

Disruption & Uncertainty

The State of Grocery Retail 2021

–Europe–



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Foreword

COVID-19 hit Europe in February 2020. The pandemic resulted in an unprecedented health and economic crisis over the past twelve months. Unlike fashion, food wholesale, or other retailers who had to close or saw dramatically reduced footfall, grocery retailers fulfilled the essential role of keeping people fed and provided necessary cleaning and personal hygiene products. In many ways, grocers were also heroes of the pandemic.

Food retail sales increased due to the initial wave of panic-driven buying, restaurants being closed, and people staying, working, and cooking at home. However, retailers' costs rose too, because of the disruption in supply chains from unprecedented demand or illness in suppliers' factories, the measures to keep staff and customers safe, and the acceleration and expansion of investments for online services and delivery.

The year ahead is characterized by unusually high uncertainty for the grocery industry. The development and trajectory of the industry will heavily depend on the evolution of the COVID-19 pandemic and how consumers will behave in response. Which consumer behaviors observed during the pandemic will stick? What new trends might emerge post-pandemic? Will online grocery sales continue to accelerate? How can retailers make it profitable? Will food nationalism continue, or will focus shift to trading down and price? Will safety and health be important factors? How about the broader topics of sustainability and climate change? This report aims to address these questions.

The State of Grocery Retail is an annual global publication covering three continents through five dedicated reports across Europe, North America, China, Japan, and India. Our goal is to produce the industry's leading publication that frames major trends and issues for CEOs seeking to keep pace and stay ahead of market shifts. We do this through surveys and interviews, and by providing insights and analyses from the best in the game.

In its inaugural year, ***Disruption and Uncertainty – The State of Grocery Retail 2021: Europe*** marks a partnership between McKinsey & Company and EuroCommerce designed to provide executives a comprehensive view on an industry forced to adapt at unprecedented speed. We surveyed more than 10,000 consumers and around 50 grocery executives across Europe. We interviewed six industry thought leaders and pioneers. We combined EuroCommerce's policy and sector knowledge with McKinsey's global expertise and analytical rigor.

We hope this report will offer new insights and perspectives that help grocers remain competitive through the uncertainty.



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Gemma has been with McKinsey for 15 years and currently leads the Consumer and Retail practices in Italy. She has extensive experience across the sector and has served leading players in the grocery and retail space in Europe and the Middle East. In particular, she has supported clients on transformative journeys in digital acceleration, advanced analytics, and on organizational topics such as upskilling or reskilling at scale.



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State of the industry

The coronavirus pandemic has reshaped the European grocery-retail landscape at unprecedented speed and scale. Five major forces at the heart of this change came together and reinforced each other.

*by Richard Herbert, Jean-Albert Nyssens,
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"Food and grocery market KPIs"
on page 16

For many European grocery retailers, 2020 was the year that saw emerging consumer trends suddenly go into overdrive. With restaurants, offices, and schools largely closed in most countries during the first wave of the pandemic, consumers rushed to stock up on groceries, both in stores and online. In France, Germany, Italy, Spain, and the United Kingdom, grocery sales during the onset of the first lockdown in March 2020 increased by about 20 percent, on average, over the same period in 2019. Retailers faced difficulties to fulfill the sudden peaks in demand as fear of stock-outs led to hoarding, which, in turn, created further stock-outs—all leading to further stress for consumers.

It wasn't until after this major disruption that both consumers and grocers realized the pandemic was going to last for months, and adapted their business models and shopping behavior accordingly. Two fundamental drivers, however, continue to shape the way consumers shop for groceries.

Government restrictions. More safety regulations led to an increase in demand for both online and (especially in cases of harder lockdowns) local shopping, while the closure of restaurants and cafés combined with a rise in remote working led consumers to shift their food spending from foodservice to grocery retail.

Consumer focus on health. With growing insight into infection risks and prevention measures, consumers increasingly preferred to avoid crowded places—such as busy stores or public transportation—in an effort to protect themselves and others.

Together, both government restrictions and a focus on health led to massive changes in mobility patterns. European consumers reduced their shopping frequencies by around 5 percent on average, while increasing basket sizes by approximately 16 percent.¹ Overall, mobility of consumers has decreased and mobility patterns have been redistributed amongst different destinations. For instance, on average, the number of visitors to workplaces had decreased by 25 percent, while visits to residential areas had increased by 8 percent in 2020.² The online channel, for example, grew by about 55 percent on average across Europe, while hypermarkets only saw a growth of about 3 percent.

While these trends generally hold true across Europe, consumer behavior differed in individual regions depending on local circumstances. In Italy, which restricted people to shopping only within close proximity to their homes, sales at local neighborhood stores soared. By contrast, in Sweden—which implemented the fewest restrictions in Europe and thus saw much less change to mobility patterns than other countries—consumers consolidated their shopping and tended to do it in large hypermarkets on the outskirts of town, which they perceived to be less busy and thus safer. In part due to this perception, shopping frequency of Swedish consumers increased slightly, contrary to the predominant trend in the rest of Europe. As a consequence, Swedish hypermarkets grew their revenues at a pace more than twice as high as the European average of 3.3 percent.³

¹ Based on Europanel data.

² Google COVID-19 Community Mobility Report.

³ Market growth based on Europanel data.

Five major forces shaping the market in 2020

Five major forces stood out across European grocery retail markets, reshaping consumption patterns and everyday operations of grocers.

1) Grocery spending at an all-time high

Grocery was one of just a few retail subsectors that grew consistently in 2020: volume increased by around 8 percent and value by slightly more than 10 percent, in particular in categories related to the trend of spending more time at home.⁴ With remote working, school closures, and restrictions on restaurant dining, grocery retail's share of volume rose. Other product categories that benefited from this overall context were cleaning and household products, whereas "social" categories related to going out or going to work, such as personal care, rather suffered.

We expect that the unprecedented overall growth rate of 2020 will be hard to sustain. Some new habits, such as working from home or cooking more often, may stick going forward even as the fundamental drivers, including the need to avoid infection transmission or the restrictions on restaurants and bars, will at least partly disappear. Grocery retail seems to be positioned well, even for the post-COVID-19 time, with consumer spend intentions clearly favoring grocers (positive intent) over take-out or seated restaurants (both with negative intent). Nevertheless, a clear prediction is hard to make given the very different scenarios on how quickly the health crisis will be resolved,

⁴ Value includes, besides volume, inflationary (for example, from raw materials) and up/downtrading effects; based on Europanel data.

In the "next normal," grocery retail will once again need to rebalance its role within the broader ecosystem with restaurants and other options.

and how significant the economic crisis will turn out to be. It does however seem improbable that grocery spendings will stay at their very unusual high levels: once the pandemic eventually ends and economic recovery sets in, people are highly likely to return to the "next normal"—where grocery retail will once again need to rebalance its role within the broader ecosystem with restaurants and other options.

2) Further polarized demand with consumers trading up or down

The economic effects of the pandemic have led to a polarization of consumers—some trade up

to buy more expensive products, while others trade down to cheaper versions. Uptrading is very likely due to higher disposable incomes from lower spending in other categories, coupled with the increased importance of cooking at home and healthy eating. Overall, around 30 percent of consumers say that they are planning to spend more money on sustainable and healthy products in 2021 compared with last year. Meanwhile, consumers who were hit directly by the economic effects of the crisis have clearly tended to shift toward value. Indeed, 19 percent of consumers say that they have downtraded over the past year. Polarization of customer segments thus has further increased in 2020.

While all countries experience both uptrading and downtrading, the extent varies across countries—with some displaying stronger signs of trading up (for example, Germany, the Netherlands, and the United Kingdom), while others see a heavier trend toward trading down (for example, France, Portugal, and Sweden). Both uptrading and downtrading being present within countries often leads to overall averages that tend to hide the order of magnitude of both. As would be expected, countries experiencing a higher downtrading typically also saw an increase in the purchase of private-label products.

Even with society likely to return to a new normal step by step, this polarization in buying behavior is likely to linger, since it is the acceleration of a trend that we have seen for years. In particular, we expect to see both downtrading and uptrading in 2021 as reactions to the ongoing economic crisis and the limited availability of other food options.

3) Continued online-grocery sales growth

The online channel has experienced unprecedented growth during the COVID-19 pandemic, propelled by consumers looking for safe shopping alternatives. In Europe overall, the online grocery channel experienced a growth of around 55 percent over the past year, compared with an average gain closer to 10 percent in 2019. We observed the highest online growth rates—all above 60 percent—in Sweden, the United Kingdom, Spain, and Italy. In comparison, average growth rates in offline channels were significantly lower: 3 to 12 percent in the main offline channels—such as hypermarkets, supermarkets, and discounters—and around 7 percent in the others. This growth corresponds to a shift in market share of approximately 1.5 percentage points to the online channel, making it the biggest winner in both growth as well as absolute market share gain. Furthermore, online channels contributed to about 20 percent of total grocery revenue growth in 2020, despite having only about 4 percent of market share in 2019.⁵

Broadly speaking, online won across all countries. In countries with an already high online-grocery penetration, players which were able to pivot quickly and address customer preferences went on to capture significant market share. UK grocery retailers for example saw their online share expand from 7.6 percent in 2019 to 11.2 percent in 2020 (reaching 13 percent market share at the highest point), corresponding to a revenue growth of 67 percent.⁶ In markets that had proven less savvy on online shopping, many incumbents benefited from their recently established online presence. For instance, in

⁵ Based on Europanel data.

⁶ Based on Europanel data.

Sweden the online channel grew by around 100 percent in 2020, compared with less than 10 percent in 2019—the strongest growth rate seen across Europe.

Though impressive, online growth rates are likely to even be underrepresenting the market potential given that at least some players were unable to keep up with the exploding demand. This “growth pain” likely left customers with a frustrating experience and may have been one driver of demand curves somewhat flattening again after the first peak. Full-year growth, albeit impressive, is likely to still be significantly below peak numbers for many countries for the same reason.

Consumer survey data are projecting that users of online grocery retail channels are

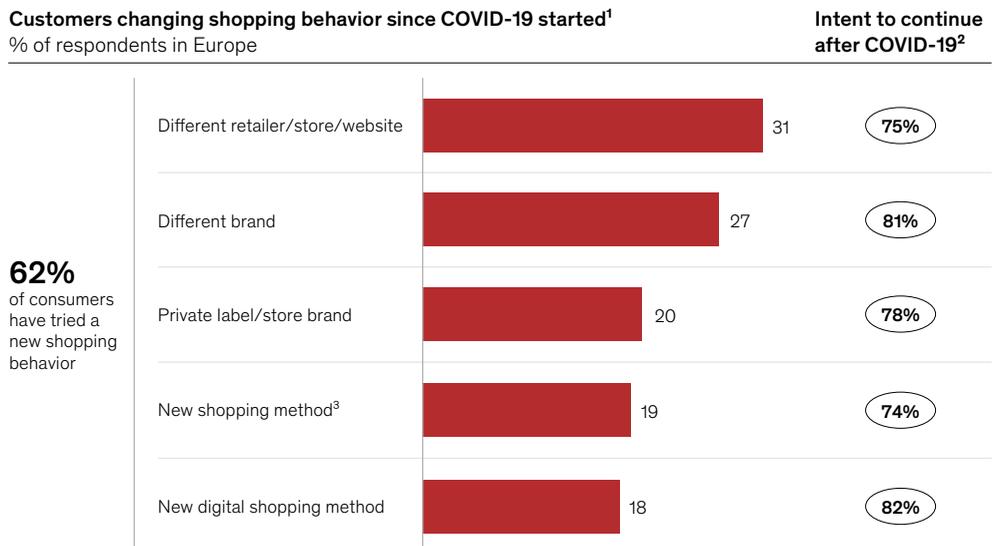
likely to largely continue their use in 2021—the spending intent after COVID-19 for online grocery is expected to drop by just 10 percent. Having learned to appreciate the convenience of shopping online, consumers will at least partly stick to this habit even after the pandemic abates—increasing the need for retailers to finally seek a path to profitability for their online offering.

4) A shock to customer loyalty

The pandemic has delivered a massive shock to customer loyalty across every dimension—providing a unique opportunity for grocers. Indeed, more than 60 percent of consumers have changed their shopping behaviors. Most importantly, 31 percent of consumers say they changed the store or banner they shop in (Exhibit 1), the key reasons being better

Exhibit 1

More than 60 percent of Europeans have tried a new shopping behavior, and most intend to continue with it beyond the crisis.



¹ Q: Since the coronavirus (COVID-19) situation started, which of the following have you done? 38% of consumers selected “none of these.”

² Q: Do you plan to continue with these shopping changes once the coronavirus (COVID-19) situation has subsided?

³ Methods include curbside pickup and delivery apps.

Source: McKinsey & Company COVID-19 Europe Consumer Pulse Survey 11/9-11/16/2020, n = 5,232 (Italy, France, Germany, Spain, UK) sampled and weighted to match European general population 18+ years

value (especially prices) and convenience—particularly easy access or delivery options (Exhibit 2). Consequently, grocery retailers have a historic opportunity to attract new customers by better adapting to their changing needs and providing them with a superior value proposition. And, since more than 70 percent of customers say that they intend to stick to their new behaviors, there is a real chance to retain them in the longer term.

5) An acceleration of consciousness about health and environment

Over the course of the pandemic, consumers shifted their spending significantly toward products that are healthy, environmentally friendly, and local. Around 60 percent of

them—across many ages, genders, or other demographics—say that they are willing to pay more for sustainable alternatives. 30 percent of European survey respondents reported that they plan to focus on healthy eating and nutrition more in 2021 compared with 2020.

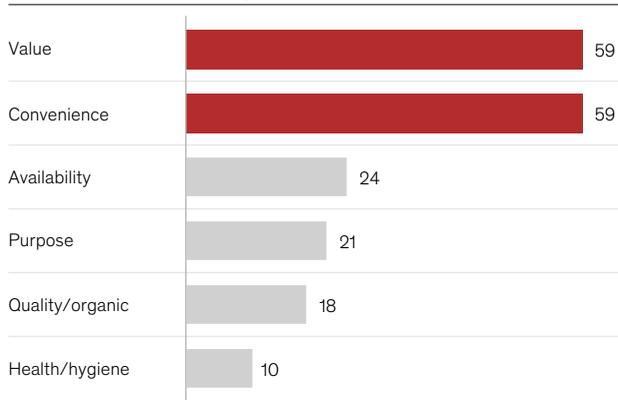
Similarly, despite the pandemic, the number of “eco-actives”—consumers who are most aware of sustainability issues and most active in reducing their environmental footprint—has continued to increase across Europe. France, Germany, and Spain, for example, saw this category rise six to ten percentage points in 2020.

The past year has also shown that consumers look not only for healthy food but also for healthy and hygienic packaging (Exhibit 3).

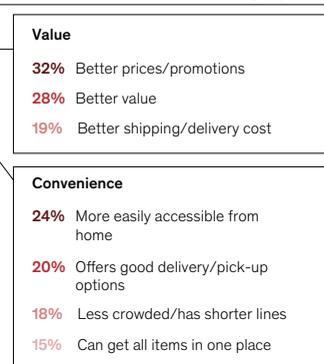
Exhibit 2

Nearly 60 percent of consumers cite value and convenience as drivers for trying new places to shop.

Reason for shopping at a new retailer/store/website in the past three months¹
 % of respondents selecting reason in top three



Breakdown of main reasons
 % of respondents per category²



¹ Q: For respondents who mentioned they've shopped from a new retailer/store/website since the coronavirus (COVID-19) situation started: What was the main reason you decided to try this new retailer/store/website? Select up to 3.
² Figures may not sum to 100%, because of rounding; figures are not exclusive.
 Source: McKinsey & Company COVID-19 Europe Consumer Pulse Survey 11/9-11/16/2020, n = 5,232 (Italy, France, Germany, Spain, UK) sampled and weighted to match European general population 18+ years

European consumers are buying based on sustainability and healthy, hygienic packaging.

Shopping behavior since COVID-19 has started,¹ % of respondents in Europe

Buying based on:	Net intent ²				
	United Kingdom	Germany	France	Spain	Italy
Healthy and hygienic packaging	+9	+7	+7	+16	+12
Retailers promotion of sustainable solutions	+7	+8	+3	+17	+12
Sustainable/eco-friendly products	+8	+10	+9	+14	+9
How companies take care of the safety of their employees	+8	+5	+7	+16	+11
Company's purpose/values	+2	-4	-1	+10	+5

■ Highest increase in intent per country
 ■ Positive intent ■ Negative intent

¹ Q: Which best describes how often you are doing each of the following items? Possible answers: "Doing less since coronavirus started"; "Doing about the same since coronavirus started"; "Doing more since coronavirus started."
² Net intent is calculated by subtracting the % of respondents stating they expect to decrease time spent from the % of respondents stating they expect to increase time spent.
 Source: McKinsey & Company COVID-19 Europe Consumer Pulse Survey 11/9-11/16/2020, n = 5,232 (Italy, France, Germany, Spain, UK) sampled and weighted to match European general population 18+ years

Buying sustainable and eco-friendly products also increased in net spending intent by 8 percent or more.

The winners of 2020

Grocery retailers that were able to capitalize on the five market forces outlined above—be it through a strong online presence, higher convenience due to proximity, or less crowded stores—emerged as the winners in 2020.

As a channel, online was the clear winner: in 2020, its market share across Europe increased, on average, by 1.5 percentage points from a 2019 base of 3.7 percent.⁷ While

the established French and British online grocers led in absolute revenue growth (some of them adding more than €1 billion in online sales), players from other countries with a smaller base grew fast on a relative scale (for instance, ICA, REWE and Picnic all grew their online businesses by 80 percent or more).⁸

By store format across European countries, discounters gained market share (+0.4 percentage points), while supermarkets remained neutral and hypermarkets (-1.2 percentage points) and other channels (-0.7 percentage points) lost out.⁹ For discounters, the picture is divided geographically: while the

⁷ Based on Europanel data. Given overall market growth, this translates into even stronger growing revenues (average increase of more than 50 percent in online in 2020).

⁸ Based on IGD Research data.

⁹ Based on Europanel data. Substantial variations across countries exist. Almost all formats, regardless of relative market share change, did grow revenues given overall market growth.

market shares of players in Western Europe stagnated, their Eastern European peers continued on a steep growth trajectory (with an increase of one to three percentage points in market shares, depending on the country) fueled by new store openings. On the negative side, hypermarkets and traditional channels continued to lose market share, a trend that was well established before 2020 and accelerated during the pandemic. It is worth noting that supermarkets—and discounters—benefited from the behavioral changes driven

by the pandemic and experienced stronger-than-average growth compared to other offline channels. They were also able to sustain their market shares more than hypermarkets and traditional channels by harnessing their convenience advantage (a one-stop shop often in close proximity to the consumer) as well as addressing consumer preferences for healthy and sustainable products with corresponding assortment offerings.

Supermarkets—and discounters—benefited from the behavioral changes driven by the pandemic and experienced stronger-than-average growth compared to other offline channels.

Key takeaways of 2020

Overall, 2020 was a highly challenging year for grocery retailers. Besides many operational issues to solve, among the hardest issues to tackle was undoubtedly the task of taking care of fears and anxiety among frontline employees—who mostly kept working with direct customer contact even during the lockdown periods. At the same time, the markedly higher demand made it a rewarding year for most players. Retailers with a strong online offering (and enough capacity) and those with stores in close proximity to consumers managed to grow their market shares.

For 2021 we expect that while some of the pandemic effects on grocery shopping will start to fade, the major developments of 2020 are likely to stick: consumer polarization will continue; a significant portion of the higher online penetration will be permanent; customers that were changing stores, channels, or brands may stick with their new choices; and healthy and sustainable food will continue to grow. Compared with 2020, grocery spending is expected to decrease slightly in 2021, and continue declining during 2022, depending on the speed of returning to a new normal. However, it will remain at a higher

level compared with 2019 thanks to the still high shares of home consumption.

The main lesson for grocers (and other retailers) is the need to be able to act with agility in unprecedented times. The ability to

adapt offerings to fast-changing consumer behaviors—by scaling capacity or flexibly adjusting services for example—proved to be crucial in 2020. The outlook for 2021 remains uncertain and the need for a continued ability to adjust is definitely here to stay.

Food and grocery market KPIs in 2020 grew on average.

