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Future of Retail and Consumer Goods: A Preview

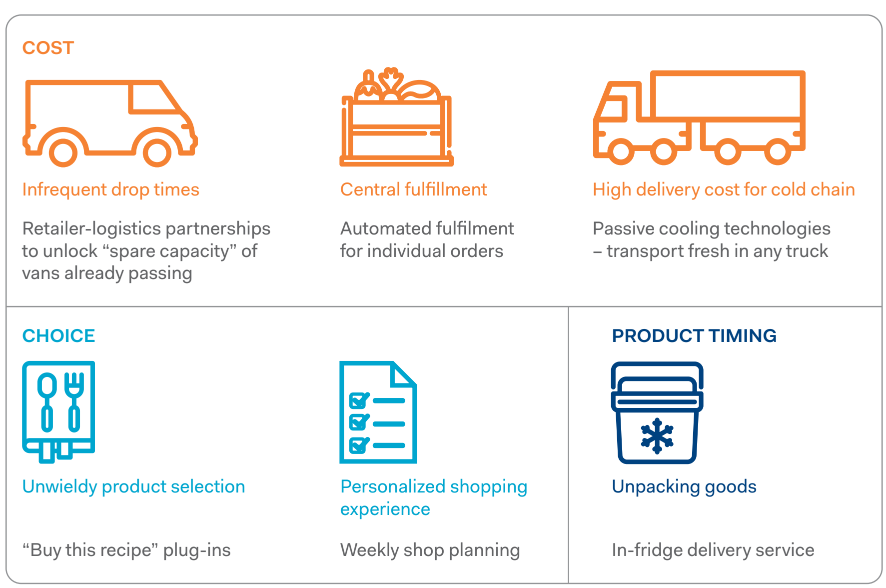
Retailers who do not sufficiently meet the challenges identified in the last chapter will struggle to thrive – or will go under. It would be a mistake, however, to think that merely meeting those challenges will be enough to guarantee long-term success. The trends that are affecting nonfood retail – most notably the **rise of online shopping** – are only just beginning to impact food. Consumers report that digital retailers can offer better value and more convenience than a brick-and-mortar experience. Even the most casual observer of the industry could cite aggressive moves by the largest players in this space. Current trends would suggest between 5 percent and 10 percent of sales will be conducted online by 2030. The demand, however, is much greater.

The biggest, most disruptive changes are yet to come: The shape and composition of the **value chain will change dramatically** in response to shifts in how customers shop. Brick-and-mortar retailers will experience new pressures and will need to **innovate** to survive and thrive. The necessity of scale for funding innovations will further drive firm consolidation. In turn, these behemoth retailers will put pressure on manufacturers and drive those that can to develop new, direct-to-consumer channels. Retailers and manufacturers will start to compete directly, in more expansive channels in which neither is completely on home turf.

New intermediaries and platforms will flourish, pressuring the value chain further. Some intermediaries will be technology innovators who can deliver a more-personalized shopping experience. In speaking to industry leaders, almost all agreed that the online consumer food shopping experience is not what it could be. Yet few are taking steps to address its deficiencies. This sets the stage for innovators outside of the retail space to bring forth solutions.

Others will offer fulfilment solutions to mitigate the additional costs of individual order fulfilment and last mile delivery. Not all intermediaries will be upstarts though. Large logistics players who have traditionally been irrelevant to the food sector could now become relevant. Alibaba's Jack Ma credits three elements ("Iron Triangle") to his company's success: one of them is the company's logistics network of third-party providers.

Exhibit 1: Tipping point innovation



THE FUTURE OF RETAIL IS OMNI-CHANNEL

Most consumers love the idea of shopping online, but share remains low. Why?

People hate shopping online because the web interface can be slow and clunky, providing poor photos and confusing information. Delivery costs are high and waiting at home for a delivery is inconvenient. Worst of all, there's rarely anyone to speak to for help.

People love shopping online because they can consult a limitless catalogue, filter rapidly by feature and price, and consult user and expert reviews. They can also compare retailers for the best prices. Best of all, they can skip physical stores' check-out queues and the traffic jams en route.

An omnichannel model that gives consumers the best aspects of traditional shopping – and spares them the worst – will be a key to the future of retail. Online shopping has already taken over sectors such as music. Yet in other sectors, such as in food, it has been slow to spread.

