Retail speaks

Seven imperatives for the industry

RETAIL INDUSTRY LEADERS ASSOCIATION

Knowledge partner

McKinsey & Company

After a year like no other, the US retail industry faces a still-uncertain future. Our latest research highlights seven imperatives that will position retailers for success—regardless of what is next.

Every retailer, to some degree, has long had a sense of what the future of retail could look like: consumers shopping from anywhere at any time on their computers or mobile devices, stores morphing into showrooms or fulfillment centers, products being shipped for home delivery at ever-increasing speeds, and digitization everywhere. Some forward-thinking retailers started making big investments a few years ago to prepare for—and to help shape—such a future. Others took a wait-and-see stance, expecting the trends would take time to play out.

But the future came early. In March 2020, COVID-19 shut down retail locations across the country, forcing US consumers to change their buying behaviors. Trends that had been on a multiyear trajectory saw dramatic acceleration. For example, demand for buy online, pick up in store (BOPIS) has surged 40 percent since the start of the pandemic. Three out of every four US consumers tried new shopping channels. E-commerce volumes grew as much in the first quarter of 2020 as in the previous ten years.

Amid the unpredictability and the head-spinning pace of change, retailers mobilized—finding novel ways to continue to move products and serve

customers. The retail industry has seen more innovation in the past year than it did in the prior decade. When faced with lockdowns, an array of new health-and-safety regulations, and volatile consumer demand, the best retailers proved resilient and agile. The K-shaped recovery for the general economy—in which some parts bounced back more quickly while those at the bottom of the ladder struggled—applied to retail as well. The largest businesses had the resources to adapt and have pulled away from the rest: industry leaders are delivering two to three times the shareholder returns of their less-nimble competitors.

What has set the top performers apart? And how can retailers thrive in 2021 and beyond, even amid continuing uncertainty? The answers aren't trivial: as the nation's largest private-sector employer, the retail industry affects the lives and livelihoods of millions. In this report, we present research findings from the Retail Industry Leaders Association (RILA), with McKinsey & Company as a knowledge partner. Our analysis identified seven imperatives that can give retailers the ability to adapt to a changing consumer landscape while pursuing new opportunities.

About the research

The Retail Industry Leaders Association (RILA), with McKinsey & Company as a knowledge partner, conducted research on how retailers are approaching strategy and operations. Executives (such as CFOs, chief marketing officers, chief digital officers, and chief supply chain officers) at more than 30 US companies completed a benchmarking survey that covered more than 100

metrics and explored consumer outlook, digital acceleration, and future supply chain. The survey was augmented by in-depth interviews with top retail CEOs as well as proprietary McKinsey & Company customer research. The analyses and discussions identified the imperatives that will be critical to retail success now and in the future.

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Seven imperatives for rethinking retail

The changing competitive landscape will require retailers to pursue seven imperatives. The first four will be familiar to retailers, so the challenge will be to accelerate progress. The next three imperatives represent additional strategies and efforts that will be increasingly critical in the coming years. The ideal recipe will vary by retailer, so executives should review these imperatives based on their organization's starting point, their business strategy, and the approach that fits best with their brand's DNA.

Doubling down on consumer-driven commerce

1

Become omnipotent on omnichannel

Consumers will choose retailers based on ease and richness of end-to-end experience

2

This time (and all the time), it's personal

Consumers expect personalized experiences and offers as table stakes; most retailers fall short of these expectations today

3

Turbocharge delivery

As consumer expectations approach same day, stress on supply chain will mount

4

Take a stand or take a seat

Consumers are finally voting with their wallets for sustainability and broader purpose

Investing for growth

5

Recalibrate talent strategies

Winning the war for diverse talent, next-gen skills, and embracing a fluid workplace will give retailers a performance advantage

6

Pursue an eco(system)-friendly strategy

Winners will embrace the networked economy to win consumer mindshare and accelerate capabilities

7

Take productivity from foundational to transformational

Analytics and automation will enable the step change in productivity needed to fund the other imperatives

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Consumers are finally voting with their wallets for sustainability and broader purpose

To handle shifting consumer preferences and harness the power of digital technologies, leading retailers have increased their investments and capabilities in four areas. These imperatives aren't new: omnichannel experiences and personalization have been on retailers' radar for years. However, the seismic impact of the pandemic—and changing consumer preferences that will endure after it abates—requires retailers to redouble their efforts in these areas.