YoY growth 2019 vs 2020, %

■ Negative change
■ No change
■ Positive change

	Germany	United Kingdom	Netherlands	France	Spain	Italy	Portugal	Sweden	Czech Republic	Poland	Russia	Weighted average ¹
Food market—Segment growth												
Foodservice² YoY growth ³	-28.5	-47.7	N/A	-30.6	-42.7	-31.2	-36.2	-18.4	-27.1	-14.5	N/A	-34.0
Grocery retail⁴ YoY growth	12.3	13.1	9.6	7.7	13.8	10.0	13.3	15.8	8.4	6.7	4.8	10.4
Modern retail ⁵ YoY growth	12.6	13.6	9.5	8.4	13.6	12.9	13.2	15.4	9.9	10.4	8.2	11.5
Other formats ⁶ YoY growth	11.2	10.3	10.4	1.4	14.3	0.6	14.1	20.4	4.2	0.4	-0.3	7.2
Modern retail—Growth breakdown												
Revenue⁴ YoY growth	12.6	13.6	9.5	8.4	13.6	12.9	13.4	15.4	10.1	10.5	8.3	11.6
Hypermarket ⁷ YoY growth	9.9	4.4	N/A	3.4	7.9	-2.7	N/A ¹⁰	7.6	8.0	-6.7	-5.6	3.3
Supermarket ⁸ YoY growth	16.7	9.6	7.0	9.8	13.6	12.2	11.1	12.3	7.8	16.5	-0.4	10.6
Online YoY growth	39.9	66.7	55.9	41.9	63.2	62.4	58.6	101.1	17.7	55.2	50.9	53.9
Discounter ⁹ YoY growth	8.9	12.2	6.5	7.5	12.9	19.5	16.1	16.3	13.3	13.6	14.4	11.9
Sales area YoY growth	1.1	0.9	1.2	0.9	0.2	-2.1	2.5	1.0	0.9	0.9	5.7	1.4
Hypermarket ¹⁰ YoY growth	0.1	-0.1	N/A	0.3	0.6	0.1	N/A ¹⁰	2.0	-0.3	-3.3	-0.4	-0.6
Supermarket ¹¹ YoY growth	0.9	0.0	0.7	0.9	1.9	-8.8 ¹⁴	1.4	5.4	0.8	0.3	6.4	0.9
Discounter ¹² YoY growth	1.9	6.9	3.3	2.5	-1.5	6.1	6.1	-11.4 ¹⁵	3.9	5.4	10.1	4.0
Sales/m² '20, € '000/m ²	4.2	8.6	6.1	3.4	4.9	3.7	4.3	4.0	4.3	2.4	4.3	4.9
Sales/m² YoY growth	10.6	7.4	5.6	5.0	12.1	13.9	9.4	10.6	8.7	8.8	0.7	8.0

¹ Weighted according to 2020 total grocery revenues for each country.

² Includes food and beverage service activities providing complete meals or drinks fit for immediate consumption (eg, traditional restaurants, self-service, or take-away restaurants).

³ Estimated based on indexed foodservice data from Eurostat.

⁴ Europanel revenue data only measures value of purchases that are taken home (excludes value of purchases that are consumed on the go, at work, etc.).

⁵ Consists of hypermarkets, supermarkets, online stores and discounters.

⁶ Remaining store types not covered by "modern retail." Examples include small corner store, pharmacy, drugstore and open market.

⁷ Large retail outlets under common ownership with sales area > 2,500m².

⁸ Smaller retail outlets under common ownership, excluding discounters. Sales area between 450m² to 2,500m².

⁹ Limited range discount retailers such as Aldi, Lidl, Biedronka, Norma, Netto, Eurospin, Penny, Dia, Leader Price.

¹⁰ Sales area between 3,000 to 6,000m², substantial non-grocery store offering.

¹¹ Sales area ranging from 300 to 6,000m², store offering is predominantly food.

¹² Sales area from 300 to 1,500m² (potentially up to 6,000m²), narrow range (<4,000 SKUs) with a focus on everyday low prices. Offerings typically dominated by private label and stores operate with low-cost business model.

¹³ Included in supermarkets within Europanel dataset due to sample size.

¹⁴ Supermarket chain exited the Italian market mid-2019; change in sales area only reflected in 2020 data.

¹⁵ Discounter chain acquired by a supermarket chain in mid-2019; re-categorization of sales area only reflected in 2020 data.

■ Negative change
■ No change
■ Positive change

	Germany	United Kingdom	Netherlands	France	Spain	Italy	Portugal	Sweden	Czech Republic	Poland	Russia	Weighted average ¹
Grocery retail—price and volume growth												
Volume <i>YoY growth</i>	6.6	10.2	4.5	7.9	11.3	6.6	12.1	14.1	4.4	2.6	4.2	7.5
Basket size volume <i>YoY growth</i>	5.5	26.4	8.4	13.1	14.4	11.7	12.6	12.7	9.9	18.9	8.5	16.3
Frequency <i>YoY growth</i>	1.0	-12.8	-3.6	-4.6	-2.7	-4.6	-0.4	1.2	-5.0	-13.7	-4.0	-4.8
Price changes (inflation) <i>YoY growth</i>	2.6	1.0	2.1	2.1	2.6	1.6	2.1	2.3	4.7	5.1	3.5	2.4
Up/down trading changes <i>YoY growth</i>	3.1	1.9	3.0	-2.3	-0.1	1.8	-0.9	-0.6	-0.7	-1.0	-2.9	0.5
Other key grocery indicators												
Online channel market share <i>'20 share</i>	2.5	11.2	6.4	8.3	2.6	3.1	3.5	6.6	3.8	1.6	3.6	5.3
Private label share <i>'20 share</i>	32.4	49.6	42.6	35.2	25.7	28.0	37.5	23.3	24.2	19.3	5.1	30.3
Private label share <i>p.p.¹⁶ share change</i>	-0.6	-0.6	-0.5	0.5	0.3	1.1	1.5	1.4	1.7	0.9	0.7	0.2
Promo share <i>'20 share</i>	18.7	31.1	21.2	13.7	13.2	34.7	31.4	26.9	51.2	24.2	31.5	24.4
Promo share <i>p.p.¹⁶ share change</i>	-0.4	-2.6	0.2	-1.2	-0.5	-4.6	-1.0	-1.0	-1.0	-0.2	0.0	-1.2
Consumer indicators												
Consumer confidence <i>p.p.¹⁶ share change</i>	-7.3	-6.9	-5.9	-4.7	-16.3	-3.5	-15.9	0.8	-10.6	-16.4	-8.0	-8.0
Eco-active consumer¹⁶ <i>'20 share</i>	38.0	23.0	N/A	19.0	24.0	23.0	18.0	22.0	18.0	22.0	N/A	26.1
Eco-active consumer <i>p.p.¹⁶ share change</i>	8.0	1.0	N/A	6.0	10.0	N/A	N/A	N/A	2.0	3.0	N/A	5.5

¹⁶ Consumers that take the most actions to reduce their environmental impact, such as using their own bags, bottles, and cups, and avoiding plastic.

Source: Europanel; Eurostat; IGD Research



The path forward—

Key trends

Consumer shifts around online, value, and lifestyle agendas are creating an attractive opportunity for grocery retailers to capture market shares over the next two to three years. However, both the growth of online and the trend toward value are likely to put further pressure on grocers' margins, especially given that the overall market may shrink once restaurants return. Grocery retailers thus will need to strive for further efficiency and find new margin pools to grow profitably.

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"Ten trends shaping grocery retail" on page 28

In January 2021, EuroCommerce and McKinsey conducted grocery retail surveys across Europe, asking 48 CEOs and more than 10,000 consumers about their outlook and intentions for the next two to three years.

The research identified ten trends we expect to shape the grocery retail market in the coming years. The essence of these trends are shaped by three key shifts: online becomes core, value is king again (downtrading), and consumer lifestyle agendas drive demand through focus on health, sustainability, and convenience food. These shifts emerged as consistent patterns across most European markets. Low-income consumer segments trend more toward downtrading, while high-income segments trend more toward online and lifestyle-driven products. But all the shifts are emerging to some extent across income groups.

The combination of continued online growth after the penetration spike in 2020 with a shift to value or downtrading and the shift from grocery sales back to restaurants is very likely to put more pressure on grocers' profitability. They will need to further increase their efficiency—through automation, for example, or an evolved online business—and find new pools of margin, through analytics or a shift to more differentiated, premium-type products. These trends are a top concern for many of the CEOs we surveyed.

A declining market?

Following a record year for sales in 2020, the CEOs and consumers we surveyed expect that the European grocery market will stagnate

or decline over the next one to two years as COVID-19 restrictions are lifted. However, consumers plan to keep spending more on groceries after the pandemic subsides compared to pre-pandemic, suggesting that the market will not return fully to pre-COVID-19 levels but will remain slightly larger. The timing and magnitude of the likely future contraction of the market are highly uncertain and dependent on several factors linked to the further evolution of the COVID-19 crisis.

In line with this, nearly half of CEOs expect that the market situation will worsen in 2021 and remain highly uncertain. Just 26 percent anticipate that the situation will improve. The words CEOs most commonly associate with their expectations for 2021 are “challenging,” “uncertain,” “price-focused,” “competitive,” and “online” (Exhibit 1).

Consumers indicated that they plan to maintain some of their changed behaviors in the postpandemic era. In particular, up to 10 percent of consumers said they intend to keep spending more on grocery stores and less on other food channels than they did pre-COVID-19. This could be because consumers have become more accustomed to cooking at home or because they expect to keep working from home more than they did in the past (Exhibit 2).

While the general market outlook remains uncertain, both CEOs and consumers agree on the trends that are most likely to shape the market.

Exhibit 1

Nearly half of CEOs surveyed anticipate that market conditions will worsen for grocers in 2021.

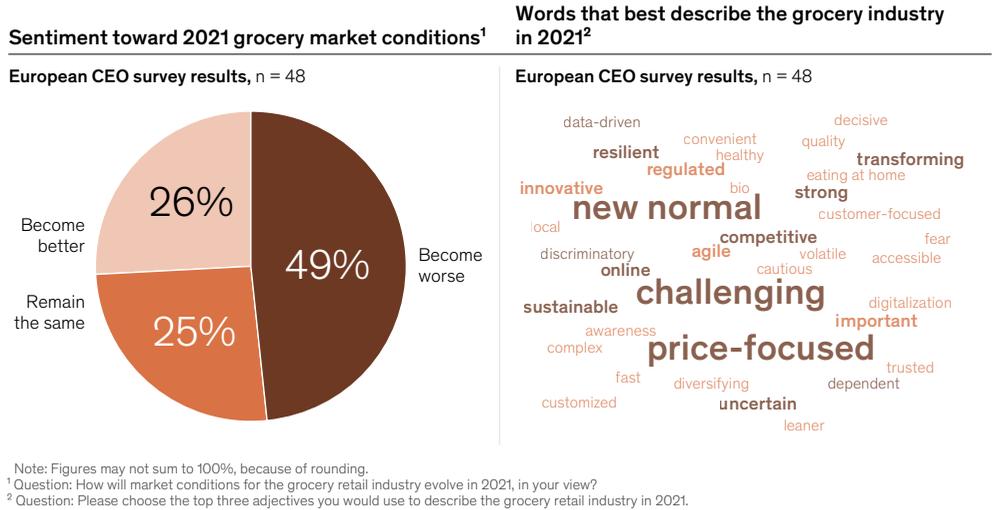
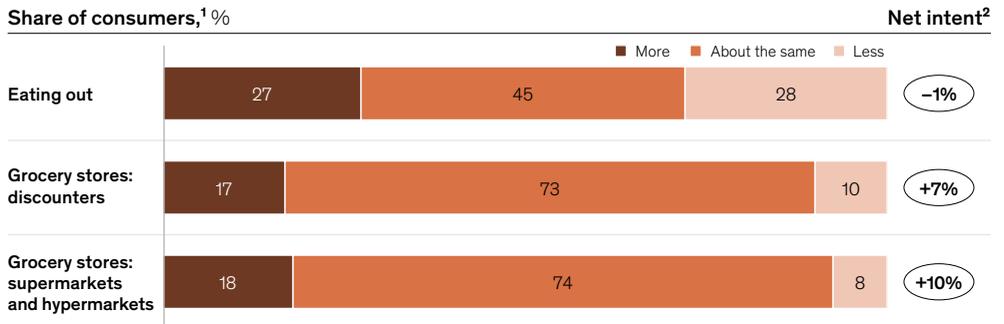


Exhibit 2

Consumers expect to spend more money on groceries postpandemic than they did prepandemic.



¹ Question: Thinking about after COVID-19, do you expect that you will spend more, about the same, or less money on food in these channels as compared with pre-COVID-19?
² Net intent is calculated by subtracting the percentage of respondents stating they expect to decrease spending from the percentage of respondents stating they expect to increase spending.

Key trends shaping the industry

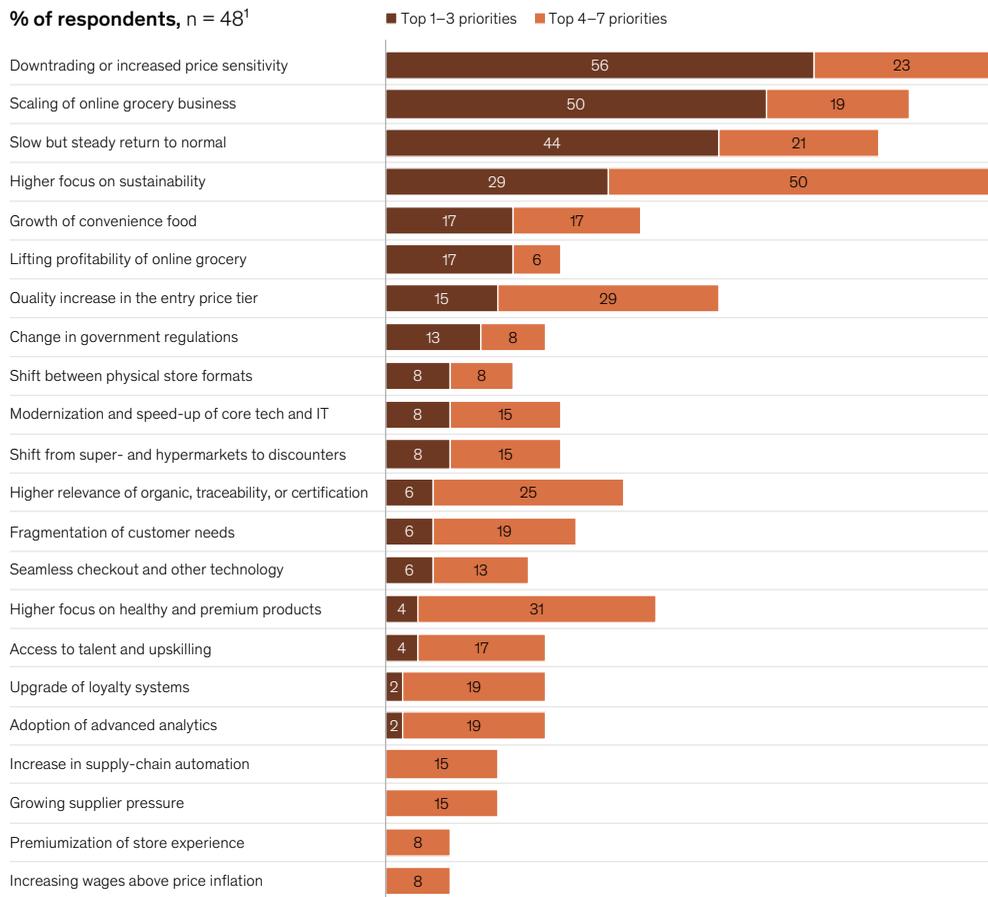
Based on both CEO surveys and consumer research, we identified ten trends that we believe will shape the industry over the next years (see sidebar, “Ten trends shaping grocery retail through 2025”). This analysis is

based on what CEOs see as the key industry-shaping changes (Exhibit 3) and the shopping intentions of consumers (Exhibits 4).

The most pronounced trends show that online is becoming core for grocery retailers, value is king again, and lifestyle agendas are driving food demand.

Exhibit 3

We asked CEOs to rank the top seven trends they expect to shape the grocery industry in 2021–22.



¹ Respondents were asked to name their top 3 priorities and then their top 7 priorities.

Customer intentions guide key changes for grocery retail in 2021.

Net share of consumers,¹ %

High  Low

I plan to ...	France	Germany	Italy	Nether-lands	Poland	Russia	Spain	Sweden	Switzer-land	United Kingdom	European Average
Online becomes core											
... buy groceries online	12	5	7	9	11	11	13	11	9	16	10
Value is king again											
... look for ways to save money when shopping	33	27	39	27	35	36	44	26	35	38	34
... actively search for best promotions	27	23	40	20	32	34	34	19	24	22	27
... switch to less expensive products	11	11	18	15	15	17	30	9	20	24	17
Lifestyle driven growth in food demand											
... focus on healthy eating and nutrition	31	37	32	30	34	16	36	27	29	29	30
... spend more on regional or local products	34	31	31	20	22	6	30	20	29	21	24
... spend more on environmentally friendly products	24	24	20	16	22	2	26	15	21	17	19
... buy imported products	-37	-34	-20	-19	-18	-22	-23	-25	-31	-25	-25

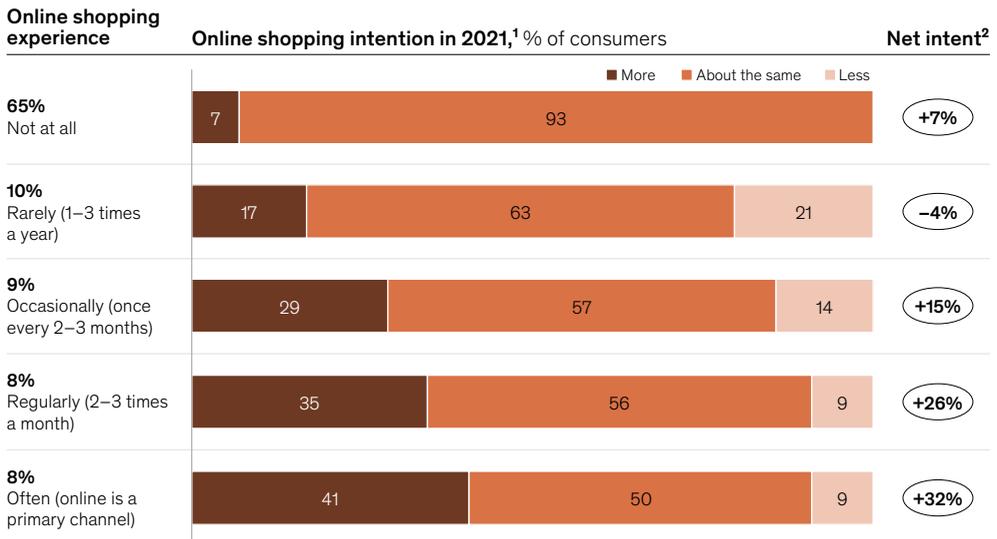
¹ Question: Which of the following statements best describes your attitude toward grocery shopping in 2021 as compared with 2020? Answers: More, about the same, less. The percentage is calculated as net sentiment (deducting the percentage of people intending to do the activity less in 2021 vs 2020 from the percentage of people intending to do the activity more).

Online becomes core

Following an exceptional take-up rate for online shopping in 2020, consumers are eager to make even more of their food purchases online in 2021. In particular, the 25 percent of consumers who already bought online at

least occasionally want to increase their online purchasing even further. The more often consumers bought online in 2020, the more likely they seem to be to increase their share of online buying (Exhibit 5).

Most consumers expect to shop online more in 2021 than they did in 2020.



Note: Figures may not sum to 100%, because of rounding.

¹ Question: Which of the following statements best describes your attitude toward grocery shopping in 2021 as compared with 2020? Result for "I plan to buy groceries online."

² Net intent is calculated by subtracting the percentage of respondents stating they plan to buy less online from the percentage of respondents stating they plan to buy more online.

However, the trend toward increased online shopping does not extend to all consumer groups. Consumers who rarely purchased food online in the past (10 percent of all consumers) said they plan to cut rather than increase their online spending (-4 percent net intent). And of the consumers who did not shop online in 2020—the clear majority at 65 percent—only 7 percent said they intend to start buying online in 2021.

Less frequent online shoppers may have had to resort to online grocery shopping in 2020 and found the experience disappointing, which could explain their reluctance to continue shopping online in 2021. When non-online and rare-online shoppers were asked what is preventing them from buying online, 49 percent indicated they preferred personal contact in stores, 33 percent think delivery charges are too expensive, and 22 percent said minimum order requirements are too high.

CEOs rank the accelerated growth of online channels as their second most important priority. They also see a need to improve online profitability (ranked sixth).

Value is king again

CEOs see downtrading, or increased price sensitivity, as the most influential trend for the grocery market, with 56 percent of CEOs listing it among their top-three priorities. The downtrading trend is amplified by an increased quality expectation of consumers at the entry-level price tier (ranked at number seven in the CEO survey) as it puts pressure on grocery retailers regarding both price and quality (Exhibit 3).

Our consumer survey confirms this downtrading trend. Across Europe, net 34 percent of consumers indicated that they want to save money when shopping in 2021 compared with 2020, 27 percent plan to research promotions more actively, and 17 percent want to switch to less expensive products.

Lifestyle agendas drive food demand

The COVID-19 crisis accelerated the trend toward more healthy, sustainable, and local products with no apparent slowdown so far. Across Europe, net 30 percent of respondents plan to focus more on healthy eating and nutrition in 2021 compared with 2020, 24 percent plan to spend more on regional and local products, and 19 percent plan to spend more on environmentally friendly products (Exhibit 4).

These effects continue to be strongly influenced by individual economic situations.

Shifts like online, health, sustainability and value existed before, but the speed and magnitude has significantly changed.

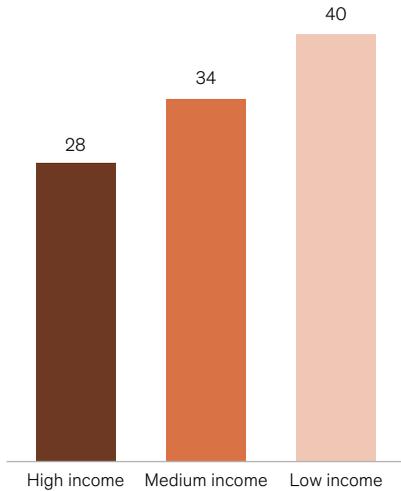
Higher-income segments tend to be less price conscious and more willing to spend on healthy eating and nutrition. In contrast, lower-income segments focus more on saving money and are less concerned about healthy food choices (Exhibit 6).

