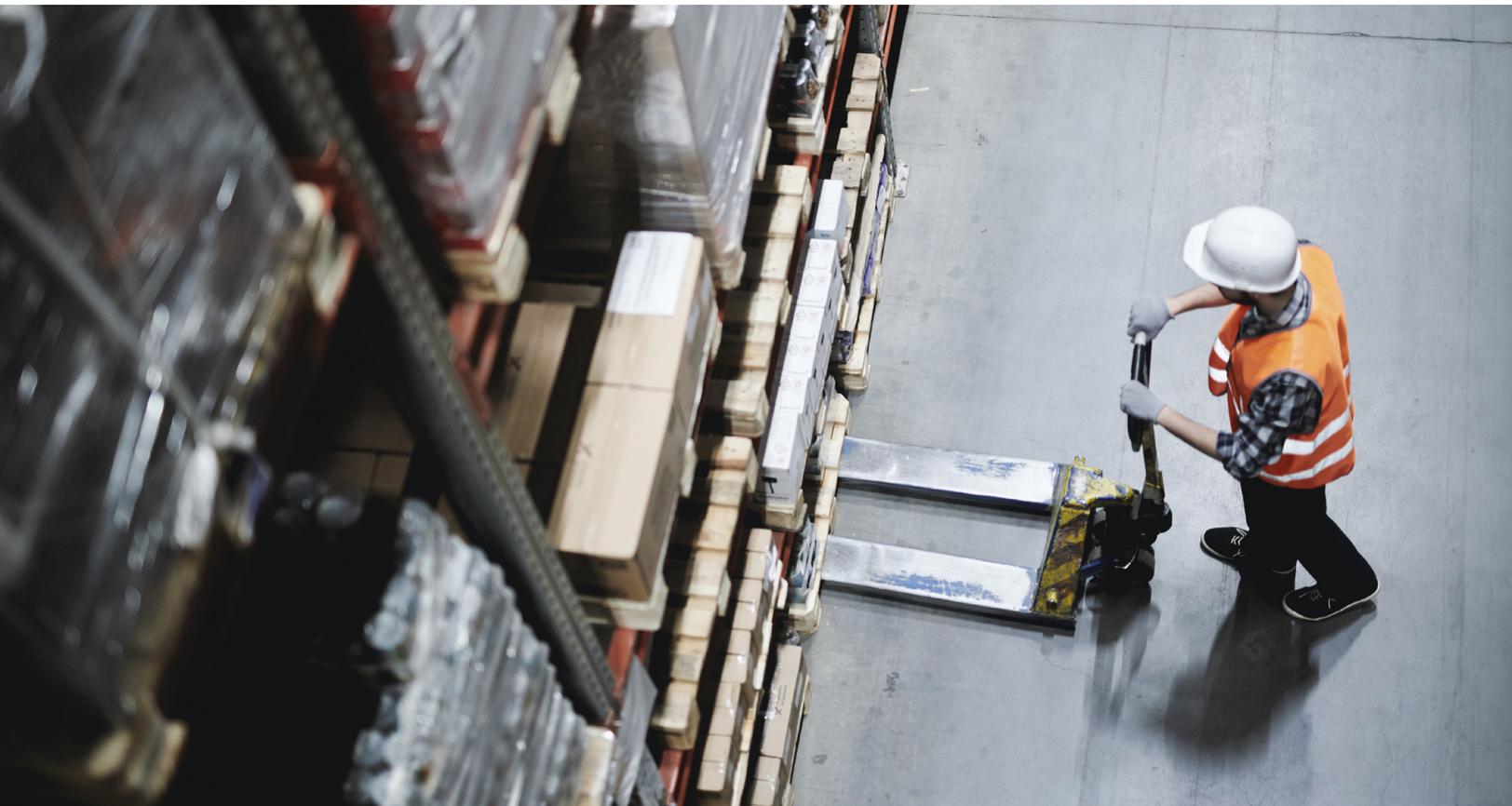


Retail Practice

Five actions retail supply chains can take to navigate the coronavirus pandemic

Retail supply chains are grappling with the humanitarian impact of the outbreak, as well as new operational risks. Five actions can help retailers bring goods to communities and help employees.

by Manik Aryapadi, Vishwa Chandra, Ashutosh Dekhne, Kenza Haddioui, Tim Lange, and Kumar Venkataraman



As the coronavirus outbreak has spread and its humanitarian impact has grown, retailers have stepped up their efforts to provide consumers with essential goods and to protect the health and well-being of the communities they serve. Particular challenges have arisen in global retail supply chains, where the pandemic's far-reaching effects have weighed heavily on the health and well-being of employees and jeopardized livelihoods and economic lifelines in many communities.

