusive access to products and services in the future. |
| **Trust:**<br>What level of trust is there among senior management? | LOW – HIGH<br>1 2 3 4 5 | Trust is critical to the success of a joint initiative. Senior management at both parties need to buy in to the change and act as role models for the required change in mindset. Both parties need to see the venture as an opportunity and not a new way to get profit out of each other. |

# BUILD A RESPECTFUL, PRODUCTIVE RELATIONSHIP BASED ON TRUST

The objective for any project of this kind should be to build sustained competitive advantage. This will only happen if, early on, the retailer and supplier commit to a multiple-year journey built around a defined, respectful, and ongoing framework that builds trust over time. In successful transformations, there are both process changes and attitude changes on all sides.

Both parties must have a shared target. This is often complex to agree upon: Typically, the target is not typically just about price and volume but rather market share, customer satisfaction, product quality and innovation, supply chain efficiency, and other broader issues.

With such a target, both sides work more closely together, for example by setting up joint teams around product development, forecasting or logistics management, or at the very least increasing the frequency of joint meetings. In our experience, the partners should aim for top management to meet at least twice a year, and operational teams (including product development, supply chain, quality, and forecasting) should meet at least monthly.

The objective in all of these meetings is to ensure that progress on the joint projects is tracked, new collaboration options are identified and investigated, and day-to-day issues are resolved promptly. However, increasing the frequency of meetings is pointless if both companies do not share relevant data and are not aligned on which KPIs to track and how to calculate them. A powerful approach can be to create joint scoreboards that collate live data from retailer and supplier and are used to help top management and operational teams on both sides look at exactly the same information. (See Exhibit 3.)

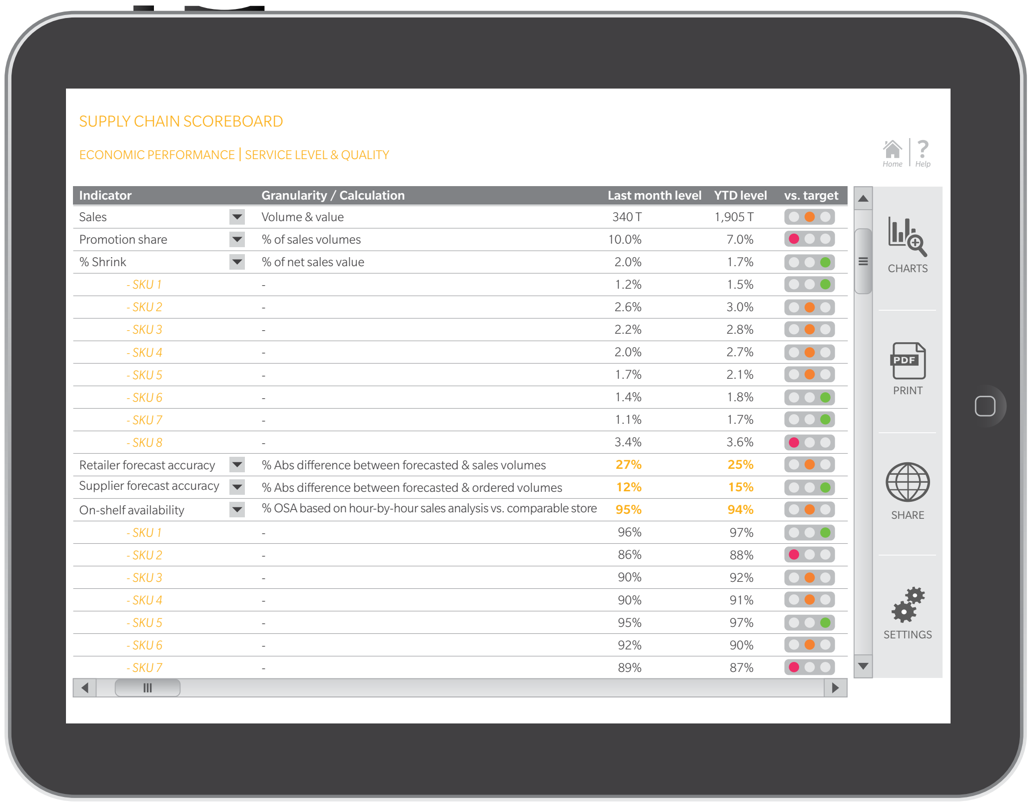
The companies with the most advanced programs often change the incentives schemes of their employees to align with the KPIs defined for the joint relationship. Once employees from both parties are incentivized to build a joint success story, the positive outcomes of the programs often increase two- or three-fold.