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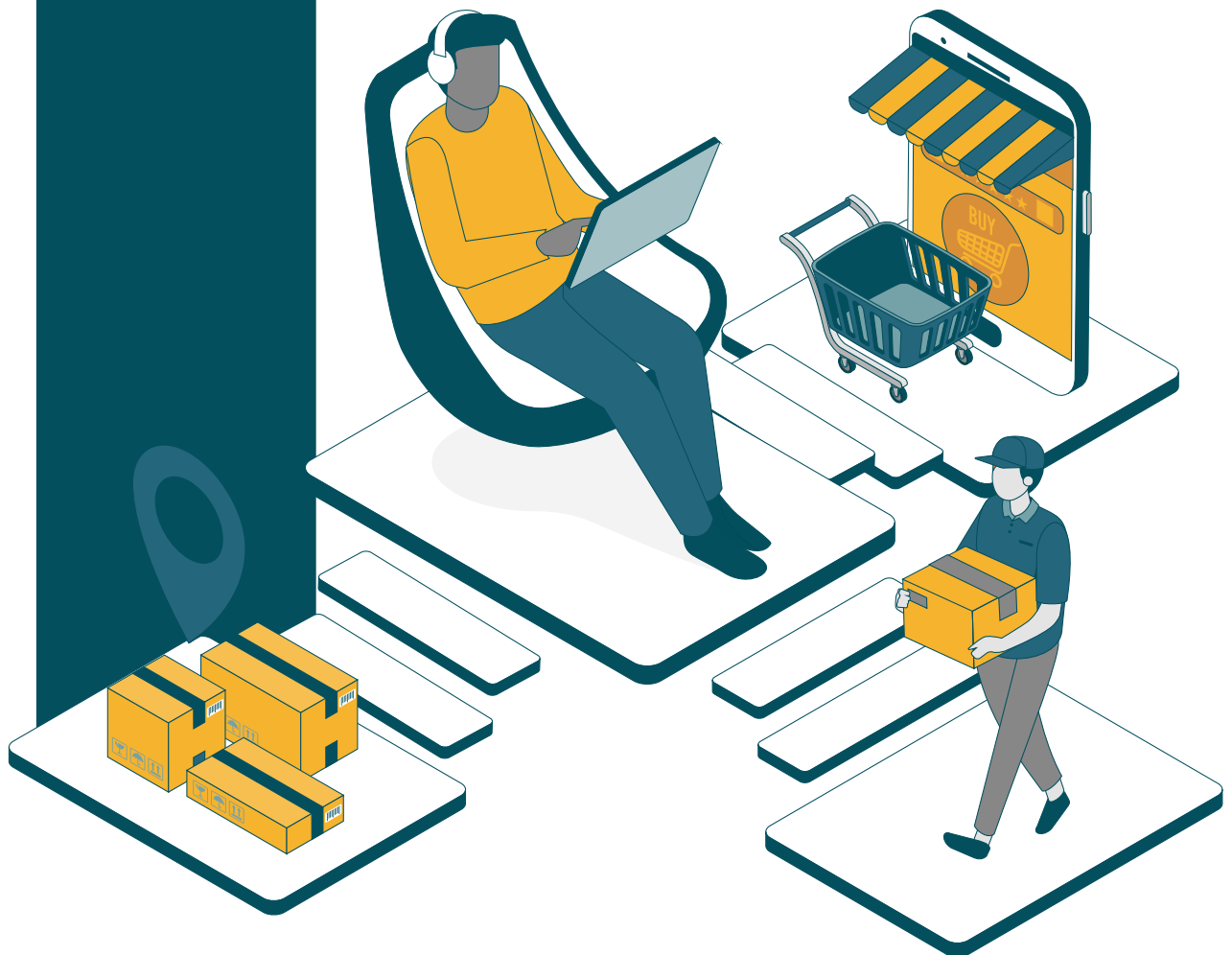
Two-thirds of survey respondents cited the growth of omnichannel and digital shopping as the most significant trend affecting the industry—and the greatest challenge. The growth of e-commerce and demands by consumers for seamless omnichannel experiences are here to stay. According to McKinsey consumer response research, consumers expect to continue making more purchases online after the pandemic than before it began. E-commerce is projected to reach 25 to 40 percent of sales across categories after the pandemic abates, with an increase of two times or more for sports and leisure and home improvement goods (Exhibit 1).
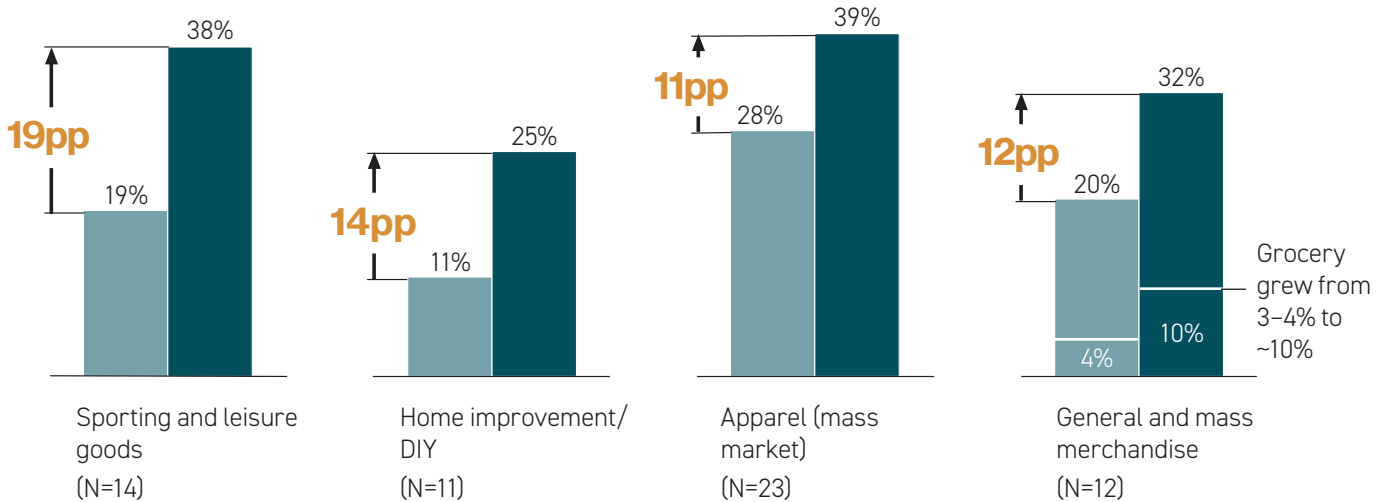
"For us, some e-commerce priorities that were previously five years out are now more of a three-year horizon. We need to more quickly understand how to satisfy that consumer and accelerate our timelines accordingly."