Our 2017 Digital Shopping survey shows that over 70 percent of consumers are open to shopping online: they either already shop online regularly, or would switch if the experience or value for money improved. While there was a slightly higher prevalence amongst under-45s, even our 60+ age group was 50-60 percent open to online shopping for at least some products. Despite this, online sales still only account for 15 percent of the nonfood market in much of North America and Europe, and just 3 percent in food.

Two factors in particular have been blocking greater penetration by retailers' online businesses to date, thus holding up the growth of online or omnichannel retail overall: the digital shopping experience and the costs of fulfilment and last-mile delivery. However, we think developments in both areas will lead to big advances.

Make It Fun, Make It Easy. The online shopping experience has come a long way in the past 15 years. Still, for many shoppers online browsing is not as intuitive as walking through a store – particularly when assembling complex baskets as customers do for groceries. For customers who are less comfortable with the web or mobile browsers, voice-recognition technology such as Amazon's Alexa or Google Home could help make digital shopping a daily activity. Further innovations – for instance through augmented and virtual reality – could make the online experience more compelling, and add some of the theatre put on by physical stores. For example, VR applications that let consumers experiment with different looks help sell makeup online.

In some respects, the digital experience has the potential even to surpass physical stores. Some sectors might develop personalized curation services, such as those offered by Cladwell and Thread. These provide customers the advice they would get from the best stores – perhaps better, as they work with algorithms that know far more about the customer than even the best shop assistants. This kind of digital technology will advance the more it is used, because it improves after training on larger, more-diverse data sets. It could be licensed to multiple retailers, saving them the development costs.

Efficient fulfillment and last mile operations are essential for all retailers, as the costs of picking and delivering online orders are substantial. In food, for example, delivery fees can run to over 10 percent of the average basket, discouraging new customers. Today, retailers typically either pass some of these costs on to the customer through high fees or a large minimum order, or they take a profit hit from absorbing these – which means they tend to offer fewer delivery slots to save costs. So reducing the cost of last mile delivery will be the key to improving this aspect of the consumer experience and increasing adoption.

By understanding these drivers, we can model the effects of rising consumer demand, fees and other barriers, and the supply-side cost structures of different countries. We can then predict the likely online share in each sector under different scenarios. The UK is one of the world's most advanced grocery markets, but costly packaging and delivery still necessitate fees or minimum basket sizes. Our prediction shows that if current fee levels persist in the UK, then the online share of food retail will probably peak at 8 percent, not far above the current level of 6 percent. However, if costs decline and fees disappear, online share could rise to 16 percent by 2030, and continue on up. It will be easier to reduce delivery costs in densely populated areas, where a large number of deliveries can be made in a given journey time. But if cost-effective delivery also becomes feasible in sparsely populated areas, the online share of food might be as high as 19 percent by 2030.

Partnerships Save Time and Money. To date, many retailers have struggled to deliver these improvements in online shopping. Some of the new capabilities are costly to develop, and many physical retailers lack the right skills. They also have less innovation in their DNA; they face a higher cost of capital than online incumbents and well-funded startups; and they fear that their efforts could result in self-cannibalization.

One solution – which is becoming more prominent – is to obtain the necessary capabilities from elsewhere. Traditionally, a store has sent round its own truck for home deliveries, but from now on someone else might fulfil the task, as DHL does for Amazon Fresh in Germany. A greater variety of services will likely crop up: Passive-cooling packaging is widening the range of options, as non-refrigerated vehicles can be used. That might allow Uber-Eats-type arrangements to emerge, with retailers taking advantage of networks of freelancers. In future, delivery might be supplied as a utility. To enhance the shopping experience, rather than trying to develop voice recognition algorithms in-house, Walmart has partnered with Google Home to use its mature software to deliver a seamless voice-ordering experience.

Forming this kind of partnership is far from straightforward, but retailers of all sizes are increasingly adopting the tactic. Smaller supermarkets such as Morrisons are turning to Ocado, an online supermarket with no stores of its own. Primark, GNC, and Trader Joe's are partnering with e-commerce platform specialists such as Aptos.