# INNOVATE TOGETHER ON NEW AND IMPROVED PROCESSES

By challenging existing processes together, both the retailer and the supplier will benefit. Based on recent experience, we see product development, forecasting, task de-duplication, and supply chain as processes where collaboration can significantly and rapidly benefit the bottom line.

Exhibit 3: An illustrative screenshot of a supply chain scoreboard to support data sharing

By aligning KPIs, retailers and suppliers are able to get on the same playing field



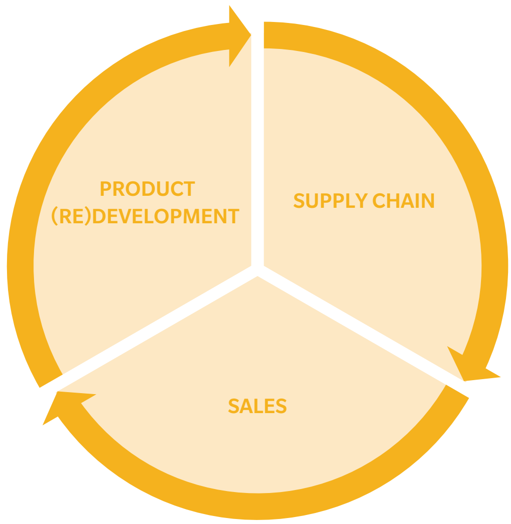

| Indicator | Granularity / Calculation | Last month level | YTD level | vs. target |
|---|---|---|---|---|
| Sales | Volume & value | 340 T | 1,905 T | |
| Promotion share | % of sales volumes | 10.0% | 7.0% | |
| % Shrink | % of net sales value | 2.0% | 1.7% | |
| - SKU 1 | - | 1.2% | 1.5% | |
| - SKU 2 | - | 2.6% | 3.0% | |
| - SKU 3 | - | 2.2% | 2.8% | |
| - SKU 4 | - | 2.0% | 2.7% | |
| - SKU 5 | - | 1.7% | 2.1% | |
| - SKU 6 | - | 1.4% | 1.8% | |
| - SKU 7 | - | 1.1% | 1.7% | |
| - SKU 8 | - | 3.4% | 3.6% | |
| Retailer forecast accuracy | % Abs difference between forecasted & sales volumes | 27% | 25% | |
| Supplier forecast accuracy | % Abs difference between forecasted & ordered volumes | 12% | 15% | |
| On-shelf availability | % OSA based on hour-by-hour sales analysis vs. comparable store | 95% | 94% | |
| - SKU 1 | - | 96% | 97% | |
| - SKU 2 | - | 86% | 88% | |
| - SKU 3 | - | 90% | 92% | |
| - SKU 4 | - | 90% | 91% | |
| - SKU 5 | - | 95% | 97% | |
| - SKU 6 | - | 92% | 90% | |
| - SKU 7 | - | 89% | 87% | |

## PRODUCT DEVELOPMENT

Across a product's development life cycle, retailers and suppliers will interact on numerous occasions. Typically, however, the processes in place at these points have not been designed collaboratively, nor do they operate jointly.