The consumer survey results confirm CEOs' expectations of overall trends toward price sensitivity and healthy products. The findings also illustrate the continued polarization across consumer segments seen in 2020, with lower-income consumers expecting to focus more on saving money and overall downtrading, while higher-income segments' product preferences may drive them to overall up-trading despite increasing price sensitivity.

Consumers in all income groups look for value and more healthy products.

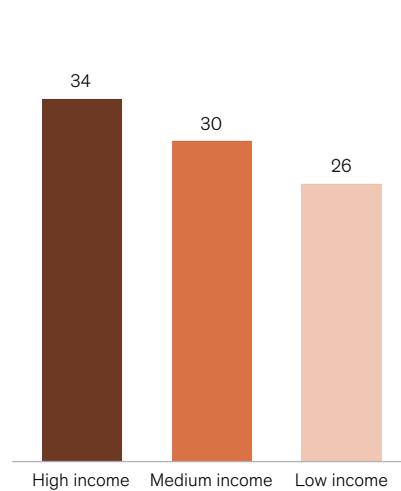
Consumers who plan to look for ways to save money¹

Net share of consumers, %²
Average in Europe



Consumers who plan to focus on healthy eating and nutrition¹

Net share of consumers, %²
Average in Europe



¹ Question: Which of the following statements best describes your attitude toward grocery shopping in 2021 as compared with 2020? Answers: More, about the same, less.

² The percentage is calculated as net sentiment (deducting the percentage of people intending to do the activity less in 2021 vs 2020 from the percentage of people intending to do the activity more).

Implications for grocers

All three of these key consumer shifts represent excellent opportunities for grocery retailers to win new customers. These shifts are happening at substantially greater magnitude and speed than ever before and could lead to significant changes in market share over the coming years. Smaller players could win by excelling in one or two of these areas and nurturing their niche. However, leading grocery retailers will have a hard time keeping or winning market shares unless they excel in all three dimensions.

While all grocery retailers are likely to work on capturing these trends, executives should examine whether their efforts are ambitious and fast enough to win. We see some retailers making bold moves—for example, introducing new health-focused private labels or expanding and improving their opening-price-point assortments. Others are reorganizing their businesses to substantially reallocate resources to online.

Value becoming king, online becoming core, and the return of restaurants will put pressure on the profitability of retailers.

While the push for value-added or premium products will counter some of this, retailers will likely have to make substantial efforts to maintain their profitability. Retailers need to further reduce their costs and find new margin pools to tap. Supply chain and back-office process automation can be one lever to do so. In addition, advanced analytics offer the opportunity to identify new margin pools and further optimize profitability (for

example, through more personalized offerings or optimized prices and promotions). In particular, assortment planning at a more granular level (even down to local or store-specific assortments) to better reflect the dynamics in the individual store's catchment area might offer significant potential, given that the polarization of consumers is likely to further increase.

Ten trends shaping grocery retail through 2025

Channel shifts

01. Restaurants return

During the pandemic, grocery retail sales across Europe rose by more than 10 percent. The majority of the factors driving this increase will abate after the pandemic, leading observers to expect the market to eventually return to its previous size, plus regular annual growth. However, this trend may be slower than anticipated because consumer research indicates that some shifts might endure. For example, net 7 to 10 percent of consumers expect to spend more on groceries and less on eating out after the pandemic than before COVID-19. In addition, more than half of consumers in the EU-5 (France, Germany, Italy, Spain, and the United Kingdom) say they intend to continue shopping online for at least some of their grocery needs.

49%

Fact: Forty-nine percent of CEOs think that the market situation will worsen in 2021 compared with 2020 (State of Grocery CEO survey). See *"How to drive value for money perception beyond price,"* on page 53.

02. Online becomes core

The shift to online is likely to have some of the most pronounced implications over the coming years. While the online share across Europe remains small (5.6 percent in 2020), it jumped to high single digits or low double digits in leading markets such as the United Kingdom (11.2 percent), France (8.3 percent), and Sweden (7.0 percent). Online accounted for nearly 20 percent of market growth in 2020 (around 40 percent in the United Kingdom) and will capture an increasing share in the short term as the channel continues to grow (based on Europanel data). For grocers, winning market share without winning online will become increasingly difficult. And keeping the overall EBIT margin without bringing online to profitability will be a challenge as well.

39%

Fact: Thirty-nine percent growth contribution of online in the UK in 2020 (18% average in Europe) (Europanel).

03. Brick-and-mortar supermarkets losing share

Prior to the pandemic, most supermarkets in Europe had either lost market share or grown with the market. Formats with distinct value propositions, such as prepared-food delivery, discounters, convenience stores, and online stores, are leaping ahead and taking market share from traditional supermarkets. We believe that the many undifferentiated supermarket formats require a clearer value proposition to stay successful.

5.9%

Fact: 5.9 percent annual growth 2015–19 of discount, online, minimarkets, and specialty stores; while supermarkets only grew by 1.6% per year (LZ Retailytics)

Ten trends shaping grocery retail through 2025

Changes in price and value

04. Value is king again

The top concern of grocery CEOs in Europe is consumers trading down to cheaper products— 56 percent see this as one of their top three priorities for the next two to three years. In addition, net 17 percent of consumers indicate they plan to switch to less expensive products to save money in 2021, and even more are looking for ways to save money more broadly. While the overall picture was mixed in 2020 (with countries such as Germany, the Netherlands, and Italy trading up overall, and others, such as France, Spain, and Sweden, trading down overall), the consumer attitude going forward is consistent across all countries.

37%

Fact: Thirty-seven percent of consumers plan to look for ways to save money while grocery shopping (State of Grocery consumer survey). See *“The e-grocery challenge—moving toward profitable growth,”* on page 67.

05. Higher quality expectations in entry-level price tiers

The entry-level price tier is on the move thanks to quality improvements achieved by hard discounters as well as consumers increasingly demanding good quality even at the lowest price. Many grocery retailers reacted by relaunching their entry-level brands and products over the past few years with more attractive packaging and better quality. In many categories, the entry-level price tier has become increasingly indistinguishable from the mid-price tier. We expect this trend to continue, leading to a significant rebalancing of the assortment—a strengthened entry-level price tier, fewer products in the undifferentiated mid-price tier, and a further increase in value-added and premium products.

26%

Fact: Twenty-six percent of consumers want to save more money on food in 2021 and ask for more sustainable and healthy products at the same time (State of Grocery consumer survey). See *“The path forward for grocery sustainability,”* on page 89.

Ten trends shaping grocery retail through 2025

Lifestyle agendas drive food demand

06. Health and organic

Consumers continue to demand organically certified and especially healthier products, such as plant-based, all-natural, high protein and free-from GMOs. The European Union is the world's second-largest market for products produced in compliance with organic standards, after the United States, with a market that grew to €45 billion in 2019 (a rise of 8 percent from 2018). Our consumer survey shows that consumers across all generational cohorts, from millennials to baby boomers, intend to adopt healthier diets and stated a willingness to pay a premium for organic and healthy products.

30%

Fact: Thirty percent of consumers intend to spend more on healthy eating in 2021 (State of Grocery consumer survey).

07. Sustainability

Sustainability was already emerging as a prominent topic before the pandemic, and COVID-19 accelerated this trend. The share of eco-conscious consumers has increased significantly in 2020; for example, Germany saw a 27 percent year-over-year growth. We increasingly see consumers shifting their spending behaviors accordingly, despite a continued disparity between stated preferences and actual willingness to pay. Unsurprisingly, 29 percent of CEOs expect sustainability to be a top-three trend in coming years, and an additional 50 percent expect it to be among the top seven trends. Retailers will have to make their offerings and operations more sustainable.

19%

Fact: Nineteen percent of consumers intend to spend more on environmentally friendly products in 2021 (State of Grocery consumer survey).

08. Convenience food

Consumers are emphasizing more convenience, such as food delivery and more ready-to-eat food. This consumer shift accelerated over the past year, and we expect several factors will continue to fuel it: the growing number of millennials taking over households (and shifting away from cooking to more food delivery) and changing households and workplaces (for example, remote-working arrangements). COVID-19 had mixed effects on convenience: it increased food delivery and ready-to-cook food, but ready-to-eat products have temporarily decreased.

34%

Fact: Thirty-four percent of CEOs name convenience food as a top priority (State of Grocery consumer survey). See *"Brick-and-mortar supermarkets—A success story under threat,"* on page 35.

Ten trends shaping grocery retail through 2025

Efficiency and new value pools

09. Technology as a differentiator

Historically, technology and IT in grocery were not viewed with the same importance as other functions, such as category management or supply chain. This has started to change as technology and innovation are increasingly becoming important differentiators. This trend is being propelled not only by the critical role of online channels and new store technologies, such as seamless checkouts, but also by the promise of supply-chain automation and automation of the commercial back-end process to move to Amazon-like efficiency. Still, only about 20 percent of CEOs say that technology and IT are among their top seven priorities.

13%

Fact: Thirteen percent annual growth of investments in warehouse automation; speed in IT becomes a differentiator (McKinsey Corporate Performance Analytics). See *"Automation in the supply chain has reached a tipping point,"* on page 63, and *"Prioritizing flexibility: How to get the most out of technology,"* on page 79.

10. Advanced analytics and the path toward personalization

The first wave of analytics applications has reached maturity, and grocery retailers have moved from experimenting with data to adopting it as the new standard. Many grocers are investing heavily in analytics and mastering specific use cases, such as pricing, mass promotion, and assortment optimization. Our discussions with grocers indicate that this trend has only just started; for example, advanced analytics will enable grocers to move from mass to personalized promotions and from harmonized assortments to store-specific ones. To further scale, grocers must invest not only in technical solutions but also in organizational capabilities to embed data insights into their operational processes and business models.

3–6%

Fact: Three to six percent additional sales potential through advanced analytics.¹ See *"How data analytics can fuel growth,"* on page 43.

¹ For more, see "Notes from the AI frontier: Applications and value of deep learning," McKinsey Global Institute, April 2018, McKinsey.com.





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Brick-and-mortar supermarkets—

A success story under threat

The supermarket is threatened as alternative formats cater to a more fragmented customer landscape. To remain competitive, supermarkets must rediscover their distinctive offering.

by Daniel Läubli, Virginia Simmons, and Rickard Vallöf



Interview with Matt Simister
on page 38



Supermarkets have historically been retail success stories. After the first supermarket opened in 1930 in the United States, this new shopping format quickly gained popularity throughout the world because it offered customers superior value, convenience, and inspiration compared with offerings from traditional local grocers. Through economies of scale in procurement and more efficient operations, these stores could provide lower prices and consequently better value. Supermarkets offered a broad and high-quality assortment of goods—especially fresh foods—becoming a convenient one-stop shop located in or near densely populated areas. They also provided a more pleasant shopping experience for customers.

But more recently, the value proposition for supermarkets in Europe has flattened, with many growing at or below the overall market growth. In a world with more fragmented needs, the appeal of a “good compromise” in value, convenience, and inspiration increasingly fades as customers split weekly baskets along multiple stores—or at least before the COVID-19 pandemic. For each of the three dimensions, specialized players emerged: discounters for value, online and convenience stores for accessibility, and superstores (for example, smaller hypermarkets focusing on food) or specialized stores for inspiration. Moreover, these players were able to improve their “spike,” or distinctiveness, while reducing former weaknesses.

Discounters are no longer only competing with lower prices. Initially winning with a small assortment and low prices, players such as Lidl have evolved and gradually expanded their SKUs without adding costs or sacrificing the perception of low prices. More recently, they expanded their fresh offerings, essentially transforming into “soft discounters.”

The appeal of supermarkets—“good compromise” in value, convenience, and inspiration—increasingly fades in favor of more distinct formats.

Online and convenience stores. Innovative digital players continue taking share from offline stores—mainly supermarkets and hypermarkets—as they compete on price, assortment, and ultra-convenience through features such as home delivery of groceries and nonfood items. Convenience stores have also made a comeback in recent years, offering a highly targeted assortment in a small format of less than 400 square meters. Factors include an increased demand for freshness, on-the-go options, and local convenience in high-density neighborhoods and areas with high foot traffic, along with changing demographics such as declining average household size and an aging population.

Superstores and specialized stores. Superstores have come under pressure in many markets in recent years. They built

a significant customer base by providing a broader assortment of goods than supermarkets, including nonfood items, through large stores in either shopping centers or out-of-town locations. Now, specifically nonfood assortments have come under pressure, in part through the rise of nonfood e-commerce. They still maintain a strong value proposition for food, keeping pressure on supermarkets in large-basket shopping by stocking a broad assortment and offering a higher degree of flexibility in large-scale displays and counters. Meanwhile, specialized stores have put pressure on the competition by focusing on ultrafresh, local assortment, or value-added and premium products.

In summary, traditional supermarkets are increasingly challenged—unless they start to incorporate a spike themselves. Successful supermarkets are moving away from trying to cater to all consumer priorities and are instead gravitating toward incorporating spikes from rivals. Two successful models are “soft

discounter” and superstores; both of them aspire to a clearer value proposition without sacrificing the traditional strength of the supermarket format.

Soft discounters focus on value for money but keep the assortment broad enough to remain a one-stop shop for the average shopper. Players such as Colruyt, Mercadona, Jumbo, or REMA 1000 sell a large share of high-quality private-label products and focus on offering only SKUs that cover basic needs (5,000 to 10,000 SKUs). This also enables them to gravitate more toward an everyday low price (EDLP) strategy, with occasional promotions instead of traditional high-low pricing. Lean, simplified store operations help keep costs down while still providing for a strong in-store experience.

Hypermarkets light (typically 2,500 to 5,000 square meters) offer a wide range of grocery items but in a smaller, more centrally located store format compared to classic hypermarkets. This model focuses on large food offerings but carries a narrower nonfood assortment to limit the overall number of SKUs. German hypermarket chain Kaufland and Italian hypermarket Esselunga are both successful examples of this approach. Another route would be to further emphasize the ultra-fresh in-store product assortment through extended service counters for meat and cheese, in-store bakeries, and fresh food market halls. Eat-in options such as ready meals, takeaway options, and meal kits all add convenience for busy, on-the-go shoppers.

Irrespective of the route supermarkets take, enabling omnichannel grocery and adopting technology in the store will be key in creating

Supermarkets will need to adapt to sustain their position in the long term.

a sustainable model going forward. Adopting in-store and online automation can create convenience and a better shopping experience. “Quick checkout” stores that allow shoppers to scan items as they shop, already in use by most major players at some locations, allow for quicker shopping trips.

Taking the concept further, selected Sainsbury, Co-op, and Reitan locations offer the option to purchase items without going through checkout, and the Amazon Go cashierless format is looking to expand in Europe. The

increased availability of click-and-collect allows consumers to order online and select the most convenient curbside-pickup location.



Supermarkets will need to adapt to sustain their position in the long term. In an unusual year thanks to COVID-19-related market disruptions, many supermarkets found themselves as winners in 2020. It's a unique opportunity for action, and one they should not lightly waste.



Matthew Simister Central Europe CEO, Tesco

Question: The past year has been incredibly disruptive for retailers. Which trends and developments were most notable for Tesco?

Matt Simister: Last week marked a full 52 weeks of COVID-19. We had a set of plans and then the pandemic happened. Since exactly the first week of our financial year, we were thrown into a crisis. If you look at the whole year, you get a particular perspective, but the shape was very different at various phases of the pandemic.

One interesting development is that governments in every one of the countries where we operate recognized that food retailing is a critical part of the country's infrastructure and society. Even in markets with regulatory uncertainty, this has brought us closer to the governments. We've had more direct contact, whereas sometimes we found it harder before. And the trade associations have been very active and a constant leader in how to plan the country's food supply effectively. I think people working together to try to supply food to everybody was pretty crucial to society in each country.

The hierarchy of needs really came to the fore. You saw very clearly that safety was number one. If customers did not want to go to a store, they could shop with us online. Many customers chose to visit our larger stores, where they felt safe but could also get everything they needed in one shop. Many chose to visit their nearest neighborhood store, and indeed in some cases were explicitly directed to. Across the formats we have seen a sustained shift to less visits but

with bigger baskets. Being able to access food and essential requirements at the right price in the safest way possible has been the primary objective.

Question: How do you see the pandemic shaping the industry in the coming years?

Matt Simister: I sense very distinct moods in each market. It was very difficult in the UK during the initial lockdown, while the Central European markets locked down very quickly and very effectively. You've almost got the reverse happening now, where the mood in the UK is quite buoyant because 40 percent of the adult population have been vaccinated and people see a road map forward.

In Central Europe, cases are still escalating. Just this week, we've had interventions in the Czech Republic and Hungary as the situation worsens. There's a long way to go, so it feels a bit premature to be talking about the ongoing and sustained impacts while we're still in the crisis.

The sustained patterns will stem from the changes to customer lifestyles. I think it's very unlikely that everybody is going to return to the workplace for the full week, for example. And that's going to affect the way that people shop. I'm sure that some of the shift online will accelerate as a result of people interacting with the channel more broadly.

Question: How did the online shopping business grow in your markets?

Matt Simister: We doubled our online business this year in Central Europe, but only to about 3.5 percent of sales. Within our three markets, the Czech market is the most developed. We are number two in the Czech market, competing against pure players like Rohlík and Košík, and customer service propositions are quite advanced. In Hungary, we are the market leader, competing with Auchan and Spar as well as Rohlík (with Kifli), which is trying to get a foothold there too. And in Slovakia, we are the key player in a smaller market, which we are in the process of developing as we improve our offerings across the region.

Online business in the UK has also doubled from a much larger base, and this drives our leading position in online food retailing in Europe. We very much see ourselves as a multichannel retailer and will continue to invest in online, convenience, and our core supermarket and hypermarket formats.

We expanded our online reach quite significantly during the pandemic, extending the number of stores from which we are serving customers online in every one of the three markets. And that enabled us to more than double our capacity, which was great, but we still reach only about half of the population in the three Central European markets, whereas in the UK we cover the whole market.

Our online business has gone through phases. First, we expanded fast to meet changing customer needs. Then we had a phase of making it more profitable while consolidating market share. And I think we're now in the third phase, where we prioritize both. So our strategy is to grow online and to grow profitably.

Question: How would you see your mix of formats evolving over the next several years?

Matt Simister: We now run four store formats in Central Europe: convenience stores, supermarkets, compact hypermarkets, and large hypermarkets. Over the past three or four years, we've been rightsizing our large hypermarkets and now don't operate formats of 10,000–16,000 square meters anymore. Most of them are now 6,000 square meters or smaller. I do think the oversized hypermarkets will be challenged going forward as the nature of the physical one-stop shop changes with the development of online shopping. However, in the Central European markets, compact and large formats in good locations within larger cities still do very well. And some of the prime shopping malls still represent the best shopping destinations.

Our supermarkets do very well everywhere, so I don't see a threat to that format. In fact, I think one of the reasons discounters do well is because they are a supermarket format.

Question: Describe what you mean.

Matt Simister: My observation of watching discounters evolve across Europe is they start by winning customers' top-up shops, and then evolve to take more of the main shopping missions too—they are limited-range, competitively priced, often well-located supermarkets. Their roots are in low-priced core groceries, but of course as they develop their fresh and chilled ranges and take on more brands, they become more like a supermarket. Their cost structure also evolves accordingly.

I think that the German discounters are very good retailers, by the way. They have a simple and effective operating model with high sales densities, which is transferrable across multiple geographies via many locations. I have a particular respect for Lidl, as they are a leading player in all of the markets we operate in. Their offer is limited by definition, so it's not for everyone, or every mission, but they have a high value perception in Central Europe and are certainly formidable competitors.

Question: Our research suggests that grocery retailers will face increased price pressure and downtrading. Is that what you've seen?

Matt Simister: Inevitably, price will continue to be a key driver for customers. We launched our Starlines three years ago in Central Europe, which means that customers never need to go elsewhere to find cheaper prices. These lines are predominantly Tesco-branded, and sales have

been growing every year. I imagine that this trend will continue. During the last year we've also seen that more households appear to be struggling toward the end of the pay period. Obviously this illustrates that we have to be sensitive to changing needs.

In Central Europe, we've also seen significant and sustained pay inflation in every market as governments increased wages to drive disposable income and consumer spending. Fears of unemployment are likely to temper this trend, but I think customers' expectations of value will continue to increase—quality, freshness, and pricing. As ever, the retailers who are able to deliver the best overall value will be the winners. In Slovakia, for example, we've already seen customers who were asked to shop in the village store in late December return back to Tesco for our better ranges, fresher food, and lower prices.

Question: How do you see automation shaping Tesco's approach to stores and operations?

Matt Simister: For our business in Central Europe, scan as you shop and mobile shopping will become bigger over time. Automation and robotization are being considered from a cost perspective. We currently automate back-office administration in our service centers.

We're also looking at distribution center automation quite seriously. There's still a lot of work we can do to optimize our supply chains generally. Automation will probably play a part in that. Ultimately, it's a choice of where you want to allocate your capital.

But I don't think automation is a one-dimensional subject. We are one of the biggest private-sector employers in all of the markets where we operate. Retail is fundamentally a people business: it's a business run by people, serving people. We need to reflect the communities that we serve. If you want to understand why Tesco does what we do, it is because of our role in the communities we serve and the communities we employ.

Question: Looking to 2021, what are the three most important things you would like to achieve?

Matt Simister: I'll prioritize improving customer satisfaction, stable cash generation, and capital discipline. There are big capital decisions, and you have to balance the strategic customer trend with the short-term economic reality. What typically drives retailers out of business is poor capital discipline. These are the real choices for us. That's why we need to gear up to be very responsive to changing customer needs in the short term while we set ourselves up to be the most accessible and preferred retail choice for customers in the long term.