—Todd Vasos, CEO, Dollar General

Exhibit 1

Post-COVID-19 e-commerce penetration is expected to significantly increase to 25–40% across categories

E-commerce penetration in North America
% of total retail revenue

Pre-COVID-19   Post-COVID-19

19pp	**14pp**	**11pp**	**12pp**
19% → 38%	11% → 25%	28% → 39%	20% → 32%
Sporting and leisure goods (N=14)	Home improvement/DIY (N=11)	Apparel (mass market) (N=23)	General and mass merchandise (N=12)

General and mass merchandise: 4% → 10%; Grocery grew from 3–4% to ~10%

Q: Of total retail sales ($), what was the average e-commerce share at the retailers with which you are familiar pre-COVID? - Of total retail sales ($), what e-commerce share are you expecting at the retailers with which you are familiar post-COVID?

Source: Retail Professionals Survey, June 30–July 7, 2020, n = 50

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Understand the role of digital shifts on the customer journey

As consumers continue to embrace online channels, retailers need to understand the factors behind this shift in purchasing behavior, the different expectations that accompany it, and the impact on the omnichannel ecosystem. Today, such decisions are frequently made in a vacuum: 65 percent of retailers base store decisions on brick-and-mortar performance, with just 35 percent considering the impact of such moves on omnichannel. With the line blurring between digital and in-store purchases, a seamless omnichannel experience has evolved from a "nice to have" to a "must have." As Craig Menear, Chairman and CEO of The Home Depot noted, "Our digital platform is the front door of our store. Customers are taking us down that path—purchasing online and using online platforms as the start of the shopping experience, even if it ends in the physical world."

Upgrade e-commerce capabilities

To continuously and sustainably manage evolving digital demand and consumer expectations, retailers will need to upgrade their e-commerce capabilities along three dimensions:

- Develop inventory plans based on real-time digital and physical trends, not just historical performance.