A joint approach, in contrast, works differently. (See Exhibit 4.) By asking, "How do we increase the joint returns from this new product?," retailers and suppliers can end up sharing insights and data to improve the end-to-end process: increasing the attractiveness of the new products actually developed, cutting back on the number of approval loops, delivering a shorter time to market and less uncertainty, and enabling better ordering and production planning once the product is launched. Joint product development is often focused on white-label brands – a key differentiator for most retailers.

Exhibit 4: Product life cycle with joint collaboration
Duplicative actions can be eliminated




| | PRODUCT (RE)DEVELOPMENT | SUPPLY CHAIN | SALES |
|---|---|---|---|
| **RETAILER** | • "I provide insights on what I want my own-brand products to be like."<br>• "I share data on category gaps to identify opportunities."<br>• "I encourage my category directors to share their strategies." | • "I monitor stock levels and predict when replenishment will be needed."<br>• "I monitor sell-by dates to manage waste." | • "I'm best placed to define product placement."<br>• "I drive regular marketing activities in-store." |
| **SUPPLIER** | • "I analyze the data to identify gaps in the offer that we could fill."<br>• "I define and develop a product concept in line with the category strategy and market dynamics."<br>• "I share information around estimated cost, shelf price, and margins." | • "Using shared data I'm best placed to lead on production scheduling and operations."<br>• "I look at ways of moving my products from factory to distribution center or store faster." | • "I analyze the data to help the retailer to have a better product assortment."<br>• "I participate in in-store marketing activities." |
| **LIKELY OUTCOME** | • New product launches are successful in driving increased sales and margins for both parties<br>– Development costs are reduced on the supplier side<br>– Retailer benefits from more exclusive products fitting exactly its needs | • The end-to-end supply chain process length and its cost are, overall, reduced<br>• Fresher products are available on the retailer shelves, on-shelf availability is increased, and shrink is reduced | • Store layouts and shelf planograms are redesigned together, underperforming SKUs are cut<br>• Supplier acts like an external adviser and category captain |

## FORECASTING

The quality of forecasting is essential to ensuring products are delivered to the retailer in the right quantities, at the right time, and at the lowest cost possible to the supplier. Often, however, this doesn't happen. In some retailers, we've seen examples where two different teams prepared two different forecasts, neither of which had been shared with the supplier.

A first step is to institute a simple process of cross-checking forecasts across all parties; this process enables numbers to be aligned, refined, and improved. The best-in-class collaborations go a step further and ensure a common forecast across retailer and supplier, all based on the same raw data inputs. As a result, products are available when and where customers want them, to the quality they expect. Costs from waste and lost sales go down, and suppliers can deliver lower production cost because of lower order volatility and more forward planning.

## DUPLICATE TASKS

It might be surprising how much time can be spent on tasks that both retailer and supplier carry out, such as harmonizing data, following through ordering processes, and duplicating quality control checks. Eliminating these allows both parties to invest more time in activities that can directly improve the bottom line.

It is often not complicated to carry this out. For example, ordering forms can be submitted and processed online, rather than across two systems, each requiring a manual input. Similarly, the same quality tests might be run when products leave the factory and again when they arrive at a retailer's distribution center; but if the manufacturer and retailer share results, one set of checks could be dispensed with.

