Retail Practice

The path forward for the US retail industry

What will it take for US retailers to succeed post-COVID-19? Three McKinsey partners offer their views.

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Today, months after COVID-19 first hit US shores, it's increasingly clear that most retailers won't be able to rely on their old strategies and business models to compete effectively in the next normal. In this episode of the *McKinsey on Consumer and Retail* podcast, McKinsey's Steven Begley, Becca Coggins, and Steve Noble consider how the US retail landscape has changed and what companies must do to thrive in the postpandemic world. An edited version of their conversation with McKinsey Global Publishing's Monica Toriello follows.

Monica Toriello: Hello, and thanks for joining us today. We're now three-quarters of the way through the year 2020, and it's been a year like no other for people and businesses all over the world. In this episode, we'll talk about one of the industries most greatly affected by the pandemic: the retail industry. We'll focus today's discussion on the US retail sector, but many of the lessons and imperatives we'll discuss apply to retailers all around the world.

Joining us to share their perspectives are three McKinsey partners who have worked extensively with retailers from every subsector, including grocery, restaurant, and fashion. They've each written several articles on the retail sector, which you can find on McKinsey.com. Recently, the three of them coauthored an article titled, "The next normal in retail: Charting a path forward." Let's meet our guests. First, we have Steven Begley, a partner in McKinsey's New Jersey office. Also joining us is Becca Coggins, a senior partner based in the Chicago office and a longtime leader of McKinsey's global Retail Practice. And finally, Steve Noble is a senior partner in Minneapolis who coleads McKinsey's global work in retail transformation.

To start, I'd like to ask each of you for a short answer to my first question. One of the things that McKinsey has been tracking and that you've all been writing about is the shifts in consumer behavior, which have become evident over the past few months. What's one way that your own shopping behavior has changed during this pandemic?

Becca Coggins: Monica, I might sound like a cliché. My shopping was already very heavily online. It has accelerated that way, but, like many Americans, what I buy has shifted a fair bit. I'm a bit of an apparel junkie, but that's taken a backseat to new hobbies, new things for the home, and things to keep the kids engaged around the house.

Steven Begley: My grocery experience has gone completely digital. And my grocery experience has actually accelerated. I live in Manhattan, and I didn't frequent grocery stores prior to the pandemic, but now I'm constantly purchasing groceries, and I only do it online. So it's a different experience for me.

Steve Noble: I'll break the rule of one thing, but I'll be brief. One, my front porch looks like a warehouse full of boxes each day, so lots of online shopping. I no longer buy pants; I buy a lot more wine instead.

The migration to e-commerce

Monica Toriello: You've all brought up the migration to e-commerce, which has been one of the biggest and most obvious shifts during this period. What has worked there, and what hasn't worked? In other words, as consumers have shifted more of their spending online, what are retailers getting right? And what are they still getting wrong?

Steve Noble: I've been impressed with how quickly retailers have adapted to this new way consumers are shopping—ramping up online and curbside delivery. I live in Minneapolis; Hy-Vee is one of the local grocers, and they've always had a curbside drive-through pickup. But that capability, as you might imagine, was quickly overwhelmed. While it wasn't pretty, I was impressed with how quickly they mobilized to create more scale. They basically cordoned off a section of the parking lot and set it up with refrigerated shipping containers. You place the order online, and you give them an indication of when you'll be coming. They don't give you a slot; rather, you give them a slot. You pull up, they load the groceries in the back of your vehicle, and you drive off.

It was a great experience, and I appreciated how quickly they adapted. I imagine that over time they will reimagine the look and feel of that experience. Because things, in many cases, were stood up so quickly, they weren't done initially with, "How do you create a great customer experience?" They were done with just, "How do you get the bare minimum in place?" Now there's an opportunity to continue to think about how to make some of those delivery or fulfillment models better, more sustainable, and more enduring customer experiences.

Becca Coggins: It almost makes me think we're in the foothills of what omnichannel-driven convenience will look like—and that there'll be some big innovations that scale now that consumer expectations have been reset. That's where we'll start to see some more innovative models and some more interesting partnerships—as players try to think about new ways to meet those needs.

