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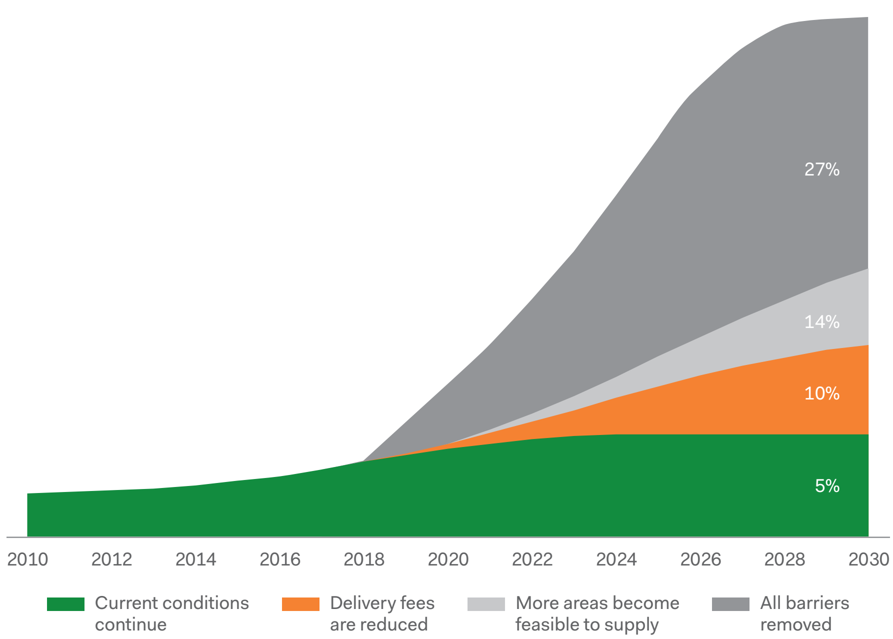
The Future of Retail

It is difficult enough for retailers to cope with the emerging issues that we will discuss in this article. But even more disquieting is the idea that the greatest disruptions to retailers and product suppliers may be yet to come.

At the January 2018 Board of Directors meeting at FMI Midwinter Executive Conference, FMI partnered with Oliver Wyman to explore the future of retail and consumer goods. Key topics included the rise of online retail, the changing role of stores, the risks of disintermediation and reintermediation, the emergence of new models, and the implications for CPG companies. After a content feature, a panel discussion was held, featuring Marc Poulin, Shelley Broader, and Paul Grimwood. The following pages summarize key elements from that discussion in January.

Oliver Wyman's full report on the future of retail, entitled *Retail's Revolution: How Retail and Consumer Goods Companies Can Adapt*, delves deeper into how consumer preferences could further disrupt the retail sector – creating opportunities for retailers and manufacturers to reach customers in new ways, while also giving rise to new competitors in the space. The full study and accompanying materials can be found at: www.oliverwyman.com/our-expertise/hubs/retails-revolution.

Exhibit 1: Food e-commerce share projection



Source: 2017 Oliver Wyman Digital Shopping Model

1. Countries: Austria, Canada, Denmark, Finland, France, Germany, Italy, Netherlands, Portugal, Spain, Sweden, United Kingdom, United States.
Source: Oliver Wyman analysis

THE RISE OF ONLINE RETAIL

Today's retail world is changing like never before. The new generation is full of digital shoppers who have grown up speaking to Amazon's Alexa and interacting with touchscreens. Something as simple as grocery shopping in the supermarket has become a special occasion, as weekly grocery orders are delivered to the doorstep.

The prevalence of technology will continue to grow and shape how consumers define shopping. A question at the forefront of food retailers' mind is: How will the rise of online retail impact the food industry?

Online retail in other sectors besides food

Before examining the food industry, it is worth assessing trends in the nonfood retail sector as a proxy for what's to come. For these categories, the penetration of online retail is already high and is expected to continue to grow. This growth has not come as a surprise, as barriers to adoption have decreased in recent years, greatly improving the customers' online experience. For example, one major stumbling block to purchasing cosmetics online has been the difficulty consumers have in envisioning how products will look on them. L'Oreal overcame this challenge by investing in an app, Makeup Genius, which demonstrates various looks on a customer's face in real time. Another challenge for online sales is the time and effort customers require in picking from an endless aisle of seemingly limitless options. Cladwell, a startup in the clothing space, catalogs its users' wardrobes and helps evaluate the incremental value of new items.