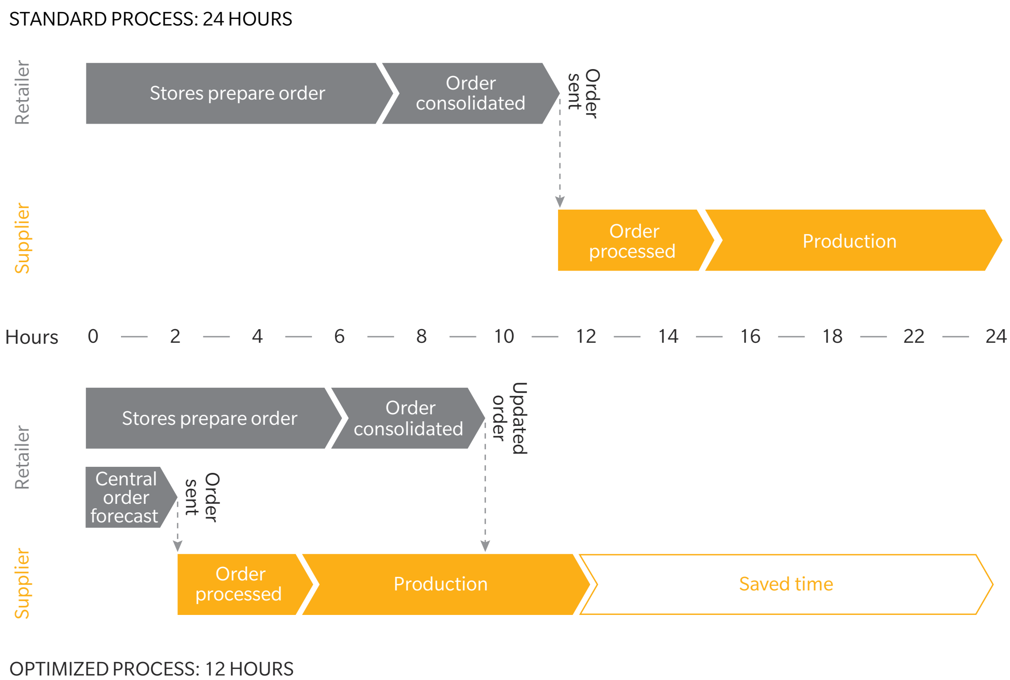
## SUPPLY CHAIN

Supply chain processes are often inherited from historical ways of working, making them ripe for optimization, particularly in fresh categories where small amounts of lost time radically affect shelf life.

The most dramatic supply chain transformations we have seen have focused around ensuring fresher products, less shrink, and improved sales by using less busy delivery windows; finding alternative delivery routes; sharing delivery routes with other suppliers or retailers; using third-party logistics providers; centralizing certain steps, such as packing and picking; and sharing data.

Having an understanding of which pieces of information are critical at each stage of the supply chain makes it very easy to speed up the most important steps. We often see retailers holding off sharing information with suppliers until they are confident of its exact accuracy. In fact, by sharing even vaguely accurate forecasts with suppliers, retailers allow manufacturers to start production while they refine their exact order, allowing for less delay in the end-to-end process. (See Exhibit 5.)

Exhibit 5: Step changing supply chain time efficiency for fresh products
Sharing forecasts, even not completely accurate ones, can optimize processes




# CONCLUSION

In most markets, the pressure on retailers and suppliers is increasing. However, around the world, billions of dollars in benefits go untapped because shared processes between retailers and suppliers are poorly optimized and no action is being taken to improve the efficiency of the overall system.

Unlocking these savings requires a radical change in the working relationship between retailers and suppliers, by forgetting about combative negotiations and putting aside old habits and rivalries to focus instead on generating more value together. Indeed, the biggest challenge is changing the culture from arguing over scraps to generating high value, collaborative work.

Our joint approach to creating value can dramatically improve innovation speed, sales, promotions performance, and overall supply chain efficiency to the benefit of both retailers and suppliers. In mature markets, such joint programs usually lead to an increase of gross margin of 5 to 10 percent for both parties – a huge prize indeed.

CASE STUDY 1

# SUPPLY CHAIN OPTIMIZATION FOR ULTRA-FRESH PRODUCTS

## CONTEXT

A grocery retailer in Eastern Europe wanted to generate a step change in its cost position and quality levels in fresh, and came to us to support a transformation of their relationship with a key supplier of fresh produce.

## WHAT WE DID

First we mapped each step of the existing joint processes, including pain points and opportunities for improvement. Using this approach, the retailer and the supplier then identified four joint ambitions: begin a new era of operational and strategic collaboration, jointly driving the business as partners; deliver a step change in the speed of the joint supply chain to claim back over 24 hours in product shelf life; jointly improve the accuracy of order forecasting to enable cost-efficient forecast- based production; and begin a continuous improvement program focused on product quality and shelf life.