If you look at how many more consumers are using e-commerce—such as using curbside pickup and buying online and picking up in store—most of them like it and plan to stick with it after the pandemic. So you have the consumer need. And retailers have done a good job of standing up things, as Steve said, to be able to meet that need. The next challenge is figuring out how to do it as a more seamless experience—in a way that's not temporary but that meets these emerging needs around convenience and speed, especially.

A 'shock to loyalty'

Monica Toriello: Becca, you mentioned that consumers plan to stick with behaviors they tried for the first time during the pandemic and that they liked. Another shift you describe in your article is the "shock to loyalty"—a greater willingness among consumers to switch brands and retailers. As you say in your article, "The beneficiaries of this shift include big brands, which are seeing 50 percent growth during the crisis," and private labels. "Some 80 percent of consumers who started buying private-label products during the pandemic indicate that they intend to continue doing so even after the COVID-19 crisis subsides." A couple of questions about that. First, should we believe consumers? Will they indeed stick with big brands and private labels postpandemic? And what are the implications for retailers?

Becca Coggins: What's interesting to us about this phenomenon is that it's not just brand switches, it's not just retail switches, it's not just channel switches. It's all of the above—to the point where three out of four Americans will change something meaningful about the way they shop, including relationships that were previously sticky and stable, like with your neighborhood grocery store, for example. Some of the examples you cited, Monica, are some of the ones that stick out. We expect these could still be dynamic—but on private label, for example, it's a bit unsurprising, given that consumers are focused on value, and they're buying more categories that are in essential consumption categories.

While some of these shocks to loyalty, whether it's the shift to larger brands or the one to private labels, started out of sheer availability—"I went to the store and didn't see the brand I typically buy, so I bought the alternative"—the reasons for the shift have started to evolve to reflect much more the shift around value and, on the retail side, where to actually get that omnichannel convenience you're looking for. So now it's all three of those things: availability, value, and convenience. We do tend to believe consumers. The private-label switch, for example, we've seen in prior recessionary periods pick up at about the same clip. Overall, the level of switching is something we haven't seen in this era, so probably it could moderate some. But consumers are satisfied, and they're continuing to shift some of those things.

The implications for retail are along the same lines of why consumers are switching. Are you providing available products, particularly in essential categories that are at the top of consumers' shopping lists? Are you providing everyday value? And are you providing the type of convenience that balances consumers' ability to get it when they need it but also in the mode that they want it—without having to navigate big crowded stores, et cetera? I think the implications are, very simply, how fast retailers can adapt to the new consumer reality, which is more focused on value and convenience than even before the COVID-19 crisis.

Monica Toriello: The migration to e-commerce is happening at the same time as another one of the shifts that you've just pointed out, which is a focus on essentials and value. Talk about what that means for omnichannel pricing. Steven, in an article you wrote in February, before the pandemic, you observed that, at least in grocery, some retailers had online price-matching policies, whereas others didn't: they had different prices online and in store. At the time, you said that the jury was out on which is the right approach. What's your latest thinking on pricing?

Steven Begley: What we're seeing is that retailers have had an opportunity to pull back on promotions as a result of the last couple of months because of the increased demand; consumers' willingness to pay has been a lot higher. Fundamentally what we're seeing, though, is at the end of the day, pricing is one of the top value drivers for why a consumer selects one retailer over another. Pricing will continue to be a core differentiator, a core pillar, in retailers' strategies going forward. We'll continue to see retailers experiment with the interplay between online versus offline pricing. But one thing we're pretty confident about is that price matching will continue to be something that most or all retailers do.

Going beyond incremental thinking

Monica Toriello: Let's talk about things that all retailers *should* do. In the article that the three of you coauthored, you name five critical areas for the next normal: revenue management, operating model, digital capabilities, capital investments, and M&A and partnerships. Those cover a lot of ground. Instead of elaborating on all five, I'd like each of you to pick one that you think retailers aren't paying enough attention to or somehow not adequately addressing. Out of those five, which one are retailers neglecting or overlooking?

Steve Noble: I'll start with revenue management. And I'd start with a perspective rooted in the financial crisis of 2008 and 2009. When we studied that crisis, we looked at what allowed some retailers to be resilient and come through relatively strongly. One of the big drivers of resiliency and success through that period of disruption and crisis was, "Did you focus sufficiently on driving the top line and on the consumer in your business?"