The removal of further barriers will continue to raise the penetration of online shopping, so that it could comprise between 20 percent and 25 percent of the US market within five years.

THE RISE OF ONLINE FOOD SHOPPING

In contrast, online penetration has remained low in the food sector. Many industry leaders are skeptical that online sales will ever make up a significant share, given the high barriers to adoption. These barriers include discomfort with a cumbersome digital shopping experience and additional charges reflecting the cost of fulfillment and delivery.

Exhibit 2: Online demand

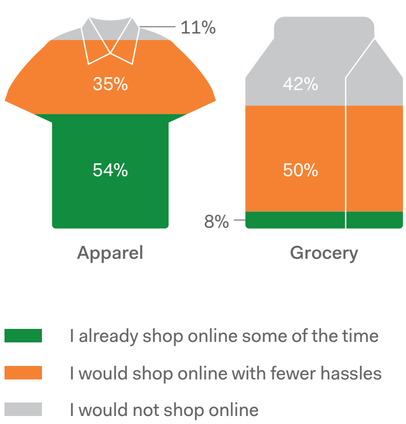


Exhibit 3: Key blockers in online food

Sample blockers	Example solutions
Difficult to choose from unwieldy product selection	Whisk "Buy this recipe" plug-in
Inconvenient to accept deliveries on schedule	August Home In-fridge delivery
Expensive deliveries	DHL Passive cooling to use existing networks

However, as shown by the survey results in Exhibit 2, the latent demand for online food shopping is similar to sectors such as apparel that already have high online penetration. In grocery, the latent demand for online shopping is significantly higher than the actual online share: 50 percent of consumers included in the survey reported they would buy food online if there were fewer hassles. This indicates the potential for a rapid increase in online penetration for food if the customer experience is improved.

Many key roadblocks in food are ripe for removal. As seen in Exhibit 3, solutions are emerging to three key challenges for food delivery – a major barrier to online sales.

Selecting products can be time-consuming and overwhelming; companies such as Whisk allow consumers to order ingredients for an entire recipe in a single click. Waiting at home for a scheduled delivery is inconvenient; in 2017, Walmart and August Home launched a trial for an "in-home" delivery service, in which the driver is given access to a customer's home and can therefore put the purchases straight in the fridge. Running a fleet of refrigerated trucks is expensive; in Germany, passive cooling technology has enabled Amazon to use DHL's network of regular trucks, which are cheap and frequent, so the cost savings can be passed onto consumers.

Although not all of these specific solutions may be successful, they are indicative of the high level of activity dedicated towards creating e-commerce solutions. Given the amount of ingenuity and investment being deployed, most of these barriers to online retail will eventually be addressed.

If retailers overcome these challenges, there will likely be a rapid uptake in online food shopping, which would be a threat to those incumbent supermarkets that are depending on low adoption for the foreseeable future.

At current growth rates, online share of food sales in the US will only reach between 5 percent and 8 percent over the next five years. However, if barriers – such as shopping experience, delivery convenience, and cost – are removed, online food penetration could rise as high as 27 percent by 2030, as seen in Exhibit 1.

"Growth will be slow initially, but ramp up quickly. Smaller retailers will start to close, reducing consumer options and driving more people online."

Marc Poulin | Former CEO, Sobeys

THE ROLE OF STORES

The role of the physical store will still be important despite the rise of online retail. In fact, brick-and-mortar retail can still thrive in the new era. Oliver Wyman's 2017 survey of consumers found that those who shop both online and in stores are more satisfied than those who only shop via one channel, as seen in Exhibit 5.

Many consumers will continue to go to physical stores for advice, to socialize, and to try out products.

"Physical stores will take on new and nontraditional roles. We may see some emerge as service or return centers in order to keep the customers coming in."

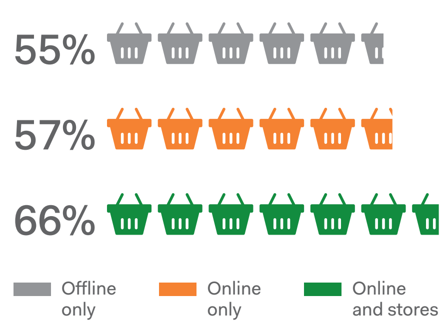
Shelley Broader | President and CEO, Chicos FAS

Traditional retailers will be able to leverage their main assets: a network of stores in key locations and knowledgeable staff with experience in assisting customers. In fact, even online retailers are starting to realize that they need to build a physical store presence.