- Adapt product assortment based on real-time trends and provide consumers with more transparency regarding availability.

- Iterate continuously through rapid testing (such as enhanced mobile shopping linked to nearby stores or partners).

Retailers have already begun to respond, especially on fulfillment of e-commerce orders. Nordstrom has now linked its digital and physical product offerings in its top ten markets to offer four times the selection available for next-day delivery while expanding pickup options for BOPIS to include their 249 Nordstrom Rack locations in addition to all 100 Nordstrom stores.

Nordstrom CEO Erik Nordstrom expects the unexpected, saying, "I can't imagine anybody knowing for sure what will happen in the future—the takeaway is that our businesses have to be agile and flexible."

Rethink the network as the role of the store blurs

Despite the growing demand for digital experiences, brick-and-mortar stores will not disappear. They will, however, take on new roles to better support an omnichannel retail strategy. When the pandemic limited in-store shopping, for instance, 44 percent of stores served partially or fully as fulfillment centers. By 2022, survey respondents expect that number to jump to 57 percent, with stores focused primarily on providing BOPIS and ship-from-store services.

Accordingly, IKEA has added fulfillment capabilities to all of its US stores to support click-and-collect services (or curbside pickup) and contactless delivery options. As Javier Quiñones, president and CSO at IKEA US, explained, "We are building a business model that will better meet the needs of consumers today and sets us up for success in the future. Having a strong fulfillment network is essential, which is why we accelerated the transformation of our stores to also support e-commerce with customer fulfillment. We are changing almost everything to ensure a seamless multichannel experience."

Dollar General has rapidly expanded its contactless shopping capabilities to respond to the spike in demand. The retailer combined the launch of its BOPIS initiative—in 17,000 stores in just nine months—with the rollout of an app with scan-and-go technology.

Dollar General CEO Todd Vasos said, "For us, some e-commerce priorities that were previously five years out are now more on a three-year horizon. We need to more quickly understand how to satisfy the consumer and accelerate our timelines accordingly."

"Both experiences and fulfillment are important uses for brick-and-mortar stores. We will continue to evolve the role of the store on our continued omnichannel strategy evolution."

—Mary Dillon, CEO, Ulta Beauty

How to get started

- **Determine where to play in omnichannel.** The opportunities in omnichannel are sprawling, so retailers must identify where to focus based on their DNA and the categories they play in.

- **Identify the unique value of each store.** A store can play multiple roles: fulfillment center, customer convenience, and experiential center. Retailers are starting to think of stores in the context of a market strategy rather than as a bunch of independent stores in a given market.

If you're on the journey, how to accelerate

- **Increase value at the store level.** Once retailers have determined the roles of stores and other facilities, they can then invest in technology, upskilling, and hiring to increase the performance of each link in the network.

- **Continue to invest in detailed, real-time customer analytics** to monitor and react to abrupt shifts in consumer demand. These insights can then be harnessed to optimize price and promotional investments or offer new, brand-relevant services to give consumers ongoing reasons to visit a store.

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This time (and all the time), it's personal

2

Consumers expect personalized experiences and offers as table stakes; most retailers fall short of these expectations today

The pandemic has weakened brand loyalty significantly: in 2020, 76 percent of consumers changed stores, brands, or channels. Personalization, supported by data and analytics, is a powerful tool to strengthen the connection to the brand, win consumer loyalty, and draw customers into stores. Retailers that excel in personalization have boosted revenues, reduced marketing costs, and increased both customer acquisition and satisfaction (Exhibit 2). Yet research has revealed that most retailers are early in their personalization journey. While 100 percent of top-quartile[1] retailers cited omnichannel personalization as a top-five priority, only 15 percent of retailers have fully implemented personalization across all channels.

To successfully implement omnichannel personalization, retailers will need to focus on several areas. They should coordinate corporate efforts with store teams to ensure store operations and frontline associate teams master new tools and engage with customers in a personalized way. Cross-channel activities should be integrated by linking the often siloed in-store systems and marketing technology stack. In addition, retailers will need to work to change customer behavior by integrating personalization into the in-store experience and encouraging customers to "opt in" by downloading and engaging with an app, interacting with a screen, or sharing information with an associate in a live interaction. Last, measurement

capabilities can be built by developing a methodology to interpret and make decisions on omnichannel tests. Some of these efforts may start small, but retailers should launch them with a long-term vision of omnichannel personalization at scale in mind.