Advanced analytics, including artificial intelligence, offers a big opportunity for the retail industry. McKinsey Global Institute estimated in a study the potential annual value of artificial intelligence for the retail industry at \$400 billion to \$800 billion globally.

For grocery retail specifically, we see the potential for an incremental increase in

earnings before interest and taxes (EBIT) of up to two percentage points if all use cases are implemented and the value is fully captured. Most of this value is driven by commercial use cases around assortment, pricing, promotions, and personalization (Exhibit 1). These are also some of the most mature use cases for which analytical approaches have begun to converge across

Exhibit 1

Most value is driven by commercial use cases that support actual business decisions.

Typical impact (contains overlaps)¹ *Enabler use case—no decision*
 Percentage points of EBIT: 💰 <0.1 💰 0.1–0.25 💰 0.25–0.5 💰 >0.5
 ☆ Existing pilots and tests ☆ In use in a few companies ☆ Becomes standard

Domain	Classic use cases (selection)	Innovative use cases (selection)
Category management	Macro space allocation 💰 ☆	Pricing (KVI identification, price recommendation) 💰 ☆
	Macro space order 💰 ☆	NLP on customer reviews to support for (de)listing decisions ☆
	SKU listing or delisting 💰 ☆	Online or dynamic pricing 💰 ☆
	Assortment localization 💰 ☆	Markdown optimization 💰 ☆
	<i>Store clustering</i>	Promo (historic effectiveness, forecast, optimization) 💰 ☆
	Planogram (position, facings) 💰 ☆	Automated product comparison (NLP) ☆
Marketing	Personalized promotions 💰 ☆	Marketing mix optimization (MROI) 💰 ☆
	E-commerce personalized content ² 💰 ☆	Facial recognition for personalization ☆
	<i>Forecasting (category, market)</i>	E-commerce improved product search ² 💰 ☆
		<i>Customer journey analytics</i>
Purchasing	Vendor negotiation support 💰 ☆	Indirect optimization (AI-based spend cube) 💰 ☆
Supply chain and operations	Store labor scheduling 💰 ☆	Warehouse labor scheduling 💰 ☆
	Store network (expansion, pruning, performance) ☆	Warehouse "digital twin" 💰 ☆
	Energy optimization in store 💰 ☆	Logistics network optimization ☆
	Order forecast and optimization (including shrink or out-of-shelf) 💰 ☆	Route optimization, including CO ₂ simulation 💰 ☆
		NLP for customer service 💰 ☆
		Seamless checkout (eg, Amazon Go) 💰 ☆
Others (eg, support)	People analytics (eg, hiring, chum) 💰 ☆	Credit scoring 💰 ☆
	Data ecosystems 💰 ☆	Fraud detection 💰 ☆
	Retail media 💰 ☆	Back-office process automation 💰 ☆
	Report optimization 💰 ☆	Automated budgeting 💰 ☆
	Analytics self-serve 💰 ☆	Sentiment analysis for customer service ☆
		Inventory and shelf monitoring 💰 ☆
	In-store tracking 💰 ☆	
	End-to-end product tracking 💰 ☆	

¹ Impact partially overlapping—up to 2 percentage points in total realistic.
² On e-commerce revenues.
 Source: McKinsey Analytics

the industry and standard analytics solutions are available on the market.

During the past five years, grocery retailers have moved beyond experimenting with advanced analytics and started to adopt these use cases in a systematic way. The majority of European grocery retailers are now embracing advanced analytics and are investing in capturing its value. For example, in 2020, Ahold Delhaize announced the implementation of tools for assortment, pricing, and promotions across its European brands. Players such as ICA, Migros, and REWE have well-established analytics organizations, and several retailers have hired additional data scientists, including discounters Aldi and Lidl.

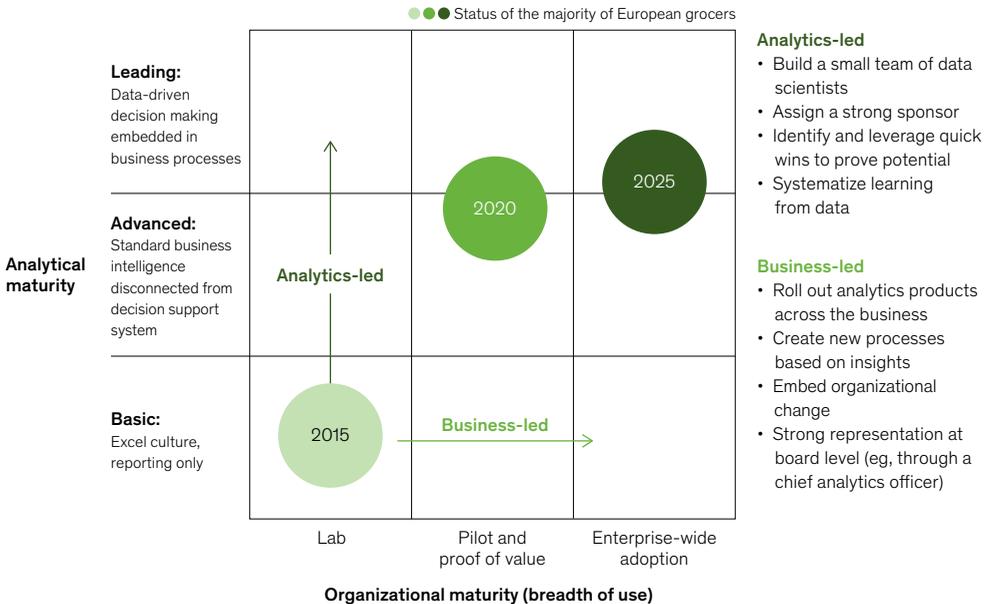
While we observe these investments, we so far do not see that the potential value is captured in the profit and loss (P&L). To determine what distinguishes analytics leaders from the pack, we analyzed grocery retailers along two dimensions: analytical and organizational maturity (Exhibit 2).

We found that capturing the value of advanced analytics depends even more on a retailer's organizational maturity than its analytical maturity. In fact, retailers can achieve results only if organizational maturity is in place—which is still the exception in the industry rather than the rule.

Many grocers have made great progress on analytical maturity. Leaders in analytics

Exhibit 2

Most companies can ramp up their analytics capacity, but many struggle to produce analytics.



Source: McKinsey Analytics

have tackled the majority of fundamental use cases, such as pricing, mass promotion, and assortment optimization. Now, they have increasingly turned their focus to pursuing new use cases along the value chain and improving the existing use cases—for example, using more granular, real-time data. These efforts are often driven by a strong analytics unit, but adoption of these use cases in the business varies. The best analytics solution does not help if it is not used and understood by the respective decision makers (such as category managers).

Organizational maturity in many cases is the main barrier to going beyond partial adoption and realizing analytics' full potential. Organizational maturity encompasses both processes to technically embed and continually improve use cases, as well as constant change management with the users of the analytical insights—fostering understanding of analytics, ensuring it is embedded in daily processes, and measuring against new key performance indicators (KPIs).

Our analysis of winners—both digital natives and traditional grocers—highlighted five strategies that have helped them excel, particularly in organizational maturity.

1. Focus on strategic use cases instead of on data.

Value is driven by business decisions based on insights provided by data (see sidebar, “An analytics use case, defined”); vast quantities of data do not generate any value by themselves. Transparency on the value of a use case, and a clear road map for how and when to realize it, is therefore key.

Grocers should create a prioritized portfolio of use cases derived from strategic priorities

Sidebar

An analytics use case, defined

An analytics use case describes an application of analytics and data to achieve an improvement of business performance and decisions. It defines the scope of change, a set of objectives with key performance indicators (KPIs), users affected, and data and analytics methods to be used.

with clear business objectives, and reallocate resources to those with the highest risk–reward potential. They should also group the defined use cases into larger units or domains (such as store operations or merchandising). This accelerates the change in a given business domain, because almost all of their decisions become more data-driven and, ideally, interconnected.

2. Create agile, interdisciplinary product teams.

One of the most crucial factors in extracting value from analytics insights is the translation process between business and technology. Many business teams don't fully understand how technology and data science teams can support them, and vice versa. As a result, businesses don't ask the right questions, while technology and data science teams try to answer questions that do not exist. This part of the analytics value chain can be regarded as the “secret sauce,” and traditional grocers have particular difficulty in achieving greater visibility and understanding between tech and business.

Winners create agile, interdisciplinary product teams that are led by the business and consist of people from business, analytics, and IT. Such an interdisciplinary team collaborates closely to achieve a defined business goal (for example, improve the delisting decision in assortment). In this approach, business is closely involved in the identification of use cases and also in designing the solution for the business case—either by providing a full-time resource in the role of product owner as part of the team or as part-time business owner. The business is key in closely defining the business objectives and use-case specifications, as well as in ensuring the necessary change in the business organization: process changes, understanding of analytics, and relentless measuring of P&L impact. The result is a product that ensures P&L impact and, above all, scalability.

3. Invest in large-scale change management to ensure use-case adoption.

Many use cases require that someone approach decisions differently or work in a different way. Therefore, deploying a use case often requires adjustments to processes, roles and responsibilities, and incentives as well as the acquisition of new capabilities. Merely giving employees access to a new tool and explaining it in a training session often is not enough.

For example, if pricing is automated based on analytics, this will have profound implications for the role of a pricing or category manager. While in the past they might have been focused on doing tactical adjustments to prices, they now might be responsible for setting strategic guidelines and providing input to the analytics team on how to further improve the pricing logic.

Providing data and insights to many business users is a key way to drive adoption and promote organizational maturity.

Even with smaller changes, we find that embedding the analytics insights deeply into the existing processes and workflows and investing heavily in building the required capabilities and understanding of the users is an elementary prerequisite to harvest the expected impact—and which is often underestimated.

4. Develop a fit-for-purpose analytics platform to maintain and scale multiple use cases.

Providing access to data and insights to many business users is a key way to drive adoption and promote organizational maturity. To achieve this goal, retailers must build a dedicated analytics platform.

Moving from legacy IT systems to a fully modernized big-data IT stack requires significant time and cost. But a complete transition may not be necessary—legacy systems can coexist with cloud-based data infrastructure. The most crucial components are data collection and an analytics platform consisting of a data lab, allowing for quick experimentation and a factory environment that can monitor, run, and scale use cases continuously. Grocers should then integrate analytics into back-end and front-end systems incrementally, one use case at a time. Eventually having an advanced analytics platform, the data layer itself, and a visualization and results layer accessible to the entire organization boosts grocery retailers' organizational maturity.

5. Decide whether to buy an existing solution or develop one in-house.

Grocers do not need to reinvent the wheel to achieve business impact. But the choice between buying a proven off-the-shelf solution and investing the resources to develop one can be surprisingly difficult. Many organizations lack expertise in certain use cases, and they must also navigate complex requirements from technical and business perspectives.

In our experience, a successful vendor strategy takes a staged and differentiated

approach. For use cases that have become a commodity and are at least in a widely available base version in the market (for example, forecasting and assortment), using external vendors and tools might be the fastest, cheapest, and least risky route. For use cases that can generate a competitive advantage or are still in early stages (for example, personalized promotions), a bespoke solution might hold more impact. Another option is to buy tools or code from vendors to start or accelerate use cases before bringing the solution in-house to create distinctive, tailored solutions.

All grocers must master advanced analytics to remain relevant. By now, for many important use cases, such as assortment, price, and mass promotions, standardized software is available in the market. This also allows for smaller retailers or retailers with lower analytics maturity to achieve first results quickly. For more analytically mature retailers, more experimental use cases, including localization of assortment or personalization of promotions, are the next frontier. To succeed, grocers must invest not only in technical solutions but also organizational capabilities, which will require significant investment in change management, driven from the very top.

The authors wish to thank Gereon Sommer for his contribution to this article.



Igor Shekhterman CEO, Chairman, and Member of the Executive Board, X5

Question: What are the most interesting trends that you've observed within the grocery retail industry over the past 12 months?

Igor Shekhterman: This year was very unique not only for retail but for the entire world due to the COVID-19 pandemic. We observed a number of trends that are going to stay and develop even further after the pandemic.

The e-grocery segment outperformed all forecasts and achieved greater than 200 percent growth in Russia. In addition, we have observed a greater convergence of offline and online. The customer can now choose from one of several equally available methods to satisfy their needs. Loyal customers now expect to be able to buy from a favorite shop offline or online, order a fast delivery, or use click and collect. Dark stores and dark kitchens, which sell meals exclusively through delivery, are no longer an experiment but are instead a normal element of a leading grocery retailer's city infrastructure.

Hypermarkets continue to suffer as they transition to online, and this trend has only been exacerbated by the pandemic. Overall, large formats have started rethinking their strategies and are starting to feel a pressure similar to that of hypermarkets. The leading grocery businesses are actively piloting a hard-discounter format, which might be different from the experience in other European markets. The first fully automated stores using scan-and-go technologies moved from the labs to the market this year.

We are also seeing nonfood digital players expanding into food, either directly or by partnering with traditional grocery businesses. This significantly changes the competitive landscape and forces us to rethink our strategy.

Grocers across the board are investing in digitizing their processes, along with investing in new openings and new businesses. Over this past year, grocery retailers invested in next-generation mobile applications to support e-commerce. Some companies made food ordering part of their super apps, while pure grocery players made their mobile applications more user-friendly, faster, and more convenient, with increased functionality.

To keep customers loyal, we need to understand them better, personalize the offers, and expand our presence earlier in the customer journey. Today's customer can make price comparisons online and access social networks and food blogs. They are searching for bargains and special assortment—such as healthy food, vegetarian, and local food—and visiting five to seven stores on average. Customers are increasingly focused on the environmental, social, and governance (ESG) stands taken by the brands they select.

Last, we observe growth in the ready-to-eat and convenience-food segment across formats and across sales channels. Our customers expect the quality of hotels, restaurants, and cafes but at a lower price and want availability both offline and online from our stores.

Question: How did your organization adapt to or harness these trends?

Igor Shekhterman: We are building a digital infrastructure around our core business to cement our presence at all stages of a customer journey, from planning to selling third-party goods and services to using post-sales services.

We also accelerated the development of digital businesses such as online hypermarkets, marketplaces, and express delivery services from stores and distributions centers and added a delivery aggregator. In addition, we are developing a specialized media platform for our customers that consolidates a broad range of resources related to food, such as recipes and nutritional advice.

Broadly speaking, we have implemented a comprehensive digital transformation program that embraces initiatives along the entire value chain, and that is expected to have a multibillion-dollar impact. This year, we prioritized the completion and launch of important commercial projects, such as using big data and AI to optimize assortment and price management, further personalize the customer experience, and better manage customer feedback.

Another key focus in 2020 has been running our own innovation lab, which has focused on selecting, testing, and implementing promising solutions developed by startups around

the world. In addition, we experimented with new formats and technology, such as our first cashierless store with fully automated checkout systems and dark stores. We also reviewed our multiformat offer, started piloting the hard-discounter model, and closed some hypermarkets while simultaneously expanding the geography of our online supermarket and express delivery services. To cater to the increased demand for convenience, we developed our own ready-to-go food business using a smart-kitchen factory.

Finally, we recognized that 2020 was an extraordinary year for the broader society but also on a very personal level for many citizens. Many have faced hardships from the pandemic either economically or in their or a family member's health. Integrating a rather complex ESG program into our efforts was thus an additional priority for us.

Question: How did digitization change the operational and commercial models of X5's formats?

Igor Shekhterman: First of all, digitization allowed us to revise our formats and introduce new projects in e-grocery. We started offering our customers next-day delivery of a broad assortment of food and nonfood items from our online hypermarket, as well as fast delivery—60 minutes—via an express delivery channel.

We also leveraged digital technology to gain broader and deeper knowledge of our customers and to preserve and expand our customer base. We were able to identify our most loyal customers and measure their lifetime value across our formats and services thanks to the introduction of a “golden customer record”: a single ID that merges all necessary customer information into one easily accessible place.

In the competitive market, where clients will become more demanding as they feel the pressure of stagnating incomes, the efficiency of internal processes is even more important to preserve earnings before interest, taxes, depreciation, and amortization (EBITDA). To do so, we incorporated digital solutions across our commercial, supply-chain, and back-office processes.

Question: What new digital services did you introduce beyond core?

Igor Shekhterman: Beyond our core offerings, our online hypermarket evolved into a marketplace of food and complementary goods. We also introduced an express delivery platform. Our logistics platform 5Post is now using the last mile to deliver parcels from our partner shops to their customers. In addition, we developed X5ID as a universal identification and access service. As previously mentioned, we also plan to launch a media platform that will consolidate popular content about food. Finally, we plan to pilot our own financial services and payment services.

Question: How do you compete with nonfood marketplaces that are looking to introduce food and compete for the same clients?

Igor Shekhterman: Nonfood marketplaces have the advantage of being digital natives—for example, digital culture, skills, technical solutions, and an approach to investments that reflects their digital core. X5 has 20 years of experience in the grocery industry with the accompanying skills, client base, geographical coverage, and offline infrastructure of a very mature food business that our competition has yet to develop. And we are increasingly able to accompany our client along all stages of the customer journey and offer them the best customer experience at every point of contact.

This infrastructure includes our expertise in specific food categories, our relations with suppliers, and our huge base of loyal clients. We have very strong brands in food, but the experience of other industries indicates that strong brands do not guarantee a bright future. So we are drawing on our strengths while also heavily investing in new capabilities via M&A as well as employer branding—we need to become an employer of choice, also, for tech talent.

Question: What advice would you give a traditional grocery retailer CEO who is contemplating a digital transformation but has concerns about the significant resources as well as the delayed return on investment?

Igor Shekhterman: I strongly believe the new age of technology has spurred the growth of new business models and new players and changed the consumer forever. If you ignore these changes, you risk lagging behind existing and even emerging competition. We have enough examples from other industries showing that underestimating the impact of convenience and availability of a new technology and overestimating a customer habit and loyalty to a traditional brand are harmful to a business. I'm convinced: e-grocery growth will continue to evolve as one of the main trends and give birth to new yet unknown models.

From my perspective, the savvy use of big data, advanced analytics, AI, the Internet of Things, and robotics gives business a tremendous opportunity to understand the consumer better, react faster, waste less, and sell more with a higher profit.

To measure the results of our digital transformation, we looked at the direct effect on EBITDA. In this context, its impact on EBITDA will exceed 120 percent of what we have originally planned. To be sure, not all investments will yield the expected return, but using an agile and modern product approach limits the risks and maximizes the rewards.



How to drive value-for-money perception beyond price

The value-for-money perception of many supermarket chains has been under pressure in recent years. The economic crisis has caused this challenge to become even more important to overcome. Competing on price alone won't be enough. Our research shows that value-for-money perception is driven by several other factors that need to be addressed.

by Claus Heintzeler, Rickard Vallöf, and François Videlaïne



Interview with Frans Muller on
page 58



Historically, price has been one of the fundamental sales drivers for grocers, and that still holds true today. In our January 2021 customer research across ten EU countries, value for money was one of the two most important factors influencing where consumers decided to shop.

But a core aspect of winning on value for money is striking the right balance by remaining competitive on prices while also figuring out where grocers can increase them without ruining price perception. Maintaining a good value-for-money perception has become more challenging and intense over the past decade—and we see three developments driving this:

Consumers are shopping more frequently across different grocers and stores. This trend has led to fragmented baskets and more variety in products and brands. Indeed, our survey reveals that only 13 percent of European customers shop at a single grocer; 36 percent use two stores, and 30 percent shop at three different grocers. This remains true across Europe, although there are some regional differences. Dutch, French, and Swedish customers, for example, seem to be more loyal, with the majority shopping at no more than two stores. On the other end, 23 percent of Germans, Poles, and Russians shop at four or more grocers. Typical customers know the market well, enabling them not only to compare prices of individual items across grocers but also to pick and choose where to buy them.

The rise of discounters has intensified price competition. Retailers used to match discounters on price and quality across a limited assortment (800 to 1,000 SKUs). But

in recent years, discounters have expanded the competitive set to 2,000 to 2,500 SKUs, so full-line grocers now often have to match pricing on more than 50 percent of sales.

In addition, the discounters over time have improved quality significantly and now compete with midtier products of typical supermarkets, putting pressure on the supermarket in terms of both price and quality.

The rise of online grocery shopping has increased price transparency and generates complexities around omnichannel pricing.

Although not all grocers have the same prices online as they do offline, online pricing provides customers an additional data point and makes it much easier to check and compare prices.

Additionally, digital platforms such as Cimri.com (Turkey—20 million visits in January 2021), Supermarktcheck.de (Germany—one million visits in January 2021), and Soysuper.com (Spain—500,000 visits in January 2021) provide the ability to compare prices. First came item-by-item comparisons, which monitored online stores to provide rankings for identical products. Now, consumers can compare full grocery baskets, a development that has significantly increased price transparency in the market, making it more difficult for grocery retailers to differentiate on price.

Drivers of value-for-money perception

It is key to understand what drives consumers' value-for-money perception to improve it in an economically sustainable way.

Our research shows that value for money is mainly driven by four money-related attributes, with value attributes playing a secondary role (see exhibit). First—unsurprisingly—it’s important for grocers to provide attractive shelf prices on products where cost matters. Second, with nearly the same importance, it is crucial to offer a large variety of cheap products. This is closely linked to the third most important attribute: a low overall basket price. A grocer can have great prices, but if it offers mainly premium products it is still perceived as more expensive than a competitor that also offers affordable products at good quality. The fourth important driver is promotions. Of course, all of the above need to be framed in consistent customer communications that reinforce the value-for-money message.