In China, JD.com announced plans to create 1 million rural stores, approximately one for every 1,300 people. However, the stores of the future will look different than the stores of yesterday. For example, Alibaba's Hema store features a number of experimental ideas that link technology to the in-store experience. Hema's stores double as warehouses for online purchases, where Hema employees fulfill orders and drop off bags on conveyer belts.

These tracks run up the wall of the store to the ceiling, allowing the bags to travel over the customers' heads to an adjacent delivery hub.

Exhibit 4: Consumers who enjoy grocery shopping



Additionally, visitors select and pay for groceries with their smartphones, and the Hema app suggests recipes and other products based on what consumers scan.

THE IMPORTANCE OF PARTNERSHIPS

Both traditional and online retailers face challenges in the new world. Incumbents find it hard to carry out digital innovation at sufficient speed, while online retailers don't have expertise in running stores. While some will still choose to build their own solutions, acquisitions and partnerships will become an increasingly common way to rapidly gain new skills, capabilities, and assets.

For example, Walmart partnered with Google Home in order to provide a new pathway for customers to access Walmart products. Through this partnership, Walmart provides customers with the ability to shop for more than 2 million items through voice shopping. In the UK, supermarket Morrisons is partnering with Amazon and Ocado to develop an online business.

Creative partnerships will open up big opportunities for today's retailers to get ahead in omni-channel retail, further accelerating online penetration.

THE RISKS OF DISINTERMEDIATION AND REINTERMEDIATION

As the value chain becomes more modular, retailers will face the risks of both disintermediation and reintermediation. Previously, retailers were the primary link between manufacturers and consumers. But in the new world, manufacturers can achieve direct access to consumers. In addition, new companies can come between retailers and customers. For example, in the US, many retailers already rely on fulfillment intermediaries such as Instacart and Rosie to provide delivery services.

Food platforms will be a large part of the disintermediation risk. In Denmark, consumer packaged goods companies pooled resources to pilot Shobr, an independent online grocery platform that allows consumers to buy grocery items straight from brand manufacturers. Although Shobr has since morphed into more of a retailer format, other companies are vying to make this model work.

In the future, choice intermediaries will pose a reintermediation threat. As consumers become more comfortable ordering via voice-operated applications, they will learn to trust a digital assistant, or "food butler." Eventually the digital assistant could be relied on to fill a basket, recommend items and recipes, and suggest where to shop.

Many consumers, especially those under 40 years old, are interested in various forms of choice intermediary. The danger for retailers is that the choice intermediary will take their place in the customer relationship. Additionally, intermediaries may start to influence where consumers shop. Choice intermediaries could begin to split baskets across multiple retailers to offer savings or start charging retailers to be the source of fulfillment to customers in overlapping catchments. Brand owners won't be immune either, as the choice intermediary could suggest lower-cost products that are functionally better, if they exist.

"The threat to private brand is most salient for mid-tier brands. They will get squeezed between private brand and national A-brands that are able to invest in both marketing and innovation."

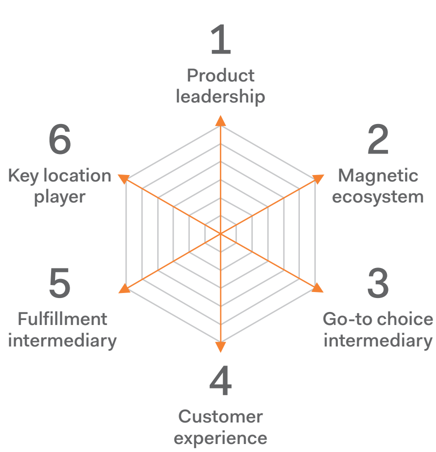
Paul Grimwood | President and CEO, Nestle USA

THE EMERGENCE OF NEW MODELS

As the ecosystem reconfigures, the traditional labels of "retailer" and "manufacturer" will become obsolete as new business models emerge. While there will be a large variety of successful models, the following six archetypes will feature strongly.

There will be **product-led companies**, which make exactly what their customers

Exhibit 5: Six archetypes



want, selling products through their own stores, but also utilizing others' channels and direct routes to market. This is traditionally the role of CPG manufacturers, but many retailers, such as Trader Joe's, have established a reputation for high-quality differentiated products that bring consumers through the door.

Some companies will develop **magnetic platforms**, which create compelling shopping and consumption experiences that give customers strong reasons not to go elsewhere. In China, Tencent's WeChat allows consumers to do everything from games and messaging to e-commerce to mobile payments. This platform is extremely magnetic; more than half of users log on at least 10 times per day.