Retailers should look to implement omnichannel personalization at each step of the end-to-end shopping experience—previsit, during the store visit, and postvisit. Doing so has the potential to increase traffic, conversion, basket size, and retention.

To capture the potential of omnichannel personalization, leading retailers are making investments in the sophisticated, largely digital capabilities needed to

While personalization is a top priority, only 15% of retailers have fully implemented personalization across all channels.
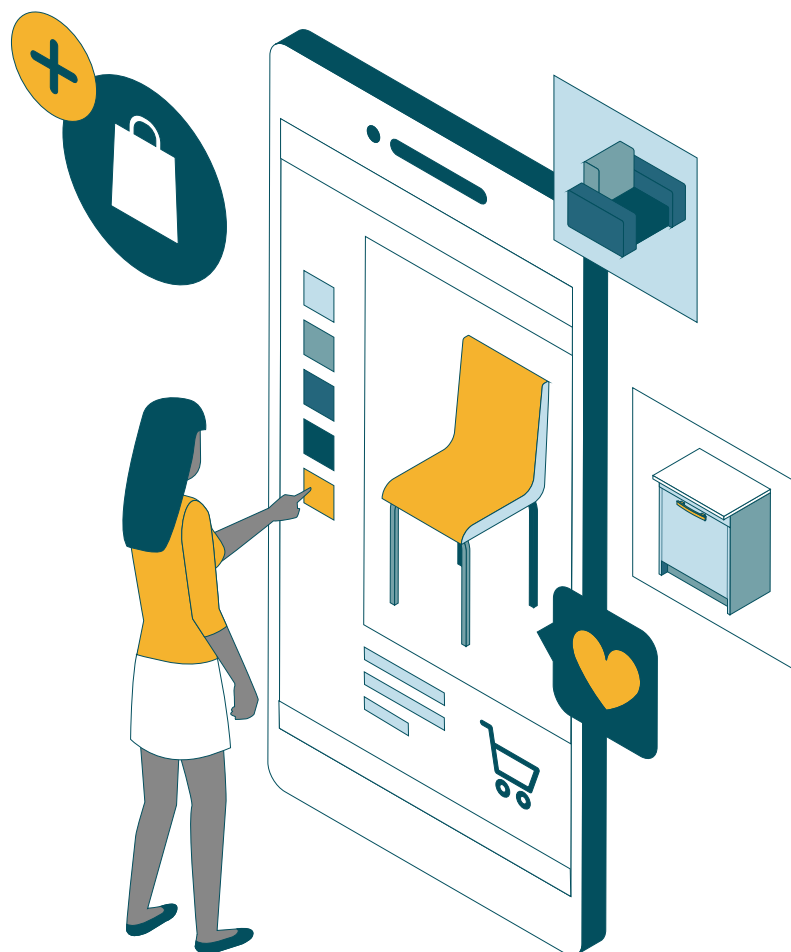
1Top-quartile retailers defined by those in the top quartile of revenue growth from 2019 to 2020.

Exhibit 2

Omnichannel personalization is increasingly becoming table stakes

Why personalization must be a top priority:

10–15%
uplift potential in
revenue and retention

10–30%
more efficient marketing
and cost savings

3–5%
increased customer
acquisition

5–10%
higher satisfaction
and engagement

… yet only 15% of marketers say they have fully implemented personalized marketing

For most retailers, the consumer's offline journey is not personalized: data is captured only at point of sale vs throughout the customer journey.

This is a missed opportunity for many at a time when ~76% of consumers have changed stores, brands, or the way they shop and consumer loyalty has been shaken up during the pandemic.

Source: McKinsey omnichannel personalization research, 2019

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create distinctive customer experiences. A critical element of personalization is building better data and insights on customers, an asset that also generates additional value across the value chain. Targeted ads based on previous purchases highlight products that will help customers continue or complete current projects.

To keep up with the growing preference for online showings, IKEA is experimenting with 3D home design and investing in augmented-reality technology that enables customers to test design choices using their phone. In November 2020, Walgreens launched a reinvented loyalty program with a

redesigned mobile app for health and wellness items. Customers can now pick up orders in-store, curbside, or through their local pharmacy's drive-thru.