We established regular meetings of the retailer's and supplier's strategy boards, operations committees, and forecasting groups, to shift interactions away from the negotiation teams, and fed them new, shared KPIs.

Instead of multiple forecasts from both parties, we established two shared forecasts and created alignment on the approach taken to forecasting and ordering. A monthly review of the promotions pipeline served to increase the notice the supplier got for promotional items.

## RESULTS

The new structure and team meetings brought all hands on deck for developing category strategies and analyzing market trends. The more aligned approach made it easier to work together to create a faster supply chain that saved money by delivering less wastage, and made money by increasing the availability of fresh products that customers wanted to buy.

We reduced forecast errors from more than 30 percent to within less than 10 percent. By jointly reviewing the promotions pipeline, special offers became more successful because the products were available when and where they were supposed to be, at the right time and in the right quantities.

CASE STUDY 2

# REDUCING TIME-TO-MARKET OF OWN-BRAND PRODUCTS BY 30 PERCENT

## CONTEXT

A European grocer identified that a slow product development cycle for its own white-label products was a strategic weakness. Together with one of its key suppliers for own-brand products, the retailer aimed to make this process faster, more efficient, and better able to respond to changing consumer demands.

## WHAT WE DID

We examined the end-to-end product development process across both companies, identifying many redundancies, such as data duplication and unnecessary product revisions due to poor communication at the start of the process. In addition, we helped the companies build capabilities and processes that allowed for new development projects to be accelerated, paused, or cancelled, depending on the changing needs of the retailer and customers.

## RESULT

The product development process became much more nimble and able to respond to changing priorities. The average time to get a new white-label product on shelves was cut by 30 percent, with priority projects moving even faster.

# ZERO IS NOT A NUMBER

## WAYS TO REDUCE FRESH FOOD WASTE

Roughly one-third of food produced for human consumption is lost or wasted – about 1.3 billion tons per year globally, at an estimated cost of $907 billion. Clearly, this is unacceptable from ethical and economic standpoints, and there is mounting pressure worldwide from governments, industry, and consumer-interest groups to tackle the issue. However, any idea that waste can be eliminated completely is an illusion. Achieving zero waste is not only unrealistic, but would also require a dramatic reduction in the availability of products and limits on consumer choice. That said, the opportunity to reduce waste is still very significant and, if pursued correctly, offers an upside for producers, retailers, and consumers alike.

If retailers improve the freshness of products they sell and increase the remaining shelf life, it will not only help to reduce waste at the consumer level and improve customer satisfaction, but also reduce retailers' operational costs and waste levels. Beyond those cost savings,

retailers excelling in freshness will also increase sales and market share, and improve their image in the eyes of consumers. And, if food waste could be reduced from 2 percent to 1.5 percent of total sales, for example, a typical retailer with a net margin of 3 percent would see its net income increase by 17 percent.

We worked with the Efficient Consumer Response (ECR) Community Shrinkage and On-Shelf Availability Group to investigate how reducing waste affects on-shelf availability, and vice versa. To this end, we launched a major international study that was conducted by a leading research institute in the retail sector, Eindhoven University of Technology in the Netherlands. This work led to three key recommendations for retailers to find the right compromise between reducing waste and driving sales for their business.

The full report can be accessed at www.ecr-shrink-group.com.

# METHODOLOGY

Three large European grocery retailers participated in the study. They provided information on more than 17,000 products and, in 27 stores, allowed for further analysis of the fresh convenience, fruits and vegetables, and fresh meat categories, where 50 percent of their waste was generated.