Retailers are now taking extraordinary measures to keep goods moving to store shelves and consumers' doorsteps. Supply-chain leaders are creating transparency and building rapid-response capabilities to mitigate the short-term fallout from the crisis. We focus in this article on the five actions retailers are taking to resolve the immediate challenges that COVID-19 presents to supply-chain workers, business partners, and operations. (In a subsequent article, we will examine how supply-chain leaders at retail companies can chart a path to the next normal, building resilience and returning the supply chain to full effectiveness while reimagining and reforming supply-chain operations to improve their performance.)

Changes in consumer spending during the outbreak

Retailers' supply-chain difficulties have largely arisen as big shifts in consumer behavior and stepped-up health restrictions have rippled back through their operations. One noteworthy shift has been an abrupt swing in purchasing patterns. Sales of nondiscretionary products, such as food, household, and personal-care products, have spiked, while sales of discretionary items, such as apparel and furnishings, have tailed off.

Our consumer research indicates that these initial shifts could persist in the very near term—though it remains to be seen how the restrictions that some

governments have placed on store openings and order deliveries might further influence consumer behavior. In recent McKinsey surveys of consumers in Italy, Spain, the United Kingdom, and the United States, respondents were more likely to say that they would increase their spending on groceries than to decrease it during the next two weeks. For most discretionary consumer-spending categories, including restaurants, apparel, and furnishings, respondents were more likely to say they would decrease spending (Exhibit 1).¹

Consumers have also said they will shift spending among channels. In the surveys noted above, McKinsey asked consumers whether they were planning to increase or decrease their in-store and online spending on various types of goods during the next two weeks. Only respondents in Italy and Spain said they were likely to increase their *in-store* spending on nondiscretionary goods, such as groceries and household supplies. Respondents in the United Kingdom and the United States, by contrast, were more likely to say they would increase their *online* spending on groceries and household items. And respondents in all four countries said they were likely to increase their online spending on a wider variety of items.²

Other research underscores these early shifts. An analysis of retail traffic in major US metropolitan areas between February 19th and March 20th showed increases in traffic at grocery stores and warehouse chains, while movie theaters, restaurants, and malls remained closed. Downloads of delivery apps for grocery retailers increased by 100 to 200 percent over the same two-week period.

Stores, logistics systems, distribution facilities, and supplier networks weren't engineered for the rapid shifts in demand patterns we are seeing today. To adjust, retailers are retooling every aspect of their supply chains, from procurement to customer service. As supply chains for nondiscretionary

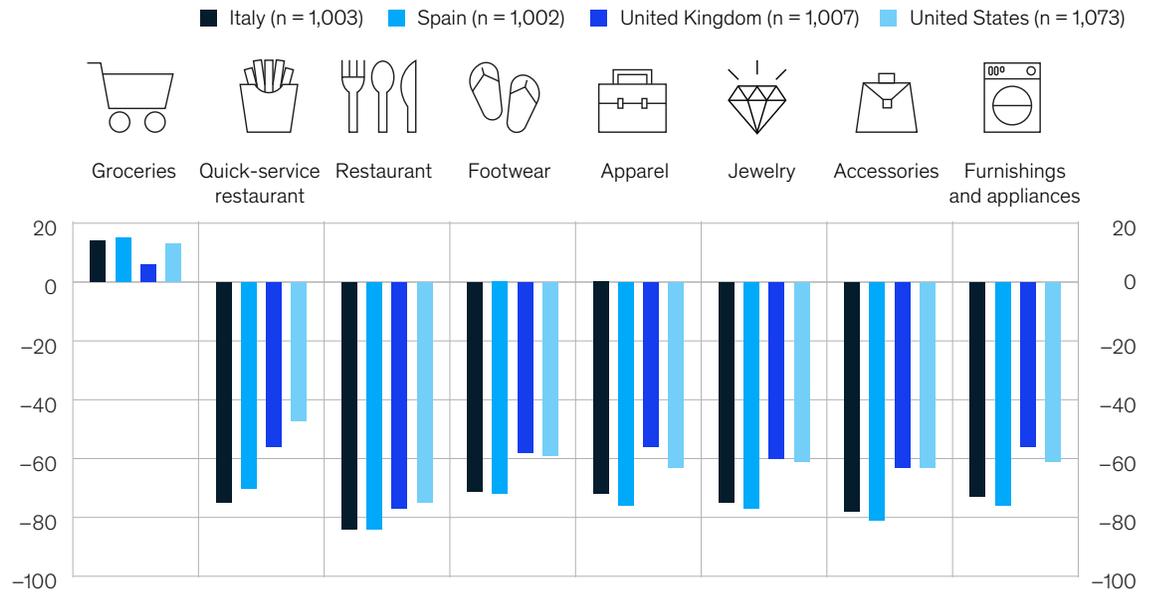
¹ "US consumer sentiment during the coronavirus crisis," March 2020, McKinsey.com; "Spanish consumer sentiment during the coronavirus crisis," March 2020, McKinsey.com; "Italian consumer sentiment during the coronavirus crisis," March 2020, McKinsey.com; "UK consumer sentiment during the coronavirus crisis," March 2020, McKinsey.com.