Ulta Beauty is using digital tools such as GLAMlab, its virtual try-on feature. In 2020, the company increased the number of SKUs available via the tool by more than 550 percent. Since the COVID-19 crisis began, guest engagement with GLAMlab has increased meaningfully, with product views rising 12-fold in 2020.

Our research suggests the ROI for personalization will quickly outpace that of traditional mass marketing. At Modern Retail Collective, McKinsey's concept store at the Mall of America, collecting

an email address linked to a personal profile was worth 2.5 times the average sale.

Of course, personalization efforts must balance potential legal and reputational risks around personalization by, for example, prioritizing data privacy and the prudent use of technologies such as facial recognition. While data privacy requirements continue to evolve, retailers can benefit from a proactive approach that moves beyond compliance to opportunity, reinforcing customer trust.

How to get started

- **Define the right moments in the customer journey** where you can provide the greatest benefit. When communicating with the customer in these moments, consider how digital and physical channels can best reinforce each other.

- **Evaluate technology options** that balance level of investment and high fidelity. For instance, could an iPad on a stand or another low-cost option sufficiently digitize elements of the in-person experience? Investment at scale will require a clear business case and proven ROI.

- **Stand up lean pilots with cross-functional teams** that obsess over the consumer, integrate and analyze data, and test and learn rapidly. This approach can scale new experiences ten times faster than traditional in-store initiatives.

- **Coordinate corporate efforts with store teams** to ensure frontline sales associates master new tools and engage with customers in a personalized way. Success will require retailers to enhance training programs, reimagine incentives, and evolve the store operating model.

- **Get customer feedback rapidly and iterate.** By using analytics on consumer reviews and returns data, and incorporating input from in-store interactions between sales associates and consumers, retailers can create an army of brand champions to guide continuous improvement.

If you're on the journey, how to accelerate

- **Double down on measurement methodologies** to inform decision making. These insights allow retailers to track and tie online and offline behavior and estimate incremental revenues for potential customers.

- **Expand to the upper and lower parts of the funnel.** Retailers can improve connection to consumers by investing in product and service discovery based on consumer preferences. These insights will inform assortment decisions—focusing on fewer quality products that meet consumers' needs, rather than offering hundreds of products and hoping one sticks.

- **Solicit crew and customer feedback actively** to generate new ideas and improve the customer journey.

3

Turbocharge delivery

As consumer expectations approach same day, stress on supply chain will mount

The pandemic has elevated the importance of order fulfillment—specifically, the speed at which retailers can deliver goods. Since the definition of warp speed looks quite different by category, retailers must understand customer expectations and then carve out a distinct value proposition. For example, we have seen a divergence between the strategies of specialty retailers and grocery and hypermarket retailers.

Retailers expect dramatic changes in customer expectations for delivery over the next three years. The vast majority of consumers—over 90 percent—see two to three days as the baseline, and 30 percent expect same-day delivery. Targets vary by retail category: two or three days for specialty, same day for grocery, and within the hour for prepared foods.

In response, retailers are setting ambitious targets for delivery times that will require significant investments to propel their supply chain fulfillment capabilities. More than 75 percent of the specialty retail supply chain leaders in our sample have made two-day delivery a priority, and 42 percent hope to offer same-day delivery by 2022. Meeting these goals will require trimming at least two to three days from today's delivery times.

Exhibit 3

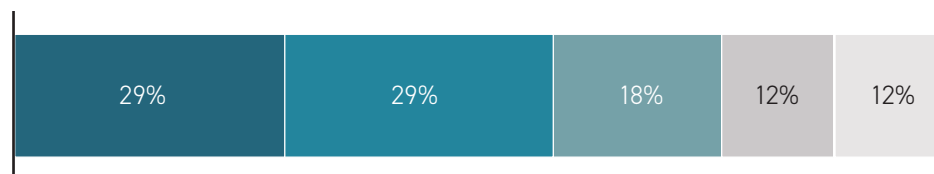**Retailers are investing in improving delivery speeds, recognizing that it provides a distinct competitive advantage**

2020 consumer delivery speed expectations
% of total[2]