# RESULTS: HOW LOW CAN YOU GO?

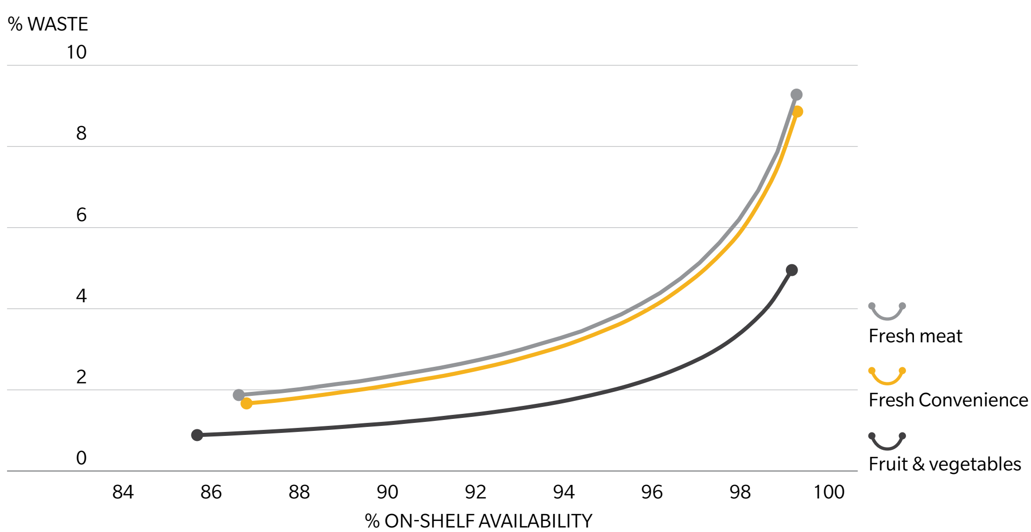
The study revealed three key findings: Waste and availability targets are a balancing act; there is a simple and accurate way to predict waste; and a high proportion of waste does not always mean lots of room for improvement.

## WASTE AND AVAILABILITY TARGETS ARE A BALANCING ACT

It is well known that higher on-shelf availability is likely to drive an increase in waste.

The study was able to quantify this relationship across three fresh categories. (See Exhibit 1.) It also showed how expected minimum waste differed between products, even when on-shelf availability was the same.

Exhibit 1: Products with similar levels of on-shelf availability can have different levels of waste




Source: Efficient Consumer Response (ECR) Community Shrinkage and On-Shelf Availability Group and Oliver Wyman research and analysis

These findings illustrate the importance of determining the right target for on-shelf availability. If a target is set too high, there is a risk of excessive waste. But if the waste target is set too aggressively, it can have a detrimental effect on on-shelf availability, missed sales, and customer satisfaction. Choosing the right target depends on the category and the store, and the decision should not be taken lightly.