Many retailers had the reaction, "We need to look first, second, and third at cost and take out every bit of cost we can, given the pressure on our business." The retailers that were most successful certainly thought about cost—but they thought much more about, "How do we make sure we're delivering a great customer experience? How do we make sure we're driving the top line? How do we think through our pricing, our assortment, and our frontline sales model to deliver a great customer experience in the spirit of taking share?" If you then fast-forward to where we are today, much of the same will apply.

We're not saying, don't think about or take out costs where it's prudent. But our belief is that retailers that will come through this the most successfully are those that are thinking about all the potential revenue levers to drive their business and outcompete those they are positioned against. We of course know that some parts of retail are experiencing record growth and others are experiencing record decline, so this is not to say that everyone should be growing robustly. But it is a real time to outplay and go on the offensive relative to your competitive set—an approach that we believe will allow you to come out of this in a much better place in the long term.

Steven Begley: Monica, I'd say the five areas that we wrote about do cover, as you pointed out, a broad swath of capabilities across any retailer's business. Now is a great time to put everything on the table and rethink it from the perspective of transformation—whether it's finally pivoting your merchandising organization to be omnichannel and tech enabled or personalizing your customer experience to a level you've never seen before. Now is a good time to release those old constraints and prepare for the next normal.

That said, on the M&A point in particular, we tend to see a lot of M&A and partnership activity anytime an industry is disrupted, and we're certainly in one of those times right now. We expect to see a lot of the traditional consolidation plays that you typically see: optimizing for COGS [cost of goods sold] and SG&A [selling, general, and administrative] opportunities. But there's also a real uptick in channel expansion and making M&A or partnership plays that allow retailers to buy into new capabilities.

A good example of this would be in the fulfillment value chain. It'll be much easier and much more practical for folks to buy into some of these technologies—like microfulfillment, for example—versus trying to build them themselves. The same argument could be made for commercial analytics. For a lot of these advanced analytics algorithms that drive pricing and promotional decisions, it's going to be much easier and much more efficient from a capital standpoint to buy these capabilities and embed them in the organization versus trying to build them from scratch. I do think we'll see quite a bit of M&A and partnership activity, particularly on the capability-building front.

Becca Coggins: There is some good news, actually, on operating model, and I would start there. Many executives we talked to are, frankly, pleasantly surprised at how quickly and effectively their companies were able to pivot in the face of the biggest exogenous shock most of us will have seen in our careers. One of the examples I find inspiring is Best Buy. They stood up curbside pickup, when all of their stores were closed, in 48 hours nationwide. That process, for a retailer of that size and scale, would typically take several months of piloting to stand up and get the kinks out. But they had a high-quality, effective, customer-friendly solution available in a weekend.

The challenge side of that, and a place we think retailers need to be focused and introspective, is how to redesign the operating model to sustainably deliver these types of outcomes. That's true for speed, it's true for efficiency, and it's likely true for ensuring that the operating model is delivering on what we've already described as new or accelerated consumer preferences and behaviors. Have you sustainably redesigned for speed and for omnichannel and for efficiency so you can deliver the best value to your customers?

Steve Noble: I might just add a broader point that sits a level above the five specific topics we're talking about. In retail, prior to six months ago, the mindset of most retail executives would be, "if I have a business that's growing at a 2 percent same-store comp rate, and I can get that to 3 percent, I'm feeling pretty good. If my margin is 4.5 percent, and I can get that to 5 percent, I'm feeling pretty good." The notion of the industry is that it's a low-growth, low-margin business in general. That tends to foster incremental-type thinking: "I don't need to get a big bump to actually feel pretty good about my performance."

If you look at where things are now, what may have been a 2 percent or 3 percent comp-growth business is now up 20 percent or maybe down 20 percent. Likewise, margins are up and down dramatically. It is a good forcing function to break the mold of incremental thinking and rethink more fundamentally how you want to reach your customer. From stores versus online versus combined channels, how do you want to think about technology as a way to reimagine the customer experience and the labor and service model that you might be delivering? The amount of disruption happening right now does create some space to think pretty big and bold in a way that just wasn't quite as typical of retail historically.