6%	65%		12%	6%	12%

Legend: 4–7 days · 2–3 days · Next day · Same day · 2–6 hours · <2 hours
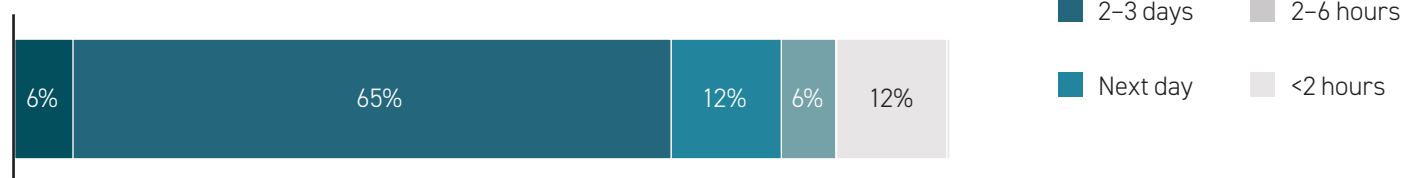
2022 retailer delivery speed goals
% of total

29%	29%	18%	12%	12%

More than 75% of specialty retail supply chain leaders have made two-day delivery a priority, and 42% hope to offer same-day delivery by 2022.

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

Grocery and hypermarket retailers are eyeing similar investments in supply chain capabilities to keep up with shifting consumer preferences. E-commerce penetration in grocery, which increased from 4 percent in 2019 to 10 percent in 2020, is expected to rise to 30 percent by 2024. Many grocery retailers already have established partnerships with marketplace providers such as DoorDash, Instacart, and Uber to enable delivery within a matter of hours. In addition, grocers are devoting millions of dollars to upgrade their own fulfillment capabilities through the adoption of robotic-process-automation (RPA) technologies.

Our survey found that 80 percent of retailers plan to concentrate their 2022 supply chain spending on addressing the constant demands on e-commerce fulfillment. Automating warehouse roles is the top digitization and automation priority for 64 percent of retailers. These expectations add tremendous pressure on already lean supply chains, and these initiatives could add 50 to 200 basis points on a retailer's profit and loss (P&L). Although such investments could have a detrimental impact on profitability in the near term, they nevertheless set up retailers for success in the longer term.

Delivering at warp speed will require several changes. Most retailers will need to build, buy, or borrow the requisite capabilities to expedite delivery and give customers more visibility into timing, as several leading retailers have done. For example:

- Target acquired Shipt in 2017 and built a network of hundreds of thousands of personal shoppers who pick up goods at Target or other retailers and deliver them to a consumer's home, usually within two hours.

- Ahold Delhaize acquired a majority stake in online pioneer FreshDirect to augment its direct-to-delivery capabilities in pure-play grocery e-commerce.

- Fashion retailers such as Decathlon and Gap are accelerating investment in RPA to speed order processing times, count inventory, and improve overall warehouse productivity for e-commerce orders.

- Grocers and hypermarket retailers such as Albertsons and Walmart are investing in partnerships with microfulfillment providers to regionalize their inventory in urban areas.

Retailers that fail to upgrade their fulfillment models run the real risk of their supply chain adversely affecting P&L. However, meeting rising consumer expectations for speedy delivery and achieving ambitious targets will require executives to rethink and invest in the supply chain.
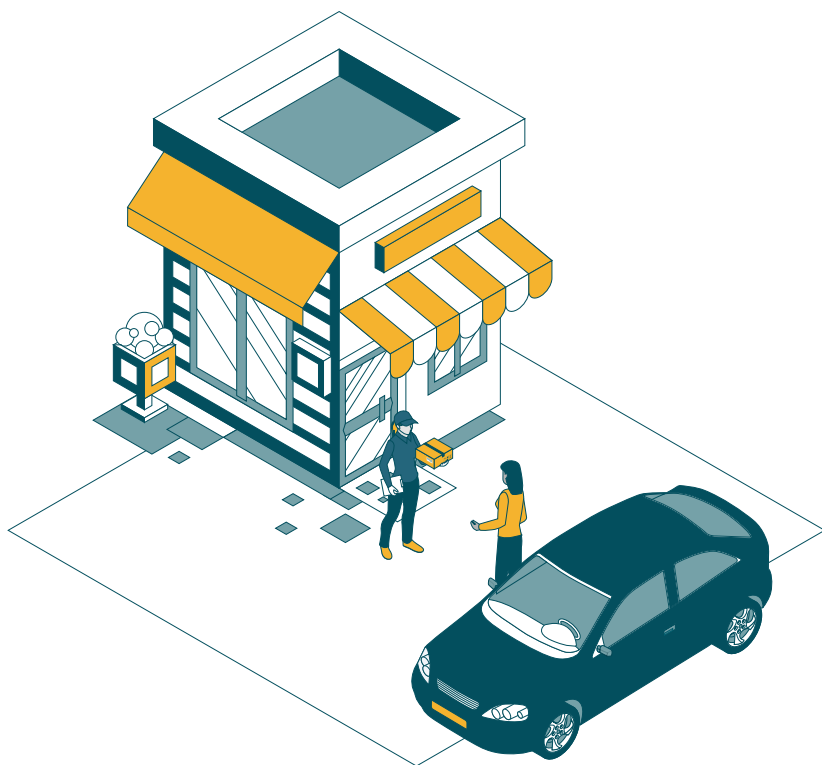