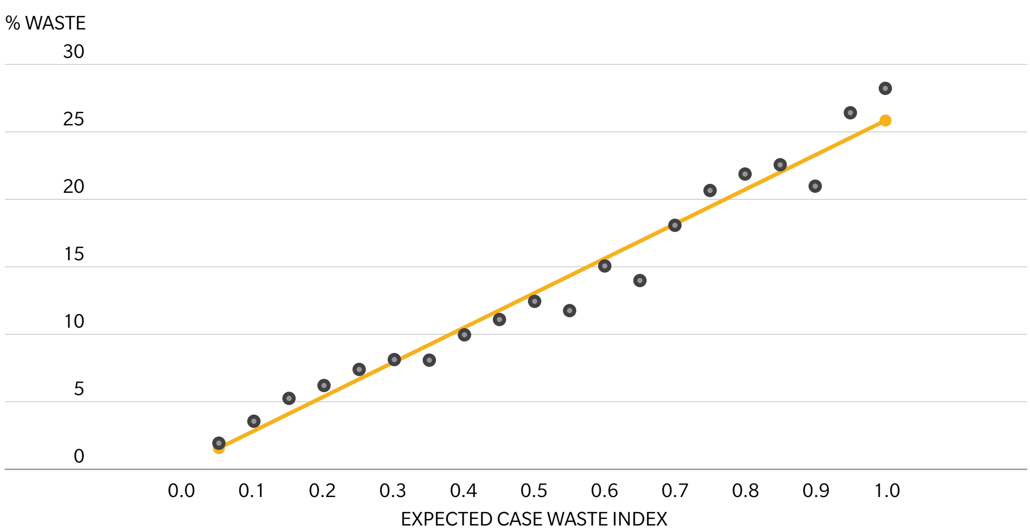
## THERE IS A SIMPLE AND ACCURATE WAY TO PREDICT WASTE

It is possible to calculate an expected case waste index for each product by measuring the average daily demand for a product, the size of each case of product, and product shelf life. The larger the index, the more likely it is that case items will go unsold before the expiration date. The lower the index, the more frequently each case will sell out before expiration, reducing waste. This makes it a good indicator for how much waste to expect for a product in a store. (See Exhibit 2.)

## A HIGH PROPORTION OF WASTE DOES NOT ALWAYS MEAN LOTS OF SCOPE FOR IMPROVEMENT

When benchmarking the 27 participating stores, significant differences in fresh waste were observed. Some of this variation was due to differences between the stores' daily sales, case sizes used, and shelf lives of the products they stocked. To control for these factors, the performance of a store – assessed as on-shelf availability and percentage waste – was compared against predicted waste. This takes into account key characteristics – like the product range, the average daily demand, and the shelf life – which may vary from store to store or between categories.

Exhibit 2: Average waste versus expected case waste index




Source: Efficient Consumer Response (ECR) Community Shrinkage and On-Shelf Availability Group and Oliver Wyman research and analysis

This makes it possible to map each store's performance against expected waste: the distance between predicted minimum waste and actual performance reflects the scope for improvement. (See Exhibit 3.)

The results illustrate how high levels of waste do not necessarily mean there is high potential to reduce it. Conversely, stores or categories with low levels of waste could still be far from optimal. If retailers focus on the wrong stores, waste reduction measures may be fruitless or even counterproductive. Recognizing where the waste reduction potential lies is crucial for tackling it effectively.

# THREE WAYS TO REDUCE WASTE

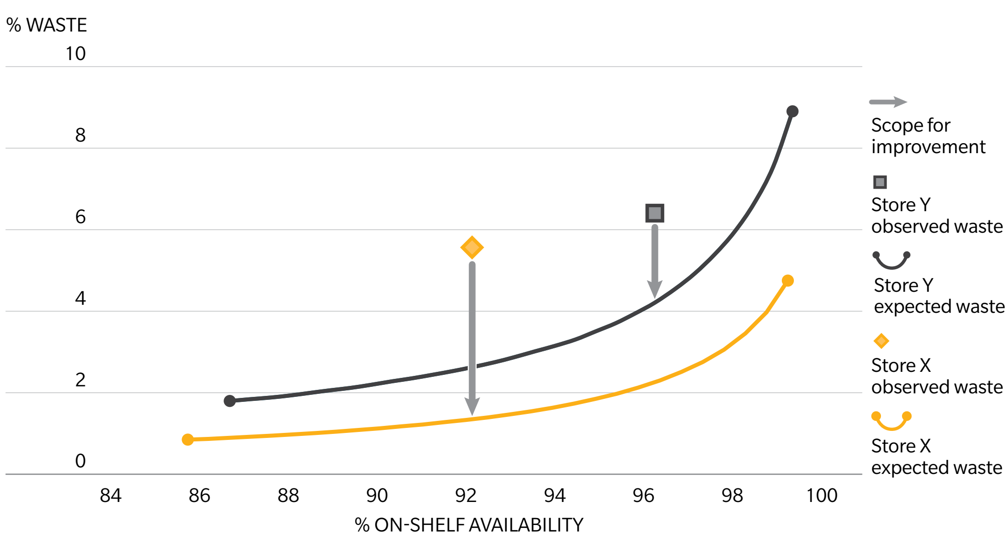
The study yielded three key recommendations for cutting back waste in fresh categories: Set the right waste and availability targets; target stores and categories that have more scope for improvement; and increase product shelf life.