There will be the emergence of **choice intermediaries**, which allow consumers to save time and money and are relied upon to find better products for consumers. The emergence of choice intermediaries is already seen in the apparel space. Dressipi provides a service to retailers such as John Lewis to help brands offer personalized recommendations on their sites based on a set of stated preferences and explicit color choices.

In some cases, **customer experience** champions will attract customers by offering engaging, high-service shopping experiences. Their stores may not actually hold inventory, and they may get paid by manufacturers for showcasing brands. In fact, they may not even be stores. Zappos, an online shoe retailer, has built a reputation for exceptional customer experience through a combination of strong service and personal attention.

Some companies will enter the **fulfillment intermediary** space, and they will excel in getting products from distribution centers and stores to the consumer's front door in the most efficient and reliable way. Recently, there has been a massive influx of venture capital flowing into fulfillment startups, such as Instacart. Although fulfillment intermediaries may look like helpful service providers at first, the danger emerges when these intermediaries start owning the customer relationship.

Finally, **key location players** will continue to access consumers by positioning themselves in convenient locations or by creating locations that people want to visit. Examples of this model include convenience stores as well as premium shopping mall operators, such as Westfield, which create destinations for shopping and leisure.

Undifferentiated players will struggle, but retailers who are able to differentiate themselves on at least one of these dimensions will continue to thrive in the new environment. The upside is huge for those who get it right.

Exhibit 6: Demand for choice intermediaries

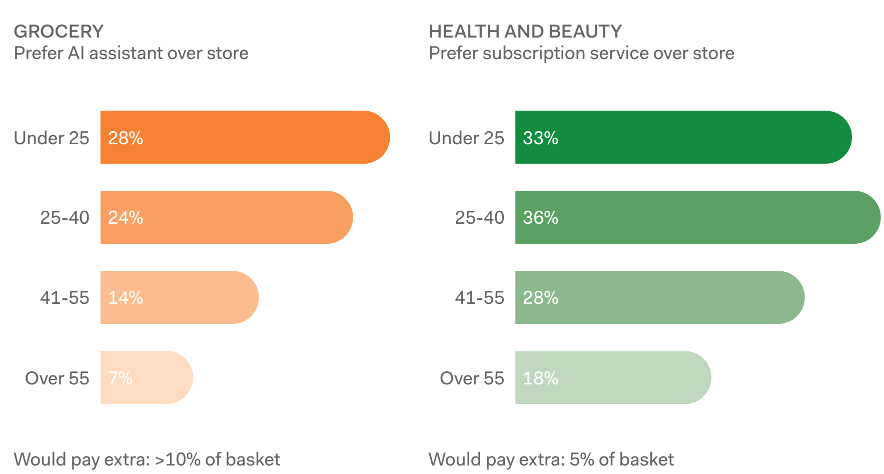
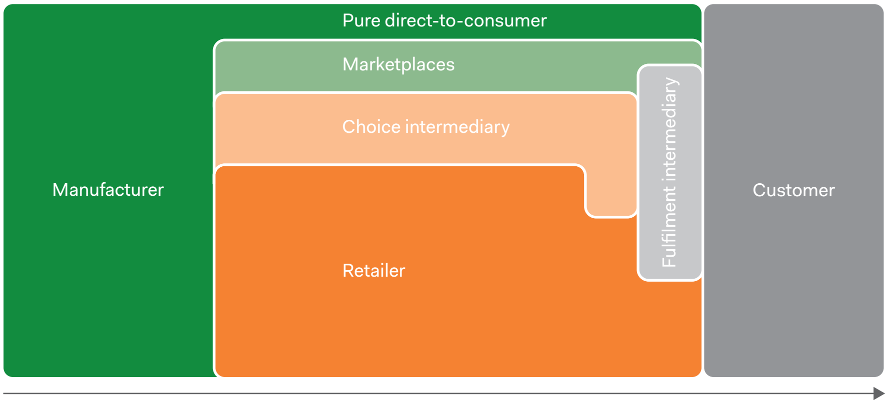


Exhibit 7: Pathways to consumers



IMPLICATIONS FOR CPG COMPANIES

In the old world, retailers acted as the gatekeepers who granted access to consumers – and were richly rewarded. Today, companies are finding new ways to get products to customers, whether direct or through new intermediaries that insert themselves into the value chain. More and more CPG companies are realizing the possibilities in the new world of retail.