Three elements to improve the perception

Among the many ways to improve value for money, there are three main levers we have found particularly helpful in most situations:

Use analytics to set low shelf prices on items and in locations that matter most

While using key value items to drive perception is nothing new, the ability to use analytics to identify key value items takes this approach to the next level.

With analytics, grocers can focus their price investments in an even more targeted way. Analytics allow for the application of a multitude of lenses—for example, to more accurately identify products that drive price awareness: they are items that are bought mainly by price-sensitive customers or that

show a high price elasticity. In addition, it is possible to identify how the key value items differ between different stores and offline versus online. This allows grocers to define a highly accurate set of key value items that are unique to a given store cluster, region, or channel, and therefore to target any price investment where it matters most for the customers in these stores and channels.

When applying this investment approach, grocers should simulate the financial impact, including competitor reaction. Historically, price elasticities have been used to estimate customer reaction (volume) to price changes and provide recommendations for how to optimize margin and ensure constant revenue. But in recent years, mature grocery players have realized that elasticities are often overrated and that they need to include competitor reaction. This enables retailers to conduct war-gaming scenarios to fully understand the impact of potential price changes.

When implementing advanced analytics, it’s important to remember that pricing is both an art and a science. While data are gold, analytically derived prices need to be complemented with guardrails and business rules to achieve an optimal result, and organizational capabilities and buy-in cannot be overemphasized.

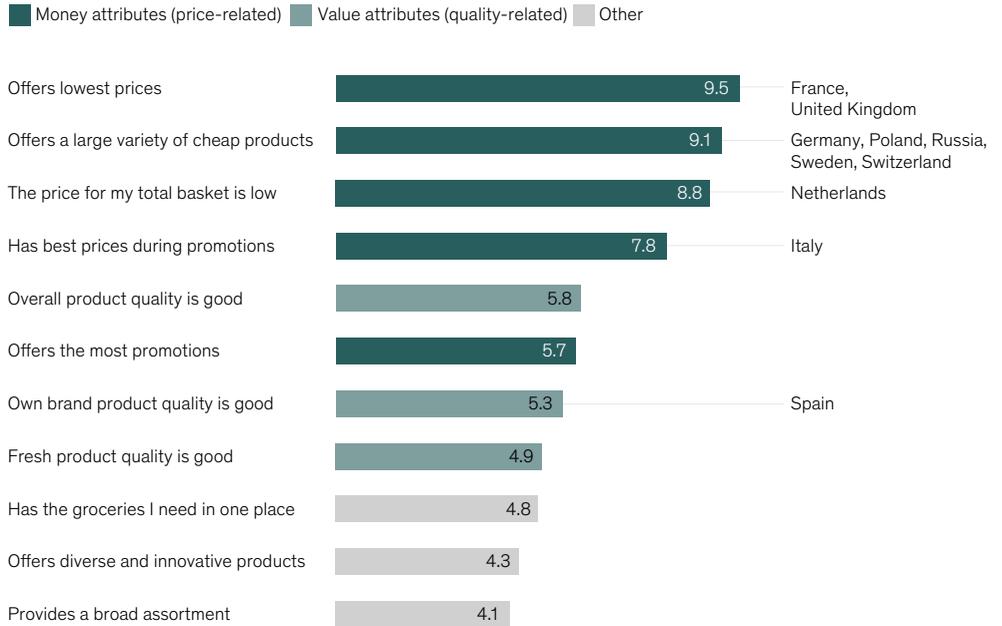
Understand how customers compare prices for private labels and fresh

Customers compare prices not only between the national brands but also between similar items—such as fresh products and private-label products. The challenge is finding out

For consumers, money is more important than value in the ‘good value-for-money’ equation.

Top attributes correlated with ‘Offers good value-for-money’ statement, relevance of value-for-money scoring, average across 10 European countries¹

Top attribute, country view



¹Relevance rebased to sum up to 100 for all attributes (total of 22 attributes).

which specific items customers are comparing. Our research shows that customers usually compare items that are perceived to be of similar quality. Interestingly, many grocers overestimate their product quality and match their private labels to competitor private labels of a better quality. For example, consumers often compare products from hard discounters not only with the entry-price tier of a supermarket but also with the midprice tier. In such a scenario, a grocer might believe

its prices are on par with discount through its entry-price tier, while consumers perceive a substantial price gap as they compare the hard-discounter prices with the more expensive midprice tier of the supermarket.

When comparing prices with those of competitors, grocers must therefore understand which products are of a similar perceived quality, not necessarily a similar specification. Some grocers have established

units with the sole task of creating product-price matches that are based on consumer research and identify quality gaps that need to be addressed.

Improve the quality and breadth of the opening-price-point private label

While shelf prices are the foundation for value-for-money perception, other levers are needed to achieve the full potential of that perception. For instance, the quality and breadth of the opening-price-point assortment are nearly as important as pricing.

In the past, many supermarkets competed on opening price points with 400 to 800 private-label products that were often low quality and

had unattractive packaging. As discounters have increased their assortment sizes and have improved quality, this type of opening-price-point private label is not competitive enough anymore. Its (perceived) quality is, for many SKUs, typically below that of the hard discounters, and the offering simply does not cover a wide enough assortment.

To be competitive with the opening price point in many markets today, it takes more than a 1,000 quality products and attractive packaging. In many categories, this means that the quality of the opening price point for private label becomes very comparable to, or the same as, the quality of products within the midtier price range. Some players, such as Albert Heijn, have therefore started

Further levers for value-for-money perception

In addition to the three main levers, there are several other commercial levers that are needed to fully drive value-for-money perception:

Communicate value for money.

Grocers should create one umbrella message about value and reinforce it consistently across various channels.

Focus on effective promotions.

Analytics can enable grocers to analyze and invest in promotions wisely to maximize a store's sales, margins, and traffic effect.

Increase quality of products.

By deploying design-to-value principles, grocers can focus spending on the quality-enhancing dimensions of products—particularly in important categories, such as fresh food.

Improve in-store experience.

Grocers can increase the perception of high quality and competitive pricing by optimizing the placement of high-quality products and items that have strong value for money.

Use personalization. Loyal customers have a significantly

more accurate perception of prices. Grocers that tailor offerings based on consumer insights on an individual level can target them directly to build loyalty—an increasingly important lever that will become more relevant in the future.

to use main brands within the midtier price range to compete at the opening-price-point level. Separately, in light of the pandemic and economic crisis, some retailers have also returned to entry-price-tier products (such as Système U's Prix Mini product line) to cater to increased price sensitivity from consumers.



Taking a more sophisticated approach to pricing is all the more crucial today because of the rise of online shopping, which has increased price transparency, fragmented consumer baskets, and grown competition from discounters.

Improving value-for-money perception goes beyond pricing, though. As our research shows, other levers, such as offering a wide selection of high-quality entry-price-tier products, are as important to value-for-money perception as low shelf prices—and in some markets even more important.

By understanding what really matters to consumers through pricing analytics and market research, grocers can make the focused investments to meet those needs across multiple levers and double down on value perception in the most economical way possible.



Frans Muller President and CEO, Ahold Delhaize

Question: What are the most interesting trends you've observed within the grocery retail industry over the past 12 months?

Frans Muller: We have seen accelerated growth in omnichannel across food and nonfood items, primarily because of the focus on safety and other retail businesses' closure. Many people who didn't shop online before are now making use of our local brands' online propositions as well, an indication of how the pandemic has provided extra fuel for omnichannel. For us, it is much more about omnichannel than online; it is about how you bring everything together, for example, under the umbrella of loyalty systems.

Over the past year, we grew online 57 percent in Europe and 105 percent in the US. To meet this demand, we added a lot of capacity. We initially maxed out on growth. So we focused on getting more capacity but also becoming more profitable.

Ahold Delhaize's challenge is that food online is dilutive to our business, especially to our overall margins in food. The question—and one many grocers are facing—is: how do we make food e-commerce more profitable?

Beyond that question, I observed three major shifts. First, COVID-19 spurred people to pay much more attention and higher priority to personal health, including healthy products, lifestyle, nutrition labelling, and ingredients, such as sodium, but also calories since obesity is a risk factor in COVID-19.

Second, sustainability is also a top trend for consumers. Across the board, we see a higher level of consciousness, urgency, and hunger for information and transparency—from sourcing info on products, farm to fork, shorter and more sustainable supply chains, and other factors. On a personal level, over the past year, I've spent much more time with my family during the lockdown to talk about how we can create a more sustainable environment and what we can do for our next generation.

Last, the pandemic has caused a shift toward in-home consumption that I believe will partially stick. As consumers swapped restaurants for in-home consumption, they rediscovered how to prepare meals and discovered meal solutions and convenience food. I believe in-home consumption will be more sticky than we thought because people realized that a good-quality, convenient meal at home is enjoyable and more economical than dining out—especially given the likely economic downturn to come.

Question: As you look to the coming year, how will the pandemic continue to influence behaviour both of consumers and within your organization?

Frans Muller: The health and well-being of our consumers and our own people will keep us very busy. The pandemic has worn people out both physically and mentally. In particular, we should not underestimate mental fatigue. I sponsored a research project on what the pandemic means to people, and I am afraid this past year will have a bigger impact than we might expect. The fear and uncertainty, the loss of family members and friends, and the emphasis on hygiene and social distancing will likely continue to shape our behaviours for years. The crisis will also significantly shape how consumers make decisions.

Within Ahold Delhaize, we're focused on the safety and mental well-being of our people. We have more than 400,000 employees in stores and distribution centers, as well as in offices. Each week, 54 million consumers visit our stores and online. That's a lot of contact that we cannot completely control. For example, to help the situation, we started to pay for sick leaves and guarantees to our employees in the US that are paid on hourly levels. We have also instituted short pulse-check surveys for employees every four weeks. These kinds of measures help us to understand how our associates are physically and mentally doing and how we can support them as a company. This is all not so visible to the public but therefore even more important.

We have also focused on the community aspect of our business. Our stores are deeply ingrained in communities, and even small gestures can reinforce our commitment to our associates and consumers and the surrounding community. Our purpose is to nourish communities to make them thrive. A purpose is a key element for an organization, so we do communicate it frequently. For example, we partner with food banks. The greater our efforts, the prouder our employees feel.

Question: How have you adjusted your assortment and pricing to address new consumer preferences?

Frans Muller: We have given a lot of thought on how we make healthy food more accessible in our stores. We also offer a progression of goods for consumers—from fresh to convenience to meal solutions. For example, when consumers go into our stores, in the first meters, they see cauliflower. Ten meters later, they can see the cut cauliflower. Another ten meters, and they find the precooked meal with cauliflower.

We also want to ensure a variety—that you have something different on the table every day of the week. Our ready-to-heat soups have been flying off the shelves during the pandemic.

We have introduced an existing nutrition navigation system in Belgium, called Nutriscore, to help consumers make healthier choices, which provides guidance about the nutritional value of products. In the US, we have taken the lead to initiate and introduce our own nutrition-navigation system, called Guiding Stars. In line with these developments, we have created SuperPlus in Belgium, which provides consumers with automatic savings when purchasing healthy foods. The more healthy you buy, the bigger discount you get. It is super personalized and purely digital.

Question: How do you see the evolution of downtrading and of the opening price tiers?

Frans Muller: We still have to see how the economic situation will influence possible trends toward more value. Interestingly in Germany, the discounters were losing market share last year to the benefit of the supermarkets.

However, over the longer-term horizon, discount might grow, putting more margin pressure on the industry. So you have to be creative with how you work on cost of goods sold (COGS), omnichannel, customer value proposition, private label and margin mix of your baskets.

We want to be there for as many people as possible. No matter if they have a small wallet or a bigger wallet, if they are good cooks or not, we want to have a good offer for them. So you will always find a strong opening price point offering with our private labels and the national brands and our higher-price-tier private labels. For example, our brand in Belgium, Delhaize, has a higher quality perception but has a broad range of opening price point offerings.

Over the last years, we have seen an increase in items in our price entry tier. Also, the quality is going up, and the specs are getting better, so you compete at a higher quality level. We now have around 1,500 products at the price of discount at similar quality. We focus on a two-tier approach because this is the most comprehensive for a consumer. With the higher quality already at entry level, you cannot differentiate anymore between the opening price point and too many price tiers.

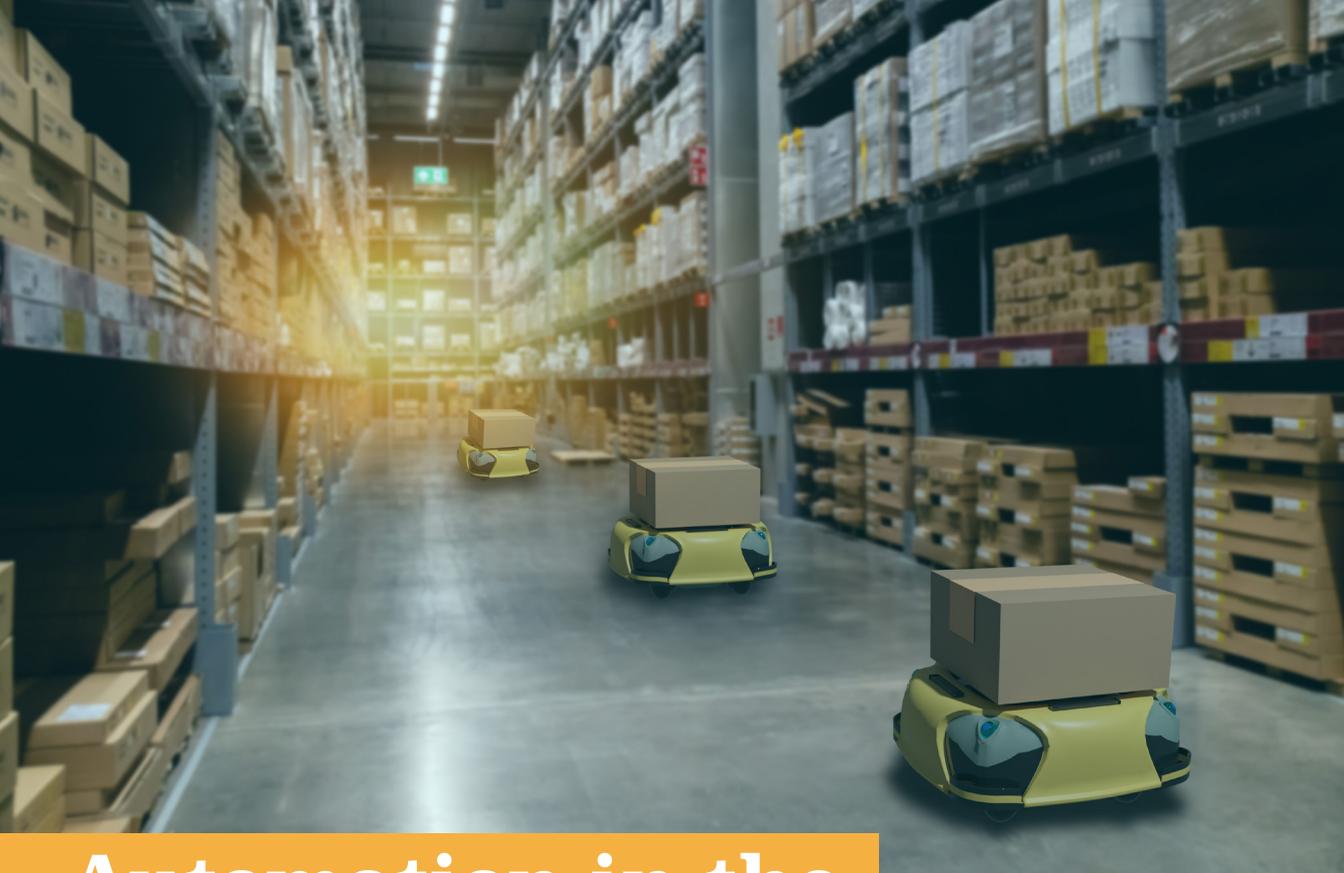
Question: How do you see the position of national brands evolving?

Frans Muller: We had a few discussions with national brands. They are not completely clear in their positioning toward the supermarkets. If you look at a macro level, discounters are growing, private label is growing, and online is growing, which is very difficult for them to scale. The national brands react by entering discounters or also joining online platforms. But in the end, with the dominance of these platforms, you will not build product innovation. This is, for me, a dead-end street.

I think strategically, for traditional brands, supermarkets are the best friends. Also, for supermarkets, national brands are essential. We love our national brands.

Question: Do you see the next price war coming?

Frans Muller: We are all more or less in the same boat. When the pandemic is over, we may look back on 2020 as a growth year, but 2021 could bring a decrease. So retailers will have to look at costs and productivity. It isn't easy because we see wage increases across the world. Also, COGS is a topic, especially in online business. Today, a supplier charges us the same price if we sell something online or in our stores but with a very different cost for us. So we need to negotiate better prices for online—for example, by offering consumer data and to share through a different media monetization platform.



Automation in the supply chain has reached a tipping point

Automation in grocery warehouses has significantly accelerated, thanks to several trends. Now is the time for retailers to reassess their automation strategies.

by Kenza Haddioui and Tim Lange



While automation has been a part of retail supply chains for decades, its prevalence has recently increased significantly. Consider that the size of the global warehouse automation market grew by 10.3 percent each year from 2015 to 2019—a more than twofold jump compared to the previous five years. This trajectory appears set to continue, with the market expected to double by 2026. In addition, about 55 percent of retail, manufacturing, and logistics professionals say they are currently investigating warehouse automation.

This rapid shift is driven by three big trends:

A steady increase in labor costs combined with workforce capacity constraints.

In Western Europe and the United States, the average hourly wage in the logistics sector has increased more than 15 percent in the past decade. Those rising wages have been amplified by a shortage of logistics workers due to increased demand, especially from e-commerce.

The growth of e-grocery. The e-grocery channel, which saw average annual growth of 15 percent over the past five years, accelerated further because of the COVID-19 lockdown. It grew by more than 50 percent—compared to 2019 growth—for key European markets, creating an even stronger need for efficient e-grocery fulfillment solutions. Smaller unit picks, mixed orders, and a high speed of delivery make e-grocery labor intensive and therefore ideal for automation.

Falling costs. The evolution of warehouse automation technologies and declining interest rates has lowered costs for retailers while also offering higher levels of flexibility and scalability. Technology and platform providers such as KNAPP, Ocado, Swisslog, Takeoff Technologies, and WITRON have extended their ever-growing portfolio of automation solutions combining software and hardware.

Examples of successful recent enhancements of proven technologies include cube storage, multishuttle, and automated guide vehicles (AGVs). Recent innovations not only optimize the throughput performance of those systems but also enable solutions to adapt to changing business needs.

Having more technology options, combined with the enhanced ability to tailor solutions, has multiple implications for retailers. It lowers the investment required to enter the space, making the case for automation even more attractive when considering rising labor rates and shortages. In addition, the enhanced ability to tailor automated solutions to specific business requirements, such as omnichannel and microfulfillment, has increased capabilities and performance, lowered operational costs even further, and provided higher flexibility and scalability than traditional automation systems and manual operations.

In brick-and-mortar grocery, several players have started to automate their packaged food, nonfood, and fresh warehouses. For example, Jumbo operates a 45,000-square-meter, WITRON-automated dry-goods-handling logistics center that can perform up to two million case picks per week. Similarly, REWE announced the construction of an automated warehouse with the capacity to pick up to 165,000 cases on a peak day in a store-friendly manner, reducing the handling efforts in the stores. The 86,500-square-meter facility will store more than 12,000 different items of dry goods and fresh food. For warehouses with large throughput capacity requirements, several alternative technologies can be used and combined to handle medium to large orders with a high share of pallet and case picking. However, multishuttle and automated tote and case-picking systems, as well as AGVs (especially for pallet picking), are often the solution of choice.

For e-grocery, companies are adding micro-fulfillment centers—especially in the United States. The requirements for e-grocery warehouses are typically a large SKU portfolio, small orders with a high share of single-unit picks, and high-speed capabilities. Because of these requirements, and due to their elevated space density, the preferred solutions for this type of warehouse are often cube storage and multishuttle. Albertsons' automated microfulfillment center with dry and nonfood items, for example, uses Takeoff Technologies to achieve about 800 item picks per hour. Another example is the REWE e-food distribution center, which is equipped with KNAPP shuttle technology. The facility has 17,000 square meters and 20,000 SKUs, so automation significantly enhances performance.

As these use cases demonstrate, leading players follow a segmented warehouse and automation design tailored to the needs of individual channels, categories, and order profiles, rather than a one-size-fits-all approach. For each of the segments, choosing

the right automation technology to provide the required flexibility for a large spread of order profiles, fulfillment speeds, and scalability makes a huge difference.

In addition to automation in warehousing, in the past few years, several grocers have started to leverage analytics to automate their planning flows. The trend is capitalizing on the strong investment in and momentum of the retail analytics market. It is expected to grow more than 20 percent annually for the next five years, with a number of enterprise resource planning providers (such as SAP and Oracle) and technology players (such as RELEX, Blue Yonder, E2open, and o9) developing new offerings. Typical benefits of automated planning flows include lower levels of shrinkage, fewer days' worth of inventory in stock, and higher service levels.

Beyond automation in warehousing and planning, the market has seen a proliferation of other supply-chain solutions, such as workforce and transport optimization solutions.

