

SUSTAINABLE RETAIL

THE GROCERIES RETAILER GAP

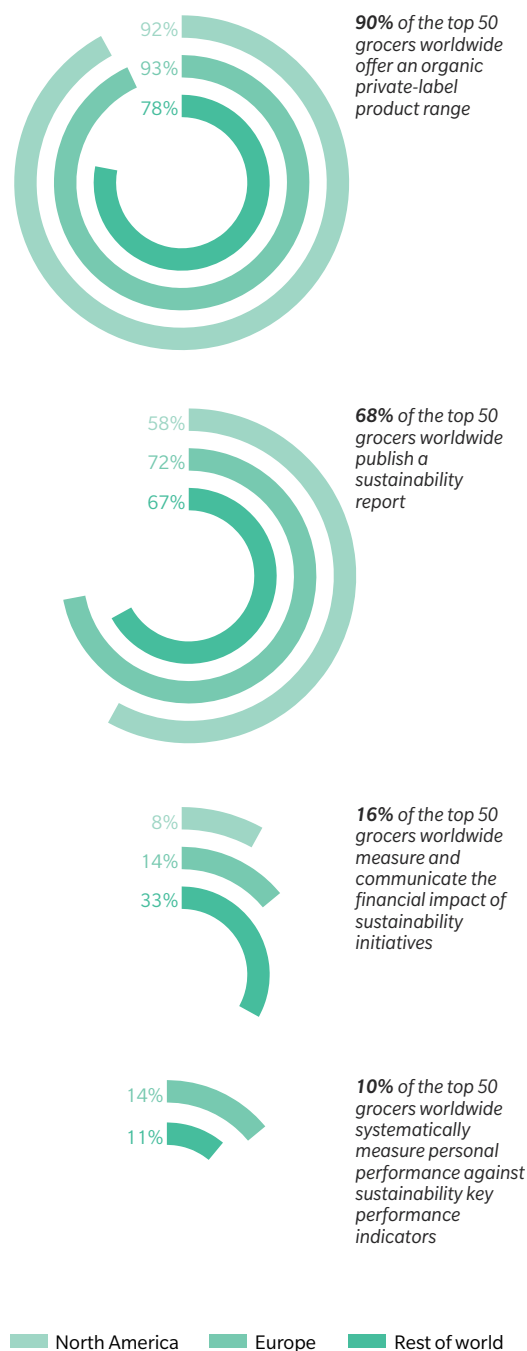
MICHAEL LIEROW AND SIRKO SIEMSSEM

Most retailers agree that sustainability will be a key competitive advantage in the future. Unfortunately, there is a wide gap between their ambitions and reality. A growing mismatch between supply and demand could erode the profits of the entire food industry within four decades. Global demand for agricultural production is expected to grow by 70 percent by mid-century and the global average per capita caloric intake is projected to increase by about 40 percent. The problem is that global food production already utilizes about 50 percent of the arable land surface available and the global agricultural sector already consumes about 70 percent of the freshwater available for human use.

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

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

Exhibit 1: Share of top 50 grocers worldwide



Source: Oliver Wyman

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

WHY SUSTAINABILITY IS NOT "STICKING"

Retail is characterized by low margins, pressing daily challenges, and complex global supply chains. With sustainability commonly associated to climate change, which is considered as a longer time frame challenge, retailers often choose to focus on the near-term urgent matters, leaving sustainability in the backseat. Even deeply committed retailers often struggle to achieve real impact.

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

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

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

MAKING SUSTAINABILITY HAPPEN

Nonetheless, leaders in sustainability have shown that it is not only possible to find ways to measure the impact of their efforts, but also to use this knowledge to achieve their ambitions.

Given how decentralized decision making is in a typical retailer, making sustainability a reality requires getting "into the bloodstream" of the whole organization, particularly the decision makers in trading and operations. Our work with clients points to five important success factors:





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




Greater transparency. Measuring the ecological and social footprint of an organization's products and operations is very difficult, especially on the product side, since most resources are used

earlier on. But the task is not impossible. To date, most retailers have focused on availability, cost, and time-to-market in their attempts to better understand upstream supply chains. In the future, supply-chain management and supply-chain collaboration will need to put as much, if not more, emphasis on resource usage, renewable resources, and social standards.