² Ibid.

Exhibit 1

In several countries, consumer surveys show a likelihood of greater spending on groceries and less spending in discretionary categories.

Net intent to change spending over the next 2 weeks, by country, by category,¹ % change



¹Net intent is calculated by subtracting the percentage of respondents stating they expect to buy more from the percentage of respondents stating they expect to buy less.

Source: McKinsey Marketing & Sales surveys conducted March 21–23, 2020; all data are weighted to match countries' populations of people 18 years and older

goods have ramped up activity, companies have had to balance the surge in demand while also prioritizing the protection of their employees' health and well-being across the supply chain. On the other hand, supply chains supporting discretionary goods have redeployed resources to support online orders or selectively ramped down operations to deal with the drop in demand.

How retail supply chains are adapting: Five priority areas

The pandemic has forced retail executives to mount urgent efforts to adapt their supply chains, whether by revising their purchase orders and merchandising plans or by reallocating all kinds of

resources—working capital, inventory, employees, transport capacity—to where they are needed most (Exhibit 2). We explore these changes in detail below.

Suppliers: Secure demand

Surging demand for nondiscretionary goods has created network-wide stockouts for some retailers. Responding to the dip in on-shelf availability, retailers are working closely with companies across their supplier bases, including consumer-packaged-goods (CPG) makers, distributors, and co-manufacturers. For the most important product categories, category captains are holding daily meetings with strategic suppliers to work through the options for securing an adequate supply of essential high-demand items.

Immediate action across the supply chain can help retailers meet consumer demand during the COVID-19 pandemic.

Retail-supply-chain changes

● Nondiscretionary categories ● Discretionary categories



Suppliers

- Establish daily meetings with strategic suppliers
- Reduce product variety
- Reduce on-time, in-full requirements, as well as payment terms for key suppliers
- Mitigate risk for existing orders, in collaboration with suppliers



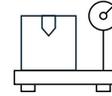
Merchandising

- Revise buy plans and reallocate staff toward high-demand categories
- Override algorithms to redirect inventory to high-density areas
- Dial down near-term buy plans to preserve cash
- Anticipate future increases in sales and adjust buy plans accordingly



Distribution

- Retrain employees and redeploy them to distribution centers in high-demand areas
- Raise wages and make temporary hires
- Maintain good workplace hygiene
- Cross-train store and back-office personnel to assist with e-commerce



Logistics

- Allocate more transport capacity to high-demand items
- Have suppliers deliver directly to stores
- Stage products at strategic hub stores to feed smaller stores
- Explore alternative and supplemental delivery options
- Offer transportation capacity if private fleet is available to support movement of critical goods



Fulfillment

- Relax same-day/next-day delivery requirements
- Optimize routing and accommodate more delivery slots
- Enforce order maximums
- Expand fulfillment and return options to give customers flexibility

The first and foremost priority for retailers operating across food, drug, and mass (FDM) categories is to secure a fast and reliable supply. Retailers are taking several steps to do so. One is simplifying their SKU profiles to reduce variety and boost quantities, which helps suppliers to accelerate the processing of orders. In addition, several retailers are easing payment terms, widening delivery-appointment windows, and relaxing on-time, in-full (OTIF) requirements.