In the workforce-optimization space, promising technologies use advanced analytics to plan and adjust for fluctuations in traffic and workload. These solutions aim to lower store and warehouse operating costs and increase visibility of future workload requirements, a capability that often leads to an improved labor experience. Variations of this technology have been applied successfully in stores and warehouses, with some players reducing costs by up to 15 percent.

On the transportation analytics side, beyond the optimization of truck-fill rates, there has been a rising interest in dynamic routing solutions. The most advanced solutions optimize trucking routes in real time based on traffic conditions and disruptions, such

Automated warehouses are becoming the new normal.

as road accidents. Typical benefits of this technology include fresher products, timelier deliveries, and lower internal costs, as well as reduced emissions. Routing solutions can also be coupled with sensor-based technologies to monitor transport conditions, which are particularly helpful to detect issues with the quality of cold-chain transport that can damage or lower the shelf life of products. Adoption of these systems has started, though there is no clear breakthrough yet.

While the acceleration of automation is encouraging, the real takeaway for grocers is the recent uptick in the adoption of warehouse automation solutions. This technology represents a clear opportunity for the sector. Though in the past the business case for a high degree of automation did not work out or the technology did not offer enough flexibility, it now might. Grocery retailers in Western Europe, North America, and other markets with high labor costs should reassess their automation strategies.

Grocers who haven't considered automation—or who may be at a point of reconsidering it—should move forward if they answer yes to one or more of the following questions:

Are you in a high-cost labor market with increasingly tight workforce availability?

Are you planning to enter or scale e-grocery?

Have you historically neglected automation due to a lack of flexibility or constraints on capital expenditures?

The steady increase in labor costs—combined with workforce capacity constraints, the growth of e-grocery, and falling technologies costs—has led to many situations in which automated warehouses are becoming the new normal. Now is the time for retailers to reassess their automation strategies.



The e-grocery challenge: Moving toward profitable growth

Winning online was a priority for growth in grocery retail even before the onset of the pandemic. Now, with the increased customer penetration and intent to stick to buying online, e-commerce acceleration and profitability have turned into top priorities for many European grocers.

by Madeleine T.P. Gi and Julia Spielvogel



Interview with Per Strömberg
on page 74



Gaining market share in grocery retail in the past few years has increasingly been linked to winning online. Before the onset of the pandemic, online business models were the primary growth driver within grocery retail. In the United Kingdom, for example, between 2015 and 2020, online accounted for more than one-third of the industry's growth. Now, with the changes brought about by COVID-19—high online grocery penetration levels and customers' stated intent to continue to do their shopping online—e-grocery is the new imperative. The results of our grocery retail CEO survey (see chapter 2) underscore this: respondents see the scaling of their online businesses as a top priority for 2021 and beyond. Many retailers are currently investing in their online business to gain a larger share of customers' wallets and stomachs. In this game, they are up against pure online competition, as well as against alternative business models, such as meal-kit providers and meal-delivery platforms—business models that are often much more highly valued by investors due to their high growth expectations.

At the onset of the COVID-19 crisis, customer demand grew rapidly within just a few months. Some grocers, such as Tesco in the United Kingdom, were able to quickly react and meet the demand, and thus their online share of sales expanded by up to 15 to 20 percent. Many other retailers, however, faced capacity and execution constraints in trying to fulfill the rising demand, often causing a poor customer experience. While consumer research indicates that the recent change in demand is likely to persist at least in part, stickiness unsurprisingly is highest among customers with a satisfactory experience. Grocers acting decisively now to offer satisfactory propositions and experiences aimed at gaining share and creating loyal customers will likely reap the rewards.

As the online channel has matured, grocers have diversified their online value propositions to cater to or shape customer expectations. Offerings now extend beyond the classic home delivery of families' weekly groceries to address different customer segments, needs, or shopping occasions through instant grocery delivery, fresh ready-to-cook, meal delivery, and the like. Just as in the offline world, a differentiated online value proposition is crucial—especially given that in more mature online grocery markets, winners tend to capture a large share. Incumbent grocers that are not in a position to feasibly invest in their own winning online business are increasingly opting for partnerships with ecosystems or for M&A with pure players and start-ups (for example, Monoprix, DIA, and others partnering with Amazon; Morrisons and others partnering with Ocado; Reitan partnering with Kolonial.no; Carrefour investing in ecosystem expansion with the acquisition of stakes in Dejbox and Quitoque; and so on). Strategic moves like these allow grocers to test new propositions, accelerate time-to-market, and benefit from their partners' capabilities in the online game.

Reaching profitability in online grocery, even only at basket level before central cost, has always been a challenge for retailers. Compared with store-based business, which mostly proves profitable also after depreciation and interest, even leading e-grocery players have struggled to be profitable, particularly while generally chasing expansion. To increase capacity and stay competitive, grocers need to continue to invest in operational infrastructure, technology, and so on. This ongoing investment makes it difficult to improve profitability, even over time. Key value drivers that grocers can optimize include average order value and frequency through their commercial offer (for example, assortment, price, personalization, and delivery fees). Media monetization can

be an additional source of income. Beyond that, grocers need to optimize operational and delivery costs (Exhibit 1). Given the current market dynamics in which grocers are reaching substantial online shares, cracking online profitability over time is essential.

With increasing scale and retailers more systematically addressing optimization levers, more profitable online grocery models have started to emerge—at least for ramped-up businesses. According to Tesco CEO Ken Murphy, the company is aiming to move closer to parity in terms of operating contribution from online and offline, which he defined as a realistic possibility in the “foreseeable future” in a recent analyst call. Partnership approaches also often aim to improve economics—for example, through generating sourcing advantages or benefiting from better drop density in crowdsourced last-mile operations for instant delivery models. Finding a way to win share online while building a profitable business model is going to be one of the key challenges for many grocers going forward.

Three pathways to profitability

With the current online outlook characterized by high customer penetration and likely sticky demand, players are pursuing different strategies to try to achieve both growth and higher profitability or even profit parity. At the same time, common themes keep resurfacing—such as differentiating customer value propositions; optimizing and automating the “operations system”; and implementing cutting-edge digital, analytics, and tech tools and capabilities, often enabled through ecosystem partnerships. Overall, there are three key types of players that are currently dominating online grocery:

1. Online pure players

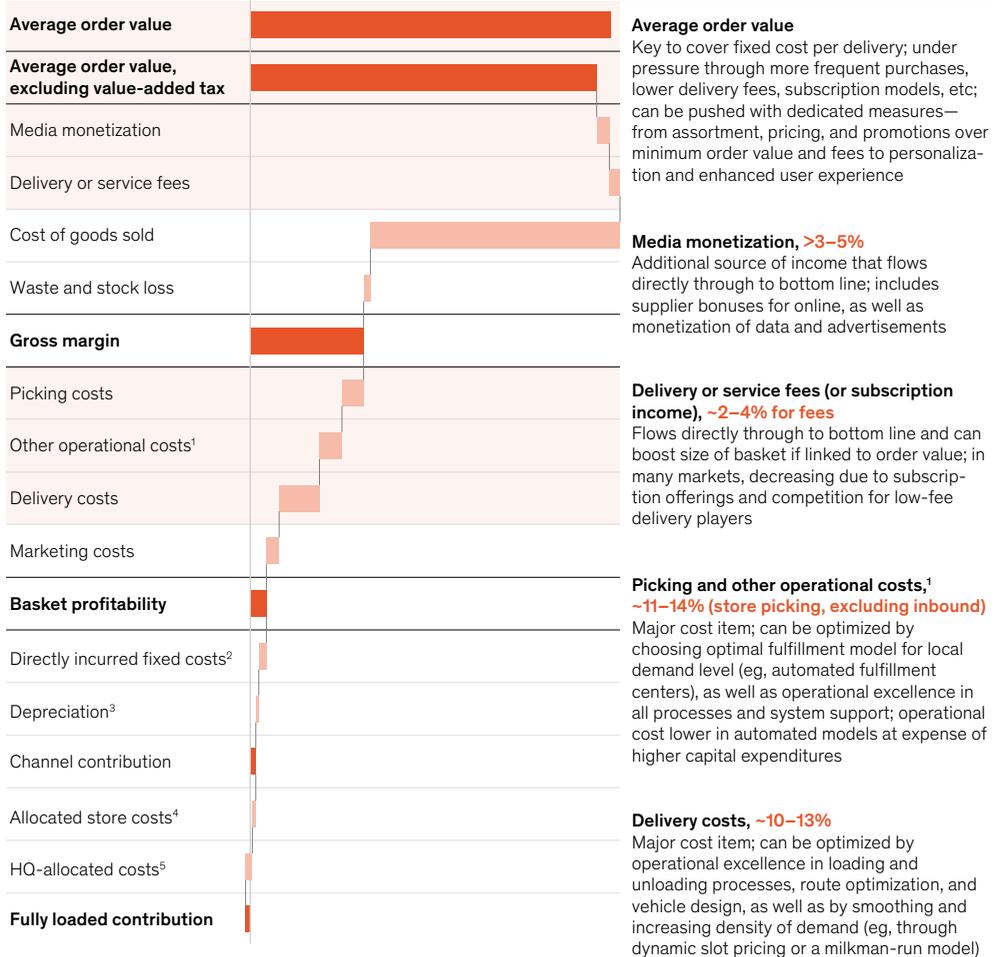
Online pure players often provide highly tailored customer value propositions, such as value-focused assortments and service levels, fresh meal kits, or farm-to-table concepts. They do not face the same limitations as offline retailers, which are often bound by the need to maintain certain levels of consistency in pricing, promotions, and assortment across channels—or by the need to deal with legacy systems and infrastructure. Leveraging digital and analytical approaches, tools, and capabilities in their workforce, pure players typically put a focus on differentiating and personalizing their customer experience to achieve higher conversion rates, larger basket sizes, longer-term loyalty, and—ultimately—greater customer lifetime value. Leading pure players often deploy modern technology throughout their supply chains to optimize fulfillment and delivery costs (for example, through microfulfillment centers or optimized last-mile vehicle deployment). While staying light in assets and overhead compared with store-based competitors, pure online players seek out purchasing and logistics partnerships to benefit from scale effects.

An example of a leading pure player is Picnic, a Dutch no-frills online grocer that provides its customers with a user-friendly app combined with competitive prices, a low minimum order value, and no delivery fees. Drawing on advanced analytics and a fit-for-purpose technology stack developed entirely in-house, Picnic optimizes order preparation and last-mile logistics. The retailer increases efficiency through a targeted assortment, warehouse automation, and a milkman-run logic where electric delivery vehicles only visit a given area once or twice a day to increase the density of deliveries in the last mile. A new partnership

Online grocers can leverage key drivers, such as operational and delivery costs, to create value.

Structure of basket economics, excludes sales cannibalization of other channels

Key value drivers, typical cost as % of sales in stock-up proposition



¹Includes credit card commissions, contact centers, replenishment, inbound supply chain, and consumables.

²Includes directly incurred store costs, IT, and e-commerce teams.

³Depreciation includes depreciated capital expenditures for online-related investments, such as website build costs and equipment.

⁴Includes utilities, back-room use, and other costs that would be incurred with or without the online business but are allocated to online.

⁵Includes items such as central office costs, central IT costs, and pension funds.

Source: McKinsey analysis

Incumbents can learn from ecosystems to take an omnichannel approach to customer-lifetime value creation—driving customer loyalty across channels and ensuring services and products that matter.

with German supermarket leader Edeka has been signed with the goal of optimizing product-sourcing costs.

Incumbent players can learn from pure players both to focus on differentiation toward customers and to align operations with their value propositions (for example, by reducing the number of delivery windows if the proposition is not focused on convenience of delivery). Moreover, incumbents could consider entering partnerships with pure players to de-risk their business models, reduce investments, leverage external capabilities, or scale. These include partnerships with crowdsourced or gig-economy delivery platforms (such as Deliveroo or Uber) for instant-delivery or meal-delivery propositions—such as those recently set up by

several UK grocers, including Morrisons, Co-op, and M&S, and also by discounters including ALDI. The platforms aggregate demand across retailers, and via crowdsourced drivers, they operate at costs that retailers are not likely to attain on their own.

2. Ecosystems

Many online giants have added grocery to their ecosystems and are using customer data from across their offerings—such as nonfood, payments, and social media—for optimization purposes. For these players, their grocery divisions do not necessarily need to be profitable as stand-alone businesses; instead, the grocery operation supports the overall profitability of the ecosystem by securing daily traffic and engagement on the platform, thereby boosting loyalty and customer lifetime value and allowing for different, new revenue models, such as media monetization.

The Chinese ecosystem Alibaba has been focusing on convenience for customers across channels as it offers instant omnichannel shopping across categories. Through its Hema retail-store format—part tech-enabled supermarket, part distribution center—customers can order groceries on their smartphones and either pick up their purchases or have them delivered within 30 to 60 minutes, depending on location. Alibaba's logistics arm and payment solutions enable this service. In fall 2020, Alibaba acquired from Auchan the majority stake in Sun Art, with approximately 500 hypermarkets in China, to further strengthen the group's offline presence. Across its many companies, offerings, and channels, Alibaba is thus optimizing customers' total lifetime spending on the company's products and services.

Amazon also took its grocery offering to the next level through its acquisition of Whole Foods in the United States. The deal not only expanded Amazon's sourcing capabilities but also allowed it to more deeply understand the customer food journey and provide customers with omnichannel offerings through Whole Foods' physical stores. The company also continues to expand in Europe—most recently with the introduction of Amazon Fresh in Spain and a deeper partnership with local player DIA. In all geographies, the Amazon Prime loyalty program connects grocery and nongrocery platforms, while Amazon's data, analytics, and e-commerce capabilities are being applied to improve the food journey. Amazon is also experimenting with tech-enabled offline formats, such as Amazon Go (physical stores with entirely automated checkouts) and the recently opened physical Amazon Fresh stores in the United States.

Incumbents can learn from ecosystems to take an omnichannel approach to customer lifetime value creation—driving customer loyalty across channels and ensuring, likely with partners, the addition of services and products that matter to them (for instance, seamless checkout and payment). To capitalize on loyalty, cutting-edge digital and analytics capabilities are prerequisites. Several incumbents have chosen to enter partnerships with leading ecosystems to create an online route to market or provide a specific proposition. The partnerships bring scale, infrastructure, and capabilities that the retailer would otherwise likely take years to build. However, fully owning customer data or ensuring the extension of loyalty to stationary stores can turn out to be challenging in these partnerships.

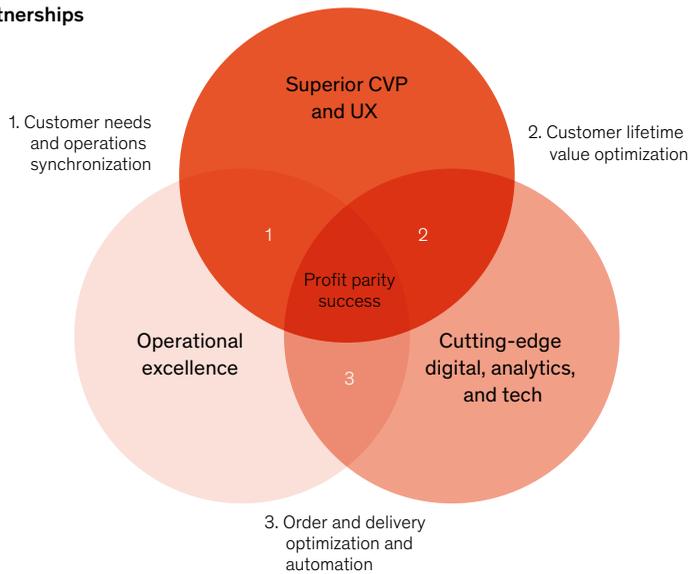
3. Own play by traditional retailers

Incumbent retailers with their own online offerings are striving to accelerate their e-commerce businesses and reach profit parity. They are currently transforming their businesses across many areas and making multiyear investments to improve and increasingly automate their operating systems and technology. Those that want to play an active role in the online game often start by rethinking the value propositions that they bring to customers. We have seen grocers optimize their online assortments in terms of size, private-label penetration, and (ultra-)fresh quality. We have also seen them increasingly decouple pricing and promotions from online and the store-based business, given the direct impact on profitability—while at the same time trying to leverage offline assets for services like click and collect. Many grocers are doubling down on customer experience, for example through basket-size personalization or by rewarding loyalty via subscriptions or specific programs. In addition, they generate further income from online supplier bonuses or from monetization of digital assets to advertisements.

Traditional retailers are also reimagining their operating systems—in particular by optimizing their networks, order preparation models, and last-mile mix—given the importance of those systems as cost drivers. To ensure future capacity and maximize profitability, grocers must set up an operational network that fulfills the forecasted demand and service-level mix in a region at the lowest total operating cost. The right level of automation can make a large difference. For example, grocers can elevate picking productivity from an average

For profit parity to materialize, several drivers across three domains need to come together.

Ecosystem partnerships



● Customer value proposition (CVP)

- Mix of propositions
- Basket size push (eg, price, promo, and assortment)
- Frequency push (eg, delivery fees, minimum order value, loyalty, and subscriptions)

● User experience (UX)

- Mobile first
- Personalization

● Fulfillment

- Excellence in warehouse operations (processes and advanced analytics)
- Automation (eg, robotics and microfulfillment)

● Delivery and last mile

- Excellence in delivery operations
- Fleet and contract optimization
- Dynamic routing optimization

● Network optimization

Other costs

- Overhead and organizational efficiency
- Direct and indirect procurement

● Media and data monetization

- Digital assets
- Vendor allowances, bonuses, etc
- Advertising

● Digital and analytics

- Omnichannel vision and incentives
- Prioritized use-case road map
- Digital and analytics talent and data platform
- Agile, product-led ways of working

● Marketing

- Spend mix on customer acquisition vs retention
- Spend mix across media

● Technology

- Stable and flexible backbone
- Omnichannel architecture

Source: McKinsey Analysis

of 100 to 150 picks per hour (for picking in-store) to up to 500 to 800 picks per hour at automated stations in microfulfillment centers. If volume and utilization are high enough, this

can improve operating cost by two to five percentage points of earnings before interest and taxes (EBIT) margin or more, depending on the starting level. For the last mile, grocers

are optimizing vehicles, processes, and routing systems and are also actively steering delivery slots to shape demand to gain efficiency—often together with partners. Leading grocers across the world are piloting solutions and making investment decisions now, given the long timelines for implementation.

Managing the online transformation effectively

To win the growth and profitability challenge in online grocery, retailers need to commit to a deliberate and transformative approach that ensures differentiation and optimization of customer lifetime value as well as cost.

As discussed, three domains need to be successfully addressed for an effective online transformation (Exhibit 2):

Superior value proposition and user experience. Grocers need to define the right mix of customer value proposition(s) and create a superior user experience that drives customer lifetime value across channels.

Operational excellence. Players need to ensure the most productive fulfillment and delivery of customer demand in an optimal network that is adapted to (future) demand density and service levels. Decisions on

partnerships need to be made sooner rather than later, as the race for capacity and partnerships is on.

Digital and analytical capabilities and operating model. Retailers must deploy cutting-edge technology and analytics to differentiate their value propositions and ensure maximum automation of their operating systems, which requires ongoing investment over the coming years. Grocers also need to build native digital and analytics capabilities in their workforces and introduce agile, product-led organizations that work cross-functionally. The monetization of core (data) assets or technology adds new income streams.

Online grocery is an exciting, high-growth business field in which incumbents and disruptors are currently moving head-to-head in the race to cater to increasing customer demand. To establish profitable business models, they will need to adapt their operating systems end to end, and they need to be ready to invest. Further transformation, technological innovation, and new partnerships are highly likely to emerge, as these will be drivers of profitable growth going forward.



Per Strömberg CEO, ICA

Question: What are the most interesting trends in the grocery business now?

Per Strömberg: I see a few trends that have accelerated in Sweden. First, price sensitivity has increased, with consumers shifting to private label. Second, the scaling of online e-commerce is very important in Sweden. But it is not only online; everything that is digital, such as digital engagement solutions, is increasing in importance.

Furthermore, we clearly see a heightened consumer interest in sustainability and health in general, which is often related. In convenience food, we have seen a shift from ready to eat in grocery to delivery platforms like Foodora.

Question: How did your organization adapt to these trends?

Per Strömberg: In Sweden, we have a very strong market position, with 36 to 37 percent market share, which means that we are a mainstream player. The most successful players during the past year have been the more price-aggressive players such as soft discounters Willys and Lidl. We are therefore reviewing our value-for-money proposition, with more competitive pricing policies and attractive private label.

Online is something we have been working on for many years. We decided to partner with Ocado a few years back, and this year we will launch an Ocado customer-facing platform, as well as an automated warehouse early next year.

In the short term, we have scaled up our dark stores, which are distribution centers used exclusively to fulfill online orders. We have one in Stockholm, and we are opening one in Göteborg. In other areas, many of our independent retailers have successfully scaled their pickup and delivery capacity.

Question: Any challenges your organization is facing from these trends?

Per Strömberg: Given the global economic environment, we expect slower GDP growth and higher unemployment rates, which will make “price to value” even more important. We also expect this online push to continue. As COVID-19 starts to wind down, we will see slower growth rates, but we believe many of the customers that have now started to use online will continue to do so. In our research, 90 percent of customers claim that they will continue to do online grocery shopping, and 40 percent claim that they will use online shopping as their main shopping channel. Like all other players in Europe, we will therefore be challenged in terms of profitability online.

Question: What share of online grocery do you anticipate for ICA in Sweden?

Per Strömberg: At the start of 2020, we had a relatively low online share—around 3 percent in active stores. We ended last year at around 6 to 7 percent. We have seen that the more closed-down society is, the more the online share goes up.