## SET THE RIGHT WASTE AND AVAILABILITY TARGETS

Setting the on-shelf availability target is a strategic decision. Retailers with a strategy focused on high levels of customer service typically aim for an on-shelf availability of at least 98 percent for dry groceries. For perishables, however, they typically aim lower, given the direct impact that availability has on the amount of waste.

To find the optimal trade-off between availability and waste, calculating the expected waste will allow retailers to understand the full bottom-line impact of raising or lowering availability targets.

Exhibit 3: Actual fresh waste performance of two stores versus predicted waste




Source: Efficient Consumer Response (ECR) Community Shrinkage and On-Shelf Availability Group and Oliver Wyman research and analysis

Different parts of the product range should have different targets. For example, slow movers with a short shelf life should have a significantly lower on-shelf availability target (and/or higher waste target) compared to fast movers with a medium to long shelf life.

The benefit of setting differentiated targets can be huge: The study found that setting different targets for fast- and slow-moving items could reduce waste by 12 percent or increase on-shelf availability by 1.3 percent, compared to a one-size-fits-all approach.

### TARGET STORES AND CATEGORIES THAT HAVE MORE SCOPE FOR IMPROVEMENT

The expected case waste index is both easy to calculate and highly predictive of waste. Category managers, supply chain managers, buyers, and suppliers can easily identify which of their items have high expected case waste and choose those as a starting point for tackling the waste problem.

Moreover, it is a useful concept to trigger the right kind of conversations across functional departments: A large case size may help to reduce logistics costs, but what is the point if half of the products regularly end up as waste?

Benchmarking also makes it possible to identify which stores and fresh departments have the biggest gap between actual performance and predicted waste. The outputs can act as a starting point for implementing best practices at underperforming stores.

### INCREASE SHELF LIFE

Increasing a fresh product’s shelf life by just one day provides big benefits. In categories where products currently have a shelf life of eight days or less, an extra day of life reduces waste by 42.8 percent or increases on-shelf availability by 3.4 percent.

A good way to improve shelf life in fresh categories is to remove minimum order sizes from the distribution center, enabling fresh products to be delivered to stores in the most flexible way possible. Businesses need to consider the operational complexity it introduces and the cost implications. But the waste reduction potential could be sizable: In our sample, this approach reduced waste by 32.5 percent and increased on-shelf availability by 2 percent.

## CONCLUSION

Retailers often view waste as a fact of life, but it is actually a question of choice. Retailers have many opportunities to reduce it, increase category and store efficiencies, and improve profits. By finding the right balance between waste and on shelf availability and recognizing areas of underperformance, retailers will be able to deliver a sizable reduction of waste.

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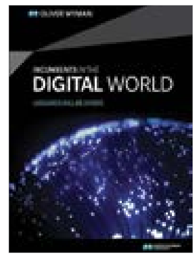


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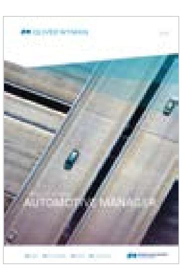

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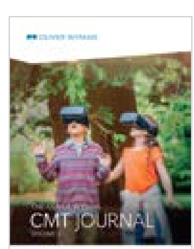


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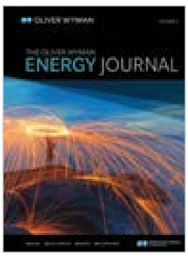


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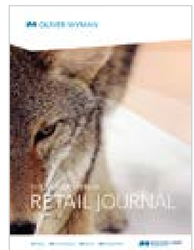


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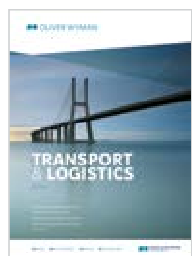


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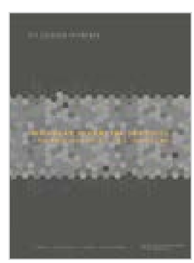

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