So, the consumer of the future will increasingly make purchases online. Penetration will increase with changes in attitude and technical literacy, but mainly because of barrier removal: innovations that make e-commerce more efficient and more fun. The winners in the new era will be those who beat the peloton to offer these sooner, without wasting millions on doomed attempts to develop capabilities in-house. Once the right technical or business process solutions have been found, they can be adopted rapidly across the industry thanks to the rise of specialists and strategic partnerships – which will be major accelerators of online penetration.

Consumers may soon find they have many more reasons to love online shopping than before – and shift their habits accordingly.

Exhibit 2: In France, last mile innovators are pushing into the market (teamed up with incumbents), turning click & collect into delivery models

RETAILER	PARTNER	DELIVERY METHODS	PRICEPOINT[1]
WEBEDIA/ POUR DE BON	CHRONOFRESH	• Run online marketplace Pour De Bon for independent fresh food retailers (butchers, bakers) • Deliveries through existing networks with isothermal packaging	€6.90 (free for orders >€30)
AUCHAN	COLISWEB	• Promises <2h delivery lead times, enabled by efficient courier selection and routing • Trial online delivery in Bordeaux	(General/Subscriber) Express: €8.90/€5.90 By Apt: €5.90/free
CARREFOUR	STUART	• On demand delivery specialist, offering grocery delivery in <1h • Leverages Carrefour's store network and store picking to guarantee delivery timetable	€4.90

Source: Oliver Wyman analysis, "Marché de la 'Foodtech' " and "Last mile delivery"; retailer and partner websites
1. Determined by comparing identical grocery baskets (~€10) across sites and recording delivery fees; also leveraged internal Oliver Wyman assessment in France

As the food ecosystem reconfigures, traditional labels of "retailer" and "manufacturer" will become obsolete as new business models emerge. There will be many successful models, but these preliminary archetypes will likely feature strongly.

- There will be **product-led companies** who make exactly what their customers want; selling through their own stores, but also utilizing other third-party channels and direct routes to market.
- There will be businesses which win customer loyalty by creating **magnetic platforms**, such as Amazon with Dash and Alexa, and Nike with connected sports devices, clothing, and virtual communities.
- We will also see businesses which increasingly, customers go to first, acting as the **choice intermediary**. These companies may know the customer – such as AI assistants automating product selection, or they may know the product really well – such as review aggregators.
- Some businesses will emerge as **customer experience champions**, who offer engaging shopping experiences in-store, online, and over the phone. Stores may not actually hold stock; they might get paid by manufacturers for showrooming their brands.
- There will be companies who bet big to win on the **fulfilment intermediary role** – creating a network of hub-and-spoke sites and delivery routes that any partner can plug into.
- The last archetype will be companies who shape the **retail real estate of the future** – owning and developing key sites based on the shopping patterns and habits of tomorrow's customers.

Firms that do not conform to one or more of these archetypes will see significant share erosion and a loss of enterprise value. **It is not yet known what firms will best take advantage of changes to the value chain to flourish**. Each set of players (incumbent brick-and-mortar retailers, pure-play online retailers, CPG manufacturers) has specific strengths that could play out as winning models if they can adapt appropriately.

But it is not only the competitive landscape that will shift. Fundamental changes are afoot in how retail and consumer companies will interact with their customers, each other, capital funders, and with the governments that regulate them. The responses we have seen from industry have been wide-ranging. From one end, we have heard leaders express hope that governments will play a limited role and "stay out of the way!" during the coming transformations. At the other end, we have heard sizeable regional players express hope that the largest players be broken up "like Standard Oil." But whatever a firm's stance is, it cannot afford to wait for government to respond. Retailers and manufacturers need to get ahead of these trends.

To help retailers, Oliver Wyman is conducting a study on the following question: Who is preparing for changes ahead, and who is doubling down in the ways of the past? We have engaged dozens of industry leaders including several FMI board members, the FMI SME and global leaders across food retail, nonfood retail, CPG manufacturers, capital funders and government regulators. The study is a collaboration with a series of industry veterans, including Richard Pennycook (formerly Co-op UK), Marc Poulin (formerly Sobeys), and Dominique Schelcher (Vice Président, Système U). This longer-term view will complement Emerging Issues as firms "future proof" themselves.