When we look at 2025, our target for online share is 7 to 8 percent, and then closer to 10 percent when you move into 2030. The longer the COVID-19 pandemic lasts, the more sticky consumer behavior will be. If customers are happy and satisfied, they will continue to do online shopping.

Question: What are the challenges to profitability in online grocery, and what measures are you taking to improve it?

Per Strömberg: If you look at last year, when we scaled quickly, we didn’t get the operational efficiency right. That requires more time. So we suffered in terms of profitability, even though we delivered very strong numbers last year overall.

The main step we are taking now is our partnership with Ocado, which has two key implications. First, we’re going to have an automated warehouse where robots are picking the products, versus a store or dark store where picking is done manually. This means that you have more than twice the efficiency. The new automated warehouse will also allow for a long-tail assortment. The other element is the Ocado customer-facing platform, which is much better in driving profitability than the platform we have today. It can improve our margins by having proportionally more of our private-label and high-margin products, better promotions, and more efficient pricing. In addition, we are looking into media monetization levers as an additional source of income, leveraging our channels to advertise.

This increased profitability will be required to fund the further investments needed for the e-commerce infrastructure.

Question: Do you think quicker delivery models will play a major role going forward in contrast to classic, next-day, large-basket delivery models?

Per Strömberg: Recently, we have seen the average basket size going up on online. We also launched an alternative service in the countryside and to some extent in the largest cities, where we offer a more narrow assortment online, with a quicker delivery service as well as some ready-to-eat meals. This ICA Pronto service is used by some 100 stores and has been particularly popular with elderly people who couldn't go to the normal stores during the pandemic.

Customers want to shop more frequently and they want faster delivery, which creates shorter lead times. In the short term, the huge increase in demand has made that challenging. Foodora, for example, established three small dark stores that are perhaps more like small supermarkets, with around 8,000 to 10,000 SKUs. They can supply customers within the Stockholm area in less than an hour. We will definitely need to meet this kind of instant service level; whether we do that with our ordinary service or with our Pronto service remains to be seen. There will also be room for alternatives like the picnic model, where consumers can sign up for a slot on a regular delivery route.

ICA was quite late to enter online. The market was started by two pure online players in grocery. Over the past three or four years, winners in the market have been mostly omnichannel. The pure online players have suffered, because they offer fewer alternatives and are more expensive. They don't have the option of letting the customer get their groceries at a pickup point such as a store and they do not have the scale of the winning omnichannel players. That means when they offer home delivery, they need to have much higher prices for home delivery in a price-sensitive market.

We will continue to challenge the pure online players. They have a decent volume now, given the total demand, but they continue to lose market share. In cities, players like Foodora will compete too. For them, grocery is something more of a complement to the ready meals and the restaurant food they supply directly to customers' homes.

Question: How do you see the big ecosystems like Amazon affecting grocery?

Per Strömberg: Amazon just launched last autumn in Sweden, but is not offering food to date. They will be very persistent, so they will probably get it right one day.

One of the things that we focused on the most is building an ecosystem around both our physical and online grocery offerings. We see that when people buy groceries online, they also buy other things like nonfood and pharmacy products or wine and spirits, and they want all the products delivered at the same time. We are working very hard to define what our future ecosystem should look like and how we can better complement our grocery offer with relevant products and services, so that it is unique.

The advantage we have is that we also have an extensive nonfood offering and are a market leader in pharmacy, for instance. Continuing to build that ecosystem will make us more competitive in the market, and it's helping us build long-term loyalty with our customers.

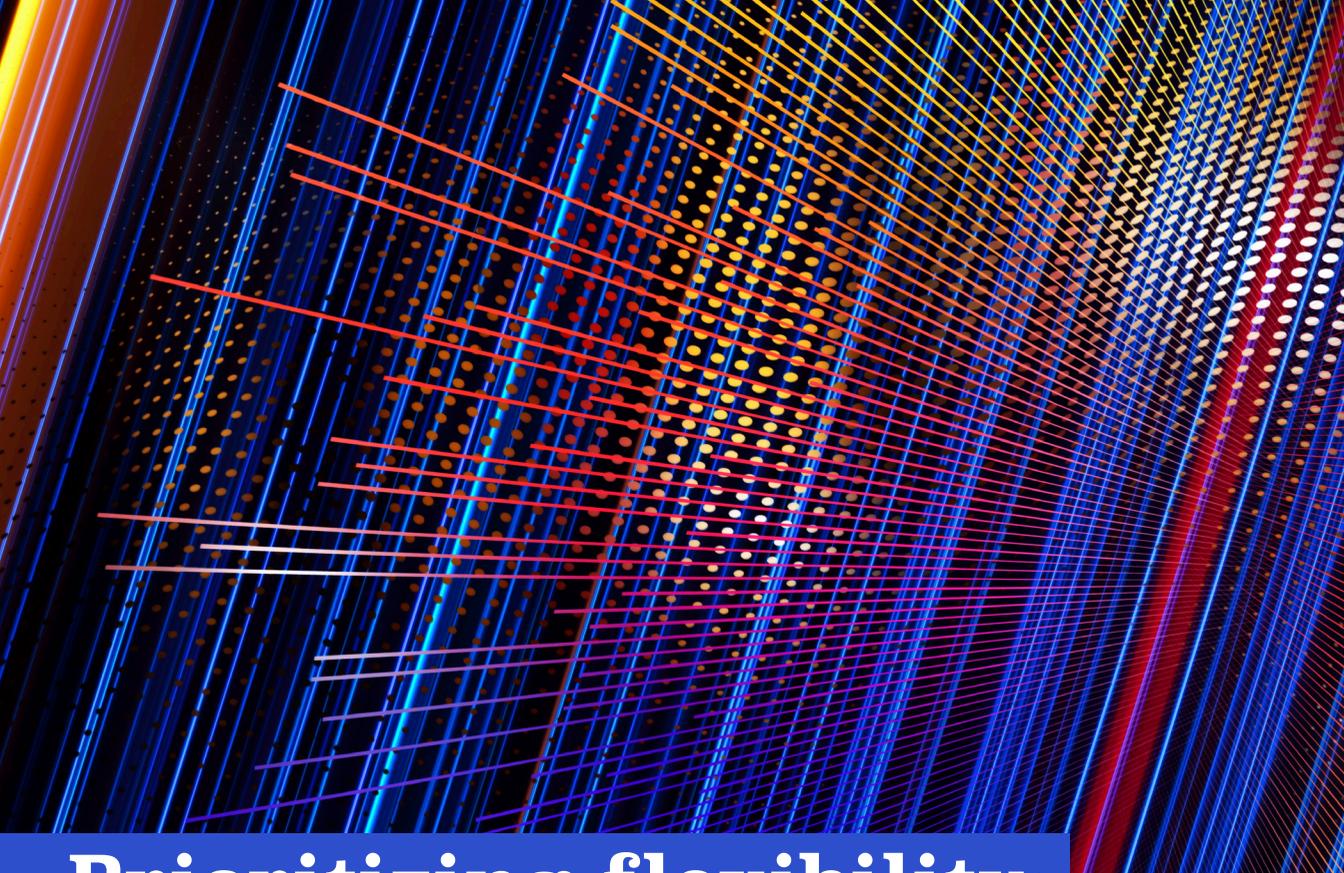
The ecosystem will also make it easier to compete with Amazon or other strong local marketplace players. Questions we are asking now are, "How should we develop the physical ecosystem around our stores? What kind of neighbors should we target? And how can we extend our health offering?"

Question: Are you considering extending to a marketplace or any other partnerships?

Per Strömberg: When building our ecosystem, we will definitely partner up with other companies. We are actually starting a pilot next week so that people can shop for pharmacy products at the same time as their grocery online shopping. When we do nonfood, we will start with the products that we have in-house. But we will definitely also need partnerships with other suppliers, companies, and restaurants to continue to provide interesting offerings our customers. There will be a marketplace, but we don't believe that our marketplace will be as big or as broad as Amazon. We will be more focused on things that are more closely related to groceries and food instead of apparel or categories like that. People are not looking for a dress at the same moment they buy their groceries.

Question: What is your key learning looking back on ICA's online grocery journey?

Per Strömberg: We did not put enough focus on the balance between scaling capacity and efficiency in our operations early enough. That has cost us from a financial perspective, and we have not been able to supply our customers in the way we wanted. Given our strong growth and the stronger growth than our competitors, we are still behind when it comes to the capacity side. I would say most of our learnings would be in that area.



Prioritizing flexibility: How to get the most out of technology

Grocers have realized that technology is core to their strategy and that flexibility is the name of the game for generating value from new technologies now—and in the future.

by Joep Beek, Stephane Bout, and Marcus Keutel



Interview with Christoph Eltze
on page 84



With the rapid emergence of a wide array of technologies in recent years—many with the potential to change the retail industry—one consistent trend has become apparent: retailers that are capable of adopting and deploying new technologies across many parts of their business—commerce, supply chain, store, and customer-facing—are typically more successful.

Accordingly, grocery retailers have been on the hunt for technologies that can help them leapfrog their competitors. But finding and implementing new solutions can also result in high costs and disappointing delays due to inflexible legacy tech platforms.

Yesterday’s digital strategies, such as multiyear targets and corresponding road maps, no longer suffice given the fast rate of change in grocery retail. Pure online players and innovative incumbents are constantly on the move; by the time they complete their two-year road map, the world looks different again. Now, fully automated replenishment software and microfulfillment centers are streamlining

supply and operations, with advanced analytics increasingly optimizing a grocer’s supply chain end to end. And who could have predicted the explosive growth of online grocery shopping due to COVID-19 restrictions?

With e-commerce being a substantial part of their business now, retailers are trying to build a truly omnichannel proposition and corresponding tech platform—which is no easy feat. At the same time, on the commercial side, merchandisers are increasingly working with largely automated, advanced tools to optimize pricing, promotion, assortment, and sourcing.

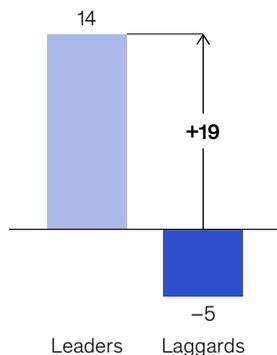
Agile, digitally savvy retailers that can derive the most benefit from new technologies will speed ahead of competitors and increase the value they provide to shareholders. Our analysis shows that total return to shareholders (TRS) for consumer and retail companies that are technology leaders grew at a CAGR of 14 percent from 2017 to 2020, while laggards’ TRS decreased by 5 percent CAGR (Exhibit 1).

Exhibit 1

Leaders in digital outperform in total return to shareholders.

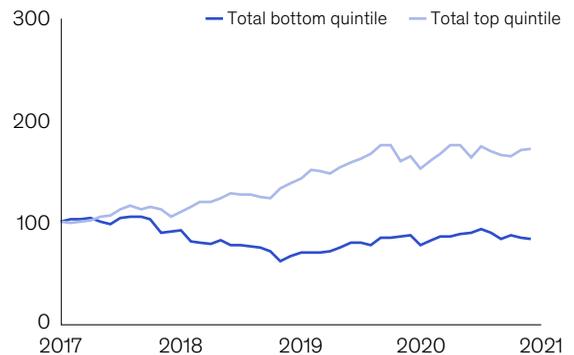
Consumer/retail companies with high digital quotient scores have higher TRS¹ growth

TRS CAGR %, 2016–20²



TRS of digital leaders has grown at twice the rate of digital laggards

TRS CAGR %, 2016–20²



¹ Total returns to shareholders.

² Four years of data (January 2017 to December 2020). Index 100 = January 2017.
Source: Capital IQ, McKinsey Analytics Quotient, McKinsey Digital Quotient

To become a tech leader that can adapt to changing circumstances, grocers can look to these five key principles for guidance:

1. Build a product-led organization

A nimble and successful tech organization is able to shift resources among priorities on short notice. It's crucial for executives to build organizations around products and not solely focus on applications. Leading grocery retailers do this by defining business domains and mapping out product teams for each domain. Retailers could have multiple

products per business domain. Each domain should be defined at such a granular level that a small team of engineers can own the development end to end (Exhibit 2). This cross-functional team comprises business and tech talent and is responsible for advancing the product's performance and overarching vision. As market dynamics change, products and their teams can be expanded, reduced, or morphed into new products and teams to capitalize on new opportunities. These business-domain product maps help organizations highlight

Exhibit 2

Leaders define business domains and product teams.

Concept in brief

Business domain maps help define products by:

- highlighting strategic priorities and allowing retailers to set measurable business targets
- allowing trade-offs and prioritizations between domains

Domains as basis for organizing product teams along the domains

Business domain map—sanitized example

	Product domains		Product areas					
Customer exposure	Channel	Channels	Web store	Express web store	App	B2B web store	Marketplace	In-store digital technologies
	Expertise	Customer experience	Customer identity	Customer attraction	Customer retention	Discovery, search, and personalization	Checkout and payment	Customer care
		Merchandising	Sourcing and supplier management		Pricing and promotion	Assortment and service management		SKU information
		Supply chain and fulfillment	End-to-end inventory management		Warehouse management	Fulfilment	Last-mile delivery	
		Enterprise	Operational finance processes			Human capital		Corporate business functions
	Platform	Platform products	Tech platform foundation			Data and analytics		

Retailers with leading technology capabilities outperform other retailers by 19 percent.

strategic priorities, set measurable business targets, and enable trade-offs when reprioritization is necessary.

While most leading players are building such product teams using in-house tech talent, the same applies for those opting for an outsourced or partner model. Smaller players, for example, may not be able to build a full-fledged in-house team in all technology domains. Still, the logic of a product organization would apply: technology partners should replicate a retailer's internal product logic on their end. Whatever the chosen model, some degree of internal control on technical quality will always be required for success.

2. Create a real tech workforce

To cope with underlying uncertainties and master new technologies, cutting-edge grocers are making sure they have the right talent, while also providing ongoing training opportunities for employees to level up where gaps exist. Today, many grocery retailers rely heavily on external developers, who may not always have the right capabilities or be able to deliver in a timely manner. The most successful organizations develop an internal tech workforce complemented with external talent where it enriches or accelerates productivity. Building capabilities, however, should not stop

at the operational level. For example, building an enterprise resource planning competence center could help organizations respond to uncertainties. With technology becoming an important driver of the business model, the decision makers should also have a better understanding of how technology works (see sidebar, "The agile approach in action").

At the same time, it's important to recognize that the current workforce includes thousands of digitally savvy frontline personnel who are working in tough conditions in stores and are rapidly adopting new collaboration tools. Technology can make it easier to manage their shifts and tasks while helping them stay safe and healthy.

3. Build architecture modules driven by business strategy

The most successful new technology developments follow a modular approach that is consistent and reusable across channels. This requires cutting legacy landscapes into smaller, self-sufficient services that can be improved independently from other parts of the landscape. At the same time, these services should be able to provide data to whichever other applications need it, without having to implement individualized point-to-point connections. This allows the development speed to accelerate and provides a consistent customer experience across multiple front ends, such as in-store point-of-sale (POS) systems, web shops, and apps.

Take, for instance, omnichannel basket calculation: while this task is often a pain point for grocers, when it is adaptable it can be used in every channel, thus allowing for easier inclusion of new features such as couponing, personalized promotions, and further loyalty features.

In addition, there is another driver for a landscape renewal: stores are increasingly

The agile approach in action

An international grocery retailer decided to double down on digital opportunities to radically change its approach to technology adoption in the span of one year. First, it created a new technology role—chief digital and product officer—on the board of directors. It then hired eight tech and product leaders who came from purely digital companies or from competitors with more advanced tech strategies. It created an offshore tech hub and hired more than 90 engineers, while also strengthening engineering capabilities at headquarters. On the system front, it transformed its underlying architecture by starting in the e-commerce space, where a monolithic system was incrementally replaced by smaller software-as-a-service (SaaS) systems or self-developed microservices. It also invested in continuous integration and deployment capabilities and established

quarterly, monthly, and even weekly business reviews to evaluate and improve the performance of key products.

With this new setup, the grocery retailer increased the return on its tech investment and enabled code deployments multiple times per day. In less than three months, it was able to launch multiple new products, including a new shopping app, a click-and-collect service, a scan-and-go feature, and an express delivery service. At the same time, its digital businesses grew rapidly. Before the new strategy was implemented, e-commerce business had stagnated at about 500 orders per day. Nine months after, the number of orders had increased to more than 20,000 per day. And since the outbreak of COVID-19, the retailer has further multiplied the number of daily orders generated by its online business.

becoming nodes in an omnichannel ecosystem for use cases such as click and collect, local promotions, and last-mile deliveries. The underlying technology architecture needs to be able to operate with sufficient flexibility to integrate third parties such as delivery partners.

4. Shorter time to market

Shorter release cycles allow retailers to better understand and meet customer expectations, while also enabling swift experimentation. Instead of big code releases a few times per year or month, teams should deliver releases multiple times per day in customer-facing systems and multiple times per month in back-end systems that incorporate real user feedback

to adjust products quickly. This can be done only if modern technology practices, such as automated code deployment, are in place.

5. Use data as the foundation for all improvements

Data are more abundant and flowing faster and across more boundaries than ever. It is no longer enough to capture structured transactional and supply-chain data. Instead, grocers need to capture millions of daily events and interactions so they can be analyzed to optimize experience and productivity. New technologies in this space are providing more flexibility—to rapidly capture, process, and analyze these data—than ever.

Data can supercharge improvements, helping companies keep close tabs on changing consumer demand. No longer is experience alone enough to make decisions. Wherever possible, direct user feedback can identify areas to improve and inform decisions about further priorities. Investments into suitable tools, such as A/B testing and performance monitoring, allow companies to better access and apply user feedback.

To get started on a tech transformation, companies are using the following strategies:

Make technology transformation a top strategic priority instead of simply an IT upgrade. The mission to transform the organization through technology should be high on the CEO's agenda rather than coming from within the IT department. The corporate mindset should shift from measuring tech spend as a percent of revenue to measuring tech spend based on the productivity and growth it is enabling outside of IT.

Focus on tech opportunities that provide the highest business value. While an endless number of possible improvements exist, consider creating minimal viable products to make the case for value quickly. Focus on doing a few things really well to generate traction and a (at least partially) self-funding road map.

Shorten technology planning cycles. Moving from an annual planning cycle to a flexible planning model with a monthly or at least quarterly time frame allows rapid prioritization and deprioritization of products based on continuous value delivery.

Embrace the change as an enterprise-wide transformation. Instead of the change being limited to certain functions, a company-wide approach will maximize impact and prevent the

change from creating different cultures within the company.

Make your entire leadership team accountable for the technology change in their domains. True agile transformation requires the entire board, the C-suite, and their teams to work across functions and silos.

Now is the time to change and make the best use of technology in grocery—not by exactly planning which technologies will be used when but by ensuring the company is transforming nimbly. The overarching objective is to build the flexibility and muscle to master the different technologies existing today and the new ones of tomorrow.



Christoph Eltze CEO, REWE Digital

Question: What are the most interesting trends that you've observed within the grocery retail industry, particularly in the past 12 months?

Christoph Eltze: I believe that three trends have set the course for the upcoming years: a shift from offline to omnichannel or online, a new definition of convenience, and conscious consumption.

In 2020, the traditional grocery industry experienced an immense acceleration of the shift from offline to omnichannel or online, which was a strong push on the e-food business. We observe this trend in our traditional stores as well as in our online businesses. While our customers use more omnichannel services in our stores, like scan-and-go solutions, the demand for our click-and-collect and delivery services has heavily increased.

Second, you see a change in how people consume food. As more convenient ways to eat arise, a new definition of convenience emerges, meaning less traditional cooking at home and more ordering of meal kits and using food delivery services.

Third, we observe a trend that we call conscious consumption—a combination of health, nutrition, and sustainability in the consumption habits of our customers. Regional as well as organic products, such as our private label REWE Bio, are in high demand. Additionally, healthy nutrition enters consumers' minds. Our Nutri score scan helps consumers to understand

the ingredients they eat. We believe this consumer trend might be harmed slightly over the coming 18 to 24 months, as COVID-19 impacts incomes, but in the end will be stronger than the economic cycles caused by the global pandemic.

Question: How did your organization adapt to or utilize these trends?

Christoph Eltze: Let me focus on the first and likely the strongest shift in purchasing behavior over the past months: the shift from offline to omnichannel or online.

We have already been actively addressing this trend for years, introducing e-food services for our customers. Being the market leader in the e-food business in Germany, we had a very good starting point in the field of delivery services, click and collect, and parcel services and marketplace solutions. Thus, when COVID-19 hit us, we were well prepared for a change in shopping behavior.

Nevertheless, we had to accelerate our efforts in this area during the past 12 months. During the first lockdown, our e-food services experienced a significant increase in demand. Thus, to offer alternative safe shopping options to our customers, we needed to scale up significantly in a very short amount of time. While our e-commerce and fulfillment technology was able to scale, we experienced physical limitations similar to what we have seen across many e-food retailers: limitations in capacity due to physical factors such as number of trucks, warehouse capacity, and staff.

We tackled these bottlenecks by taking advantage of our existing-store network. In this manner, we doubled the number of stores that offer click-and-collect services within only a few weeks. For our e-food business, we tried out innovative last-mile delivery solutions and are going to expand our business in 2021.

Question: How would you describe the changing role of technology within REWE over the past couple of years?

Christoph Eltze: As a traditional food retailer, REWE has been focused on our customers, attractive stores, highly skilled staff, and high-quality products. IT was a supporting function for fulfilling these focus areas.