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

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

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

CONCLUSION

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

However, sustainability offers immediate tangible opportunities to drive growth and reduce costs. In Switzerland, sales of the Coop Group’s private-label sustainability brands and quality labels have reached \$2 billion – more than 18 percent of its food revenues. Coop Group’s market share in Switzerland in organic products exceeds its overall market share by more than 100 percent. In the United States, Walmart’s Project Gigaton aims to remove 1 billion metric tons of GHG emissions from its supply chain by 2030. Initiatives like this are driving changes in all aspects of supply chains, including fleet transportation and operational energy use. Similar to adopting energy efficiency initiatives, Marks & Spencer in the United Kingdom has generated more than \$168 million in net benefits by reducing packaging, decreasing landfill waste, and improving transportation efficiency systems.

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

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SETTING STRATEGIES FOR SUSTAINABLE ENERGY

ENERGY TRILEMMA INDEX

2017

Which country leads in providing secure, affordable, and environmentally sustainable energy?

The annual Energy Trilemma Index tracks countries' progress in meeting the energy trilemma – the triple challenge of providing energy that is secure, affordable, and environmentally sustainable.

Three trends of decarbonization, decentralization, and digitization are driving changes in the supply, generation, and use of energy. Governments and regulators that quickly adapt to these trends will have competitive new opportunities to balance the energy trilemma and support their economies and societies.

INSIGHTS FROM THE EVOLVING ENERGY SECTOR¹

The traditional centralized electricity model is breaking open to distributed generation, distributed energy resources (including storage), electronic vehicles (e-vehicles), and two-way energy flows as consumers become "prosumers." New actors are entering the market, and policymakers need to develop frameworks to accommodate the changes at hand. Here are some of the voices of the global energy sector on the changes in the energy system and market actors.

Alison Andrew, CEO, Transpower

"Consumers have new options for making, storing, and controlling electricity. Looking forward, we expect to see more behind-the-meter technology such as interconnected appliances behind the grid storage and consumers using batteries for their e-vehicles."

Leo Birnbaum, Chief Operating Officer – Networks & Renewables, EoN

"Future energy investments could be based on long-term arrangements on the customer side, meaning that market design just becomes an optimization signal for whatever asset base utilities have built around the customer business."

Marty Sedler, Director of Global Utilities and Infrastructure, Intel

"Regulatory structure and utilities are simply not evolving fast enough to meet the needs of the changing power system and customers' changing energy needs. We need greater consistency in regulation around distributive generation."

Norbert Nuster, President, Power Systems Business, Cummins

"Storage is creating new opportunities to deploy assets as balancing forces in the grid. Currently, due to regulation, there is considerable underutilization of assets, [but] the model will change quickly as a growing number of stakeholders influence the regulatory framework."