The biggest prize for CPG companies comes with an effective direct-to-consumer strategy. Having exclusive sales channels is great commercially and allows companies to learn about customers by capturing insightful data directly. Getting results in direct-to-consumer comes down to cracking customer lock-in and reorder by supplementing brand loyalty with an ecosystem that makes it hard for customers to leave.

Developing unique strategies for different products is one approach to capturing customers by going direct. With high engagement products, such as cosmetics, direct-to-consumer may require additional content and value-added services. For lower engagement products, it may be more about subscription or ease of reorder,

Exhibit 8: Example acquisitions and partnerships

ONLINE PLAYERS SEEKING PHYSICAL PRESENCE			PHYSICAL PLAYERS SEEKING ONLINE PRESENCE		
MAJOR ACQUISITIONS			MAJOR ACQUISITIONS		
Amazon	+	Whole Foods Market	Walmart Nordstrom Target	+	Jet Hautelook Shipt
NOTABLE PARTNERSHIPS			NOTABLE PARTNERSHIPS		
Amazon Tencent JD.com Alibaba Group	+	Kohl's Walmart 7Fresh Sun Art Retail Group Ltd	The Home Depot Carrefour Auchan	+	Google Home Cogepart Colisweb

such as Amazon's strategy with Dash and Alexa. Changing product format can also drive lock-in. Nestle deployed this strategy with Nespresso. Heineken is also working on a similar offering with an in-home keg system. CPG companies have also developed captive platforms such as Shobr to get closer to consumers.

However, even going direct cannot remove the threat of choice intermediaries. In a world where a machine is choosing for customers, brand equity is beginning to lose its value. Developing "immunity" to choice intermediaries may mean ensuring products have genuine quality, specification, or price advantages. Companies need to find a way to either make the algorithm choose their products or gain unprecedented customer loyalty by creating a brand that speaks beyond quality. While choice intermediaries are good for products that hinge on points of differentiation, they could mean trouble for brands that can easily be swapped for others.

PANEL DISCUSSION INSIGHTS

Following the content feature, a panel discussion was held to discuss key challenges facing food retailers in more detail. In particular, the panel focused on the changing role of stores, e-commerce adoption, trends in consumer behavior, and the threat of private brand.

Shelley Broader, President and CEO of Chico's FAS, discussed her perspective on the changing role of physical stores in today's retail industry. Several nontraditional roles for store fronts have emerged in recent years, such as leveraging them for the purpose of returns from online purchases. As Broader put it, "Physical stores will take on new and non-traditional roles. We may see some emerge as service or return centers in order to keep the customers coming in." As our world shifts toward digital, more and more retailers are wondering how to maximize the utility of their stores while capturing online sales.

Additionally, Broader talked about her observations and predictions around consumer behavior in the retail industry. Contrary to some expectations, she found that customers welcome greater transparency and options around price. Broader has been particularly surprised by how open customers are to different pricing options, such as paying for faster shipping and accepting discounts for no returns. She also spoke about the misconception that e-commerce adoption is only for younger demographics, using her business as a primary example to debunk the myth. Chico's demographic skews older, but have rapidly adopted of e-commerce.

Marc Poulin, former CEO of Sobeys and co-author of *Retail's Revolution*, also shared his perspective on e-commerce adoption. He explained his predictions for how quickly retailers will adjust to the changing environment: "Growth will be slow initially, but ramp up quickly. Smaller retailers will start to close, reducing consumer options and driving more people online." Additionally, Poulin discussed how even a 10 percent adoption will cause a lot of marginal supermarkets to close, reducing the local brick-and-mortar options for consumers and further stimulating online shopping.

Paul Grimwood, Chairman and CEO at Nestle USA, expressed his thoughts on the threat of private brand to today's food retail players. He recognized retailers who are likely to be impacted by the rise of private brand: "The threat of private brands is most salient for mid-tier brands. They will get squeezed between private brand and national A-brands that are able to invest in both marketing and innovation." Private brands are growing fast through aggressive value engineering that replicates the quality of major brands at a significant discount. However, Grimwood was skeptical of the impact these products will have on categories other than mid-tier brands.

CONCLUSION

The future of retail will feature a high level of online penetration. The best suppliers will establish direct-to-consumer relationships, where retailers will no longer serve as the gatekeeper to the customer. Intermediaries will emerge and try to dominate the customer relationship, pushing undifferentiated retailers into a backroom role – essentially just a link in the supply chain. Disruption will impact retailers and CPG companies alike as the industry continues to follow the ever-changing wants and needs of consumers. Those who are able to differentiate themselves will continue to survive and thrive.