Today, we do not treat IT as a cost center anymore. We see it as a tool to tackle new challenges, to create new things, and to respond quicker to new circumstances such as COVID-19. This change requires a lot of rethinking of given structures and processes, which can sometimes be hard. But our efforts have paid off: our customers like our new technological offerings because they are convenient.

Besides improving our customers' shopping experience, our in-house technology development allows us to launch new business ventures. Leveraging our technological assets, we are able to offer software solutions to third parties. We recently founded a new company, fulfillmenttools, which operates as a software provider. It addresses one of the biggest challenges facing retail in Germany: omnichannel solutions for stationary stores, including in-store fulfillment. Looking ahead, I believe that advanced analytics and artificial intelligence will be behind the next big wave of technology hitting the retail industry. To surf this wave, you need to plant the seeds now: hiring talent and building an environment so they can flourish. In the end, it will still be people running advanced analytics and artificial intelligence—so you should not miss out on them.

Question: Looking back, what are the achievements that you're most proud of?

Christoph Eltze: There are many, but let me give you two examples of how one achievement led to another one. The first one is that we grew a very strong base in technology and analytics. Second, we leveraged this base—including developed tools, methodologies, and mindsets—to innovate throughout the company.

Thinking about the first achievement, we learned that a strong technological foundation requires a combination of talents, assets, and capabilities. That's exactly what we did while developing the IT infrastructure, the software, and the e-commerce and fulfillment tools, most of which were built in-house.

Once this foundation is laid, it opens up new opportunities in a broader sense. What started small—founding REWE Digital in 2014—has become our chance to transform how we do business throughout the enterprise. We are talking about new ways of working, agility, the culture of innovation, and the like. However, talking about it does not make it real. People need to experience the power of doing things differently. Only then, a true shift happens and a faster, more innovative risk-taking culture emerges.

Question: What are the things that you're doing to stimulate this culture of innovation?

Christoph Eltze: We are setting focus areas and building cross-functional teams around them. To make things work, a lot of senior management attention is required. Talking about tearing down silos does not help; you need to build the surroundings in which silos do not matter anymore. At the moment, we use technology-driven topics as a measure to actually bring those people together and let them learn from another.

Thinking about organizational setups to foster a change in culture, there are two options: you can either start where you are, meaning internally in your existing business, or you start from scratch. With the foundation of REWE Digital, the REWE Group decided to start from scratch,

creating a place for like-minded people who wanted to work differently than what was common in the corporate world. We have been able to create a unique company culture, fostering new ways of working and innovative thinking. At the same time, we never forgot where we are coming from—the traditional grocery business. This is crucial, as a digital unit can only be a vehicle for a broader organization if it is still connected to the core business. Only then can it unleash its full potential.

Question: What's next in terms of leveraging analytics in the business?

Christoph Eltze: In the past few years many retailers, including us, have experienced firsthand the power of analytics, receiving good results. Using analytics to optimize category management, like pricing and assortment management, has paid off. While this has been a first very good step toward a data- or analytics-driven organization, there is still more potential. Advanced analytics and AI hold the potential to improve every decision-making process across a variety of areas—for example, in predictive maintenance in logistics or financial and demand forecasting. To tackle those areas, it will be key to get a broader understanding of how analytics can be used off the beaten path.

Question: How would you expect the technology to evolve over the coming five to ten years?

Christoph Eltze: Technology in a broader sense will be the game changer across all industries, including retail. In this context, talking about technology includes IT, digital solutions, analytics, and the like. All of us need to embark on this journey, constantly looking ahead for the next big thing.

There's nothing wrong with starting this tech transformation with only a few elements. In retail, the majority of players have decided to initially focus on e-commerce. However, this is only the beginning. What we've seen and experienced over the past few years has only been the starting point to what will come. In that sense, we have uncovered a small fraction of the total potential impact. As new technologies emerge, it will always be hard to tell if a technology like the Internet of Things or computer vision does or does not have an impact on your business. Advanced analytics and AI create optimizations across the entire value chain. However, only time will tell the full power of new technologies.

Given that, we should ask ourselves how we best prepare to be part of the next big tech movement. I am talking about developing tech assets as well as capabilities: building a corporate culture, establishing new working methods, and having the right people will be the keys to success.



The path forward for grocery sustainability

Though grocers have focused on product safety and hygiene during the pandemic, sustainability remains a key priority for consumers and grocery CEOs alike. Now, grocers need to focus on how to deliver against their commitments and empower consumers to make sustainable choices through transparency.

by Sebastian Gatzler and Daniel Roos



Interview with Mikko Helander
on page 94



According to a recent Eurobarometer public-opinion survey, most European consumers want a stronger focus on sustainability and the environment—and they want industry stakeholders to act accordingly. Consumers also understand that the food sector plays a critical role in climate change: the production and transportation of livestock, crops, and food are responsible for about 25 percent of worldwide greenhouse gas emissions, use 50 percent of the world's arable land, and consume most of its freshwater. As the gatekeepers for consumers in this system, how should grocers respond to this vast challenge? The answer is to keep doing what retailers are doing best: anticipate and respond to consumers' demands.

Leading grocers already take sustainability very seriously. Their efforts focus not only on the environment but also on social responsibility and corporate governance—a group of topics collectively known as environmental, social, and governance (ESG). In part, these steps are reactions to changing regulations, such as China's 2018 ban on plastic waste imports and the European Union's 80-cent levy on virgin plastics introduced earlier this year. At the same time and even more important, retail decision makers are motivated by a genuine desire to create a positive impact for the world, along with value for their businesses.

Our research shows that these two goals—of sustainability and business success—indeed go hand in hand: sustainable actions pay off and a positive link exists between ESG and financial performance.¹ The growth rate for consumer goods marketed for sustainability is nearly four times higher than the market average.² As a result, sustainability is

increasingly a strategic differentiating factor for retailers and a source of value and growth in often challenging, stagnating market environments. As the coronavirus pandemic continues, many industry leaders have been asking whether safety concerns will push sustainability to the back burner for consumers and grocers.

In fact, the opposite is true. Companies with sustainability strategies have been more resilient during COVID-19 and consumer interest in sustainable products has intensified in recent months. After all, the pandemic has demonstrated more clearly than ever that the planet and all of its people share a collective fate.

In a recent McKinsey survey of consumers across Austria, Germany, and Switzerland, half of the respondents said that the pandemic had increased their willingness to pay a premium for sustainable groceries, personal care, health products, and home items (Exhibit 1). And this trend will accelerate further: 38 percent of respondents said that sustainable products will be even more important after the crisis than they are today. These results underline the growing importance of sustainability for consumers due to the crisis, which grocers and manufacturers can harness.

Of course, stated preferences do not always translate into real-life choices. However, recent research suggests otherwise, with sustainability-marketed products outgrowing their conventionally marketed counterparts on the back of a price premium.³ While it's clear that the desire for sustainability is growing among consumers overall, the picture becomes more complex upon deeper examination.

¹ Witold Henisz, Tim Koller, and Robin Nuttall, "Five ways that ESG creates value," McKinsey Quarterly, November 14, 2019, McKinsey.com.

² NYU Stern's Sustainable Market Share Index, July 16, 2020.

³ NYU Stern's Sustainable Market Share Index.

Gen Z, higher-income shoppers, and women are the most willing to pay more for sustainable products.

Stated willingness to pay for sustainability by demographic, %

	Yes	No
Overall ¹	49	51
Generation Z	60	40
Higher-income shoppers	60	40
Women	51	49
Singles	45	55

¹Germany, Austria, and Switzerland (DACH)

First, the other half of survey respondents, across a variety of age, gender, economic, and social demographics, say they are not willing to pay a premium for sustainability. Further, support for sustainability differs from one consumer profile to the next and depends on ESG priorities, products, and channels. For example, women, young customers (Gen Z), and shoppers with higher incomes value sustainability more than their counterparts in other consumer demographics. Supermarket shoppers also tend to pay slightly more attention than those buying primarily through discount formats.

Another consideration is that consumers seem to care about some sustainability aspects and criteria more than others. For grocery shoppers, environmental and social topics are more important than those related to governance. The environmental aims that most motivate them to pay more are reducing greenhouse gas emissions and conserving raw materials. The social responsibility topic of

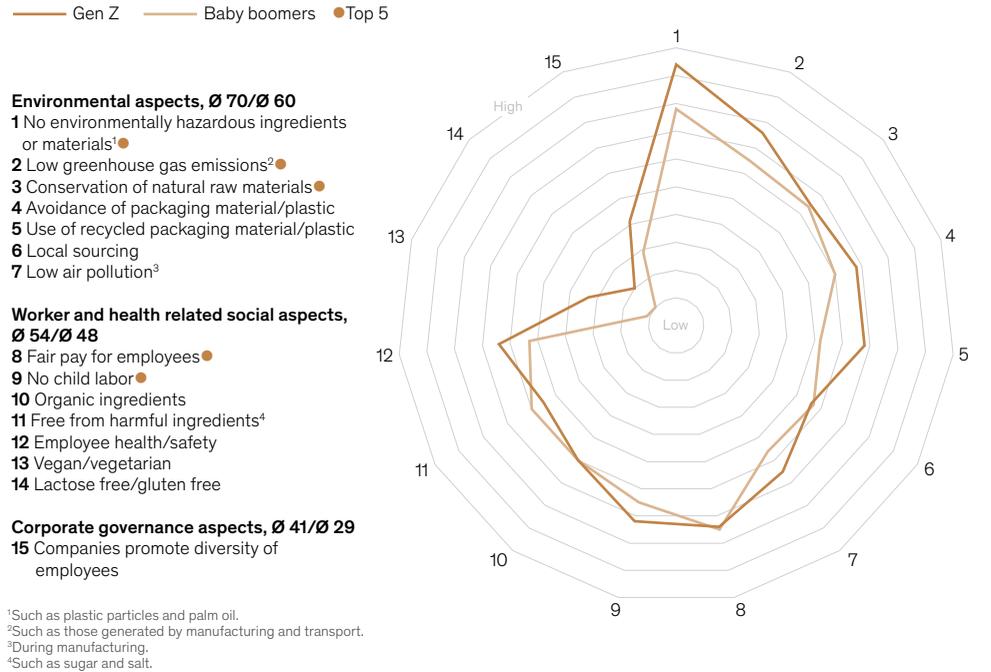
fair pay for employees along the value chain, in turn, is the largest overall driver of higher willingness to pay a premium (Exhibit 2).

Finally, not all product categories receive the same attention. Fresh food such as fruit, vegetables, and meat are most important, with seven out of ten respondents saying they're willing to pay more for these items if they are sustainable. Interestingly, the survey found only a small gap between supermarket and discount-option shoppers in these key categories. Women are more likely to pay a premium for sustainable home and personal care products such as detergents, cleaning supplies, skin care, and cosmetics. Gen Z consumers value sustainability in personal care products as well, but they prioritize it in snacks and ready-made meals more than older generations (Exhibit 3).

With sustainability being among the top three trends that will shape the grocery retail industry in 2021 and 2022, many grocers have

Customers make clear distinctions on which aspects they are willing to pay for.

For which criteria would you be willing to pay more for products?, %



also started to double down on their ESG commitments. More than 30 surveyed retailers committed to science-based emission-reduction targets by the end of last year—a tenfold increase from just three years ago. Furthermore, all have committed to being climate neutral or even climate positive in the long run. Some have set targets with even shorter horizons: Finnish grocer Kesko, for example, is aiming to become carbon neutral by 2025 and achieve net zero by 2030. The German retail giant Schwarz Group has significantly invested in circularity capabilities and its waste management and recycling business. And in governance endeavors,

Germany's REWE and Portugal's Jerónimo Martins launched initiatives to better integrate migrants into the labor market and promote intercultural cooperation.

Overall, our survey results reveal that an increasing number of grocers are looking toward a sustainable future. Retailers should view the COVID-19 pandemic as an opportunity: with bold changes in their offerings and operations, they can align with consumers' varying acceptance of premiums for sustainable products and operations and use sustainability as a competitive advantage.

Sustainability concerns vary by demographic and product category.

Stated willingness to pay more for sustainability, %

	Gender		Generation		Income		Shopper type	
	Men	Women	Average	Gen Z (15-23)	Moderate (€2,000-€4,000)	High (>€4,000)	Supermarket	Discount
Food								
Vegetables	68	72	70	80	71	79	71	65
Fruit	68	72	70	80	71	81	71	65
Meat and fish	68	71	70	79	73	82	70	66
Dairy products	62	65	64	72	66	72	64	59
Bread and cereals	59	60	60	68	61	67	60	54
Baby food	45	43	44	44	49	56	44	42
Sweet and savory snacks	37	38	37	53	36	46	37	33
Ready-made meals	37	34	36	49	37	44	35	32
Home care								
Detergents	36	41	39	47	42	50	38	35
Cleaning supplies	37	42	39	49	42	51	39	35
Dishwashing liquid	35	39	37	46	38	48	36	33
Personal care								
Skin care	40	50	45	59	46	55	45	41
Cosmetics	37	47	43	56	45	54	42	39
Consumer health								
Food supplements (vitamins)	38	43	41	53	40	51	40	37
Average	48	51	49	60	51	60	49	45

¹Statistically significant difference.

Grocers know that much of their potential impact lies beyond their own organizational boundaries. The standard framework of carbon-footprint calculation breaks emissions

into three categories. Scope 1 emissions are generated directly by the resources, such as stores or truck fleets, that a retailer owns and controls itself. Scope 2 emissions are

generated by the energy they purchase, making the retailer indirectly responsible for them. Finally, Scope 3 covers emissions generated throughout the retailer's supply chain. While Scope 3 emissions seem the furthest removed from the grocer's sphere of influence, they represent the largest arena for action, with more than 90 percent of overall emissions.

With all this in mind, we highly recommend that grocers make sustainability a strategic priority and pursue it through four avenues:

Engage the customer base. Identify new growth products and services, adjust the assortment, and provide support for customers to make their consumption more sustainable, including new circular offerings. There is also a strong need for transparency by the customer, and grocers can make a huge difference given their role in the food system.

Rethink operations. Reducing Scope 1 and 2 emissions also means eliminating inefficiencies in retail operations. Grocers should start by determining their current sustainability baseline so they can identify excess emissions and waste. Retailers can draw on abatement cost curves that show the total cost of reducing different emission types to identify the most cost-effective and impactful reduction levers. Then they can define concrete actions and put them into an implementation plan. Typical levers for in-store operations involve optimizing store lighting, heating, and refrigeration. Logistics levers focus on truck utilization and alternative fuels, while warehouse operation levers generally address isolation and refrigeration. Many grocers are also considering solar energy generation. Advanced planning tools help to optimize inventory levels while reducing food waste. E-commerce delivery and packaging are other typical focus areas for improvement.

Work with suppliers. Because Scope 3 emissions provide the biggest opportunity for impact, grocers should work with their supplier base to reduce them. Retailers can set standards for their suppliers, ensure emissions traceability, and partner with suppliers to create innovative solutions. In one prominent example, Walmart in 2017 launched the Gigaton project to avoid one billion metric tons of emissions across its value chain by 2030.

Meet the growing sustainability expectations of financial markets. Retailers need to understand sustainability metrics in order to place high in rankings from ESG data providers, develop impactful ESG reporting, and invest in meaningful change.

In order to prioritize their activities, grocers can plot their ESG topics into a matrix of stakeholder importance and financial impact. While some topics will have positive impact on both sustainability and cost, others will require investments and will not pay off with immediate efficiency gains. However, sustainability and business success will go hand in hand in the long term.

Because sustainability has clearly become a key differentiating factor within the highly competitive grocery landscape, the time has come to incorporate it consistently into retail strategy and also adapt classical retail strategy frameworks such as McKinsey's retail pentagon (comprising price, range, service, experience, and convenience). Doing so would accurately reflect the importance of making all aspects of grocers' offerings and operations more sustainable. By creating momentum through bold actions and meaningful narratives, grocers can lay the foundation for a just, more sustainable future for the planet while also building a distinct business advantage.



Mikko Helander CEO, Kesko

Question: How has COVID-19 affected your business strategy, and how has your company reacted?

Mikko Helander: Kesko is an 80-year-old company that is full of tradition and has a beautiful history. In 2014, Kesko's board of directors understood that the conglomerate must be modernized. We rolled out a new strategy in May 2015 that focused on the renewal of the company. We implemented this strategy, and it has enabled Kesko to adapt to meet those challenges and pursue opportunities linked to online retail, sustainability, and technology.

In the very early stages of the pandemic, we adapted the whole company to meet these new challenges. Our strategy, and the renewal it sparked, has made Kesko much stronger and better able to face the pandemic. As a matter of fact, in 2020, Kesko reported its all-time best results, and our market position has strengthened further.

Online has been a very important part of our success story. We allocated a lot of financial and operational resources to develop our online business, and it's been tremendously valuable to have extensive, well-functioning online services during the pandemic. We have also succeeded in maintaining our supply-chain procurement, logistics, and IT services during these difficult circumstances.

Question: Kesko is already one of the “Global 100 Most Sustainable Corporations in the World.” Why does the topic matter so much to you and your colleagues?

Mikko Helander: The foundation of our sustainability work was established 40 years ago. Since 2015, sustainability and climate-change mitigation have been cornerstones of our strategy.

At many retailers, it is still quite common for sustainability efforts to be led at the corporate level. This is one of the main differences with Kesko, compared with some other big retailers. We have taken a business-driven approach to sustainability that spans all of our businesses. Our grocery division has revenue close to €6 billion and includes grocery stores in all categories: hypermarkets, supermarkets, and neighborhood stores. We also have our B2B hospitality business, which provides services for restaurants, and it has revenue of almost €1 billion.

In the business-driven model, all of these divisions have their own sustainability plan and measures for how to become more sustainable. And each business unit, each leader of businesses, and all employees of a business have a sustainability work agenda.

Question: On a company level, you have set high targets, especially when it comes to environment and climate change. What’s the key to achieving these targets?

Mikko Helander: When we set challenging targets, a critical part of that sustainability work is reporting. We must also have good reporting in place to precisely track developments year by year. When we are reporting progress more precisely by business and markets, that makes our sustainability work more concrete, which generates better results much faster.

Twenty years ago, Kesko started to report sustainability metrics very precisely. Whereas in previous years, the head office and corporation took the lead in reporting, the businesses now report on sustainability developments. Our reporting is itself already advanced: we have thousands of targets that are based on our very precise reporting.

In the coming years, we will definitely set more granular targets for each business unit, for each business manager, and for direct reports for each business function. That represents the next level of our sustainability work.

Question: If you emphasize sustainability, sometimes it has an impact on prices. How do you address this issue?

Mikko Helander: We are the gatekeeper for the consumer. We can make the biggest difference if we ensure the transparency and sustainability of the supply chain and empower the customer to make sustainable product choices. That’s what we need to focus on.

I'll give you an example. In all European countries, consumers eat a lot of chicken. If customers visit a competitor, they can buy chicken without knowing where exactly it was produced. In Kesko stores, we provide detailed information. In some packages, you can even see that the chicken came from a particular farm in the eastern part of Finland.

In the future, I hope that all retailers will provide more detailed information to their customers—even though for some companies that are offering very low prices, this transparency will be a clear challenge.

It would be very important to have common rules for the retail industry to be more transparent and provide consumers precise information. Do we need European-wide legislation to force the retail industry to report this type of data? It would be, of course, better that the retail industry itself sets those rules.

Question: How are the customers reacting to your commitment to sustainability?

Mikko Helander: Sustainability is one reason Kesko is a great success story. For example, in 2015, our market share in Finland was 32 percent, and our grocery stores had 950,000 customers per day. Last year, our share was close to 38 percent, and we are up to almost 1.3 million in customer numbers per day. In all, we have increased sales in the grocery division by €1.8 billion in six years.

Why did we have such a big increase in customer visits? It is a combination of many things: we have put significant effort into modernizing our stores. We have developed selections and our loyalty-card system. We have put a lot of money into developing better customer data. While it is a combination of all those elements, sustainability is definitely one important reason that Kesko is better recognized by customers. When all the other elements and services are there, we can gain market share.

Question: Kesko has set the goal of being carbon neutral by 2025. What are the key sustainability projects the company is pursuing now?

Mikko Helander: Energy consumption at the stores is one of the top priorities, especially now as we determine how to reduce our own carbon footprint and meet our targets. Of course, what kind of energy we buy is also important, as we are a big user of electricity.

A big difference between us and many other retailers is that we are not just reducing our own emissions; we are focused on the whole supply chain. Sustainability transparency is an important part of our success story, but this is still a big challenge in retail. Many companies are talking about their own emissions, and nearly all companies set challenging emissions-

reduction targets for their own business. But they often forget how much emissions are coming from the supply chain. And those emissions may be 100 times bigger than what retailers produce themselves.

When we have good suppliers and we recognize that they are falling short, our first reaction is that we want to help; we want to support them to make their manufacturing and logistics more sustainable. If they don't align their business according to our principles and suggestions, we will change suppliers—but that's not our first response, and our collaboration is highly appreciated by suppliers.

Question: What would be your dream project to move the needle at the European level?

Mikko Helander: One of my dream projects would be a common platform to calculate emissions and the carbon footprint for each product in the EU, using the same formula. Even though this is complicated, we should set ambitions high. When retailers would have agreed on the formula, each retailer could ask their own suppliers to provide the needed information.

I trust that consumers are increasingly educated and better motivated to make the right choices when they have the necessary information, but today, they don't get enough information. The retail industry has a crucial role in combating climate change by being more transparent.

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