A leading mass retailer is pursuing all these measures with a special focus on improving its on-shelf availability and its replenishment speed. It is also redirecting its resources, including capital and staff, from nonessential to essential categories. Another leading producer of canned goods is holding daily “stand-up” meetings with a regional grocer to foster transparency and open communication.

Declining sales of nondiscretionary goods, on the other hand, have put pressure on the cash flows of retailers that sell or specialize in these items. To conserve cash, these retailers can remove incentives for on-time deliveries, suspend credit extensions, and do more business with suppliers that have relatively healthy cash reserves. Some retailers are counseling their suppliers to improve their management of inventory (including commodity products), advising suppliers not to buy raw materials, so they can avoid deepening their cash deficits. Retailers can also raise cash by working with their distribution partners to sell off excess inventory.

As a last resort, retailers might explore delaying or canceling orders—an approach that poses some risk to their supplier bases. Multiple suppliers in Asia are shutting down operations as purchase orders

are being canceled or pushed out. A leading apparel retailer based in North America, for example, is working closely with its vendor base to review 40 percent of its buys for the upcoming fall season while simultaneously pruning its assortment for spring 2021. These are not easy choices to make for either party and would require collaboration among retailers and vendors to benefit both sides.

Merchandising operations: Redirect inventory

As retailers recalibrate their product orders to line up with consumer demand, they will need to cascade the changes across purchasing, planning, and inventory-management operations. For nondiscretionary goods, retailers are revising their purchasing plans to favor items in high demand and to direct more of their inventories toward locations where sales are especially brisk.

To move inventory around quickly, retailers might have to bypass or override their inventory-replenishment and inventory-allocation algorithms. For example, one of North America's leading retailers is actively deploying inventory across the network to regions with the biggest product-availability deficits. In some instances, retailers will also need to reassign their merchandising-operations staffs to have enough coverage of key categories and products—a step that can require rapid onboarding and cross-training.

In addition, we are seeing retailers take money previously earmarked for in-store marketing activities and use it to build the operational flexibility they need to improve on-shelf availability for essential items. For example, a leading grocer's category teams are reallocating shelf space for canned goods and working closely with suppliers to focus on availability and replenishment speed rather than promotions.

Some merchandising moves for discretionary categories resemble those for essential-goods categories. To conserve cash, retailers can sell more merchandise they already own by reallocating inventory among geographies. They can also dial down purchasing plans for the near term. But retailers selling discretionary goods will also need to plan their strategic buys for later periods, so that they don't run out of inventory when consumer spending rebounds.

One fashion retailer's response to the outbreak reflects all these moves. The company is selectively reallocating its financial and human resources to support e-commerce operations while changing its inventory spending to adjust to the shift to online purchases, driven primarily by store closures. The retailer is also adjusting its longer-term purchases, in the expectation that the pandemic will accelerate the adoption of e-commerce.

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Distribution: Add capacity—safely

Distribution is the supply-chain segment where demand trends for nondiscretionary and discretionary goods begin to overlap significantly. We've seen some companies reassign current employees to have more capacity in nondiscretionary categories where goods are selling fastest. (In the case of discretionary-goods retailers, some are choosing to cross-train and reassign back-office and store personnel to support e-commerce operations.)

Some retailers have temporarily moved their office workers into distribution centers to perform jobs like operating forklifts, in addition to hiring associates from discretionary-goods sectors, where demand has tapered off. For example, a regional grocery retailer has been hiring fulfillment specialists from other retail sectors, including fashion and home furnishings, which have been hard hit by the crisis. The grocery retailer is quickly retraining these new workers to support pick or pack operations for the delivery of online orders.

Keeping distribution-center workers healthy during the pandemic requires taking added and necessary precautions. Tactics include staggering shifts by short intervals, so that fewer people occupy locker rooms and break rooms at the same time, as well as installing partitions to separate workers physically. A retailer, for example, has been offering day-care benefits and one-time cash incentives and is staggering shifts to improve retention and reduce turnover during this critical period.