The battle for talent

Monica Toriello: These areas that you've described all sound like they require new capabilities, especially in tech and digital and analytics—which leads me to a question about talent. Steven, again, in your February article, you say, "Digital talent may be the single-most-important determinant of a company's likelihood to succeed in the grocery market in the next few years." And that's probably even truer now, right? You had offered up some steps for retailers to take, such as hiring a chief digital officer, rethinking location strategies, and looking beyond brand-name universities. But can you talk about the battle for talent today and what retailers can do to become attractive employers for the kinds of talent they need?

Steven Begley: The battle for talent is real. And retail is not necessarily a sector that folks coming from data-science backgrounds and technology backgrounds would gravitate toward first. That said, we're seeing the disruption play out in a space where we're at just the beginning of the acceleration of many of the trends that we've talked about, so in terms of a sector that is primed for impact, retail is potentially the biggest one out there. What that means for retailers is, they need to be out in front of these populations of technologists and data scientists and statisticians and others, making the case for why retail is such an exciting place to be right now. I think all of us on this podcast would agree that it is.

We've seen a number of retailers shifting their digital businesses to more urban environments, trying to change their formats, and even changing the physical look and feel of their office structures to attract this type of talent. I think we'll see more of that and a continued pitch to the industry, so to speak, on why retail is such a great place to be.

Becca Coggins: Now is the time for retailers to get aggressive about winning the war for this talent. We're seeing, and will continue to see, a displacement of digital talent and analytics talent, certainly within the industry, where there's been momentum versus decline, but also within adjacent industries. You can imagine a pretty big influx of talent—analytical talent, especially—from sectors like travel and hospitality into retail, as well as across different subsectors of retail.

Steve Noble: I agree. The war for talent is real, and now is an important time to play it aggressively. It begs the question, what allows one retailer to differentiate itself from the next in terms of winning that war? Certainly, part of it is whether they are investing in things that are exciting, et cetera. But maybe more than ever, there's also a chance to see what a company's "DNA" is and what its values are.

The nature of the crisis we're in allows you to understand what different retailers think about caring for their people from a health-and-safety point of view. What do they think about creating flexibility for a workforce that may have kids schooling from home or family members who need to be cared for at home? What do they think about diversity and inclusion? There are a lot of different markers that we're seeing more acutely now that allow you to stare into the soul of the company a little bit. That will be probably as big a marker of which businesses win the war for talent as job descriptions and capabilities being built. Not to say those aren't important, but I do think the balance between those is probably different than it was six months ago as well.

Becca Coggins: Interestingly, customers are starting to pay a lot more attention to those same attributes: how a company treats its employees, what kind of diversity and inclusion policies they have, and how that shows up to the market. We'll start to see the whole ecosystem focus more on those things.

Steven Begley: One industry-wide example is that Eightfold AI and FMI, an industry association, came together to create something called the "Talent Exchange," which we supported. It essentially matched retailers that had employees who needed jobs with those that had opportunities for them. And when the COVID-19 crisis first hit in March and early April, it was impressive to see the speed at which those organizations came together to create the Talent Exchange and the speed at which retailers signed up to become a part of it. Companies like Macy's, Walmart, and United Airlines quickly came to the table to put opportunities into the exchange and also to create opportunities on the exchange. I thought that was a great example of the industry coming together quickly to do something good for the community.

Monica Toriello: It's been a tough year for many retailers, and it could be a long road to recovery. Last question: If a retail CEO says to you, "I want my company to thrive in the next normal. Give me your single-most-important piece of advice," what would you say?

Steven Begley: Chart out what your customers' demands are going to be three years from now, five years from now. Create that vision, get your organization aligned on it, and work back from there to figure out the costs, the implications, and the investments you need to make. Focus on who that customer is going to be, and plan from there.

Becca Coggins: I think the same thing. Follow the customer. Understand what you can do distinctively for them, and orient your business to be able to do that.

Steve Noble: Given the uncertainty and volatility in retail, you need to plan in short cycles: what's going to happen next week, next month, next quarter. But don't forget to also plan for two or three years out. How does your business look fundamentally different on the backside of this than it did prior to the pandemic, or even now? So it's that balance of being agile in the short term but also putting real thought into what comes out on the back end so you don't end up with an answer two years from now that's the amalgamation of a set of small choices. Instead, it's an intentional view of creating a much better and different business.

Monica Toriello: Great advice. Thanks for spending time with us today, and thanks to all our listeners. Join us again in a few weeks for the next episode of the *McKinsey on Consumer and Retail* podcast.

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