Rob Threlkeld, Global Manager of Renewable Energy, General Motors

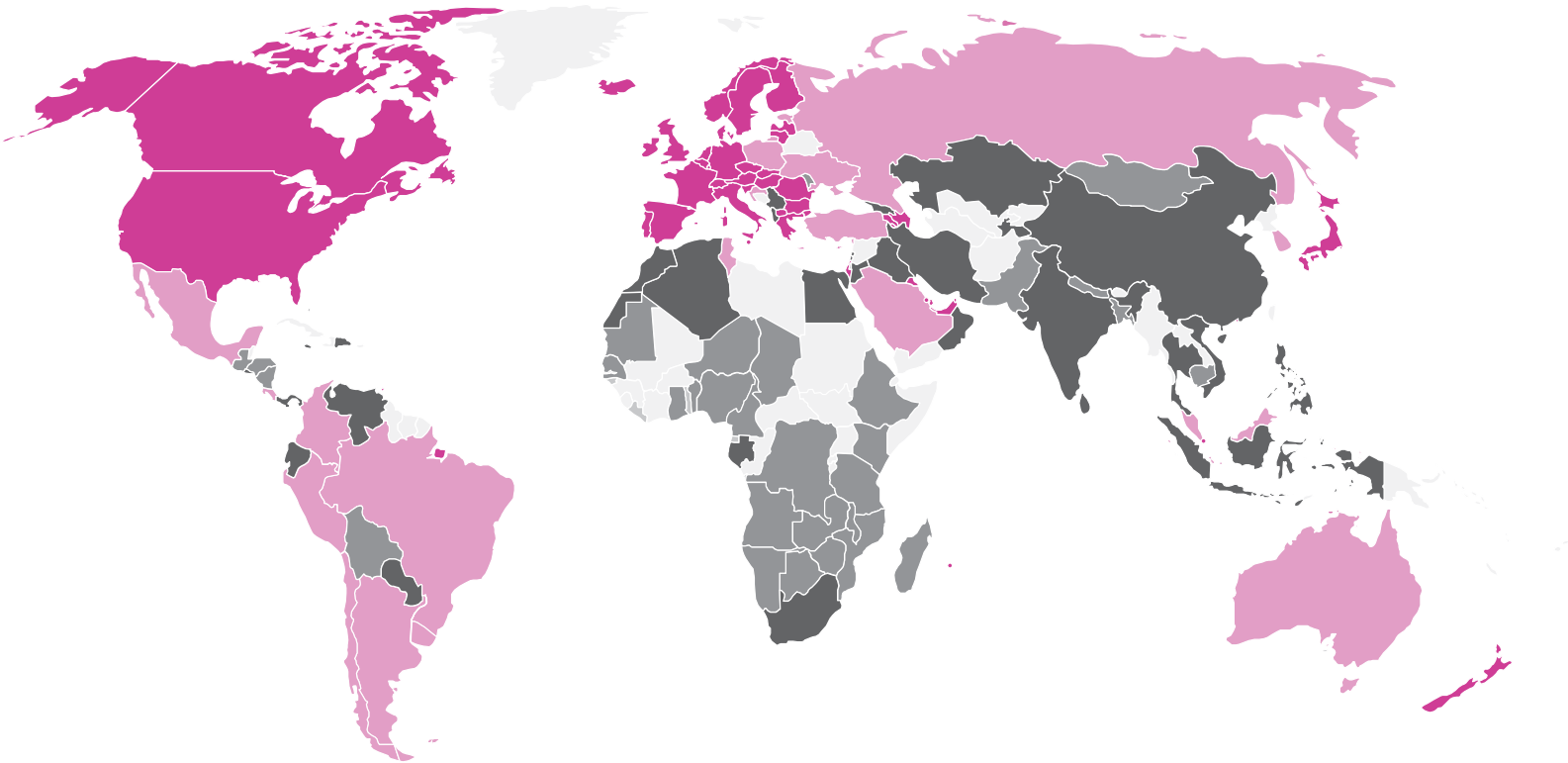
"We need a mind-shift on grid operation. Focusing on the digital transformation of the grid would enable real-time electricity pricing and facilitate collaboration and optimization by all players in the system."

Andreas Spiess, CEO, Solar Kiosk

"The central grid can be an oversized solution to rural challenges. Entrepreneurial options using new technologies, especially solar, that leverage distributed generation can focus on issuing 'right-sized' efficient and cost-effective energy solutions to households and small medium-sized enterprises (SMEs) in rural areas."

¹ To learn more, please see the World Energy Trilemma 2017, Changing dynamics – Using distributed energy resources to meet the Trilemma challenge, Oliver Wyman and World Energy Council

2017 ENERGY TRILEMMA INDEX



TOP 10 RANKED COUNTRIES

1. Denmark
2. Sweden
3. Switzerland
4. Netherlands
5. United Kingdom
6. Germany
7. Norway
8. France
9. New Zealand
10. Slovenia

ENERGY PERFORMANCE



Source: <https://trilemma.worldenergy.org/>; World Energy Trilemma Index 2017, Oliver Wyman / World Energy Council