Maintaining good workplace hygiene is also important. Between shifts, retailers can suspend operations at their distribution centers so that cleaning crews can sanitize equipment. Health screenings can quickly identify workers who are sick. And all staff, whether long-term or temporary hires, should undergo training in proper health procedures and be given the right protective equipment. A leading mass retailer is working closely with its third-party logistics providers and staffing agencies to screen temporary workers

and accelerate hiring so that it can reduce the risk of infection and ensure the continuity of essential business operations.

Logistics: Balance agility and flexibility

Now more than ever, maintaining the flexibility of logistics is essential for limiting disruption to essential services. The surge in demand across nondiscretionary product categories is slowly eating away at excess capacity. In the United States, trucking demand increased by 150 percent, year over year, in March. Freight costs have also spiked, with double-digit percentage increases in spot rates from February to March. The outbound-tender rate-reject index, which measures adherence to contracted rates for shipping, has also increased by 20 percent, indicating that carriers are rejecting contracted rates and instead selling capacity on the spot market.

The best that retailers can hope for in this tightened environment is to secure enough capacity to get essential items on store shelves reliably and swiftly. This can take some creativity—not to mention additional expense. One strategy retailers are adopting is to have suppliers bypass distribution centers and ship goods directly to stores. They are also simplifying assortments and packaging, so that suppliers can make same-SKU full-pallet shipments to hub stores or distributor-consolidation facilities. This approach puts shipping speed ahead of product variety at a time when many consumers would rather have adequate supplies of key items than a wide assortment.

Some retailers of nondiscretionary goods are supplementing their transportation capacity by partnering with discretionary-goods retailers, whose private or dedicated fleets are likely to be underutilized because of lower sales volumes. There are several examples of cooperation across industries to get products on shelves, especially in high-density urban areas. A leading North American quick-service-restaurant chain has offered its transportation capacity to food banks and FDM retailers in key metropolitan areas to help

communities by assisting deliveries of essential items. In the United Kingdom, competition laws are being relaxed so that supermarket chains can cooperate and share transportation resources and depots—and get essential products on store shelves more readily.

Fulfillment: Deliver reliably

Self-isolation, quarantining, and stay-at-home orders during the coronavirus pandemic have all contributed to notable increases in online shopping and local deliveries for nondiscretionary goods. Bringing huge numbers of deliveries to consumers at their doorsteps and modifying retail locations to facilitate curbside pickups are no small changes.

We're seeing retailers of nondiscretionary goods make these changes more successfully by adhering to several practices. One is widening delivery windows from immediate or same-day to two or three days. This allows retailers to rationalize the scheduling and routing of deliveries, so that deliveries in the same area can be grouped together and sent out in one round of drop-offs by the same driver, saving time and mileage. This approach also gives retailers more flexibility, so they can sync order deliveries with the arrival of inventory shipments.

Another practice compensates for the decline in store traffic. By converting some outlets to "dark stores," where workers pick orders, retailers can make good use of their stores' on-shelf inventories and proximity to consumers. To meet the surge in demand, some grocery retailers are also hiring more full-service shoppers, temporarily shifting

in-store employees to delivery jobs, or expanding partnerships with gig-economy delivery services. In discretionary-goods categories, retailers are trying various delivery-related promotions to boost sales. One fashion retailer lowered the order size necessary to qualify for free shipments and relaxed return windows to give customers more flexibility.

Not all consumers necessarily want their goods delivered, so retailers must find ways of accommodating those who do visit stores. These approaches include capping purchases of highly sought-after items, reserving certain periods of the day for shoppers at greatest risk of infection, and cleaning and sanitizing stores frequently. Retailers must also protect their employees' health. That might call for shortening store hours to create enough time for thorough cleaning and giving workers extra training in how to avoid infection.

The coronavirus crisis is first and foremost a humanitarian crisis. Retailers have been making sure they are protecting their employees' lives and livelihoods. It's a tough challenge, but their priorities are clear. With creative, resourceful responses to the pandemic, retail-supply-chain leaders can make sure that consumers are able to buy the goods they need while also maintaining the health and safety of both consumers and supply-chain workers. Moreover, the lessons from this challenging time can help retailers make their supply chains more resilient. The next crisis might be no less surprising, but the right plans can keep it from causing as much disruption.

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