80% of retailers plan to concentrate their 2022 supply chain spending on addressing e-commerce fulfillment.

How to get started

- **Identify the customer's "North Star."** Listen to the voice of the customer (VoC) to calibrate and tailor offerings based on segment and willingness to pay. Service levels can be tiered and personalized based on customer requirements, geography, category, and brand, with VoC informing delivery times and openness to subscription models.

- **Quantify the business case and create the road map.** Understand both the strategic and financial considerations associated with building the requisite capabilities required to deliver to customers' "North Star" expectations. These capabilities include investing in people, process, and technology enablers and building a cross-functional road map.

If you're on the journey, how to accelerate

- **Build a fit-for-purpose network.** Rethink the end-to-end network, including the role of distribution centers and stores, to balance speed, flexibility, reliability, cost, capital, and supply chain risk.

- **Foster ecosystem collaboration.** Partner with marketplace providers and suppliers to build flexibility across the network and improve service.
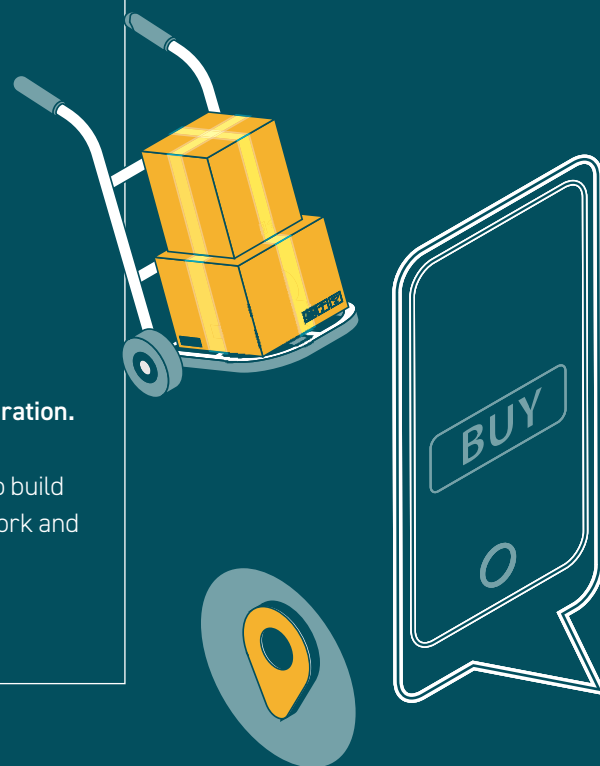
NOTIFICATION

Company pledges to …

Take a stand or take a seat

Consumers are finally voting with their wallets for sustainability and broader purpose

Over the past year, social justice has dominated the national conversation and pervaded the private sector. Environmental, social, and governance (ESG) factors became increasingly important in 2020, bringing other trends into sharp relief. Consumers are holding companies accountable for their actions to a greater degree and now expect businesses to actively support ESG principles. Although our research survey did not include questions about ESG principles, all of the CEOs we interviewed raised unprompted the importance of consumer sentiment and the scrutiny on values and corporate social responsibility.

As Javier Quiñones, president and CSO at IKEA US, noted, "Being a purpose-led brand starts with the 'why' behind what we are doing. For IKEA, it always comes back to our mission to make life better for people, and that's not just our customers but society as a whole. People will not only buy from but also buy into brands that stand up for their values."

Consumers, particularly millennials and Gen Zers, are indeed voting with their wallets, rewarding companies that have a clear purpose and adhere to ESG principles (Exhibit 4). One-third of survey respondents[3] reported they had stopped using a brand based on its social actions, and 71 percent indicated they would lose trust in a brand forever if it placed profits over people. At the same time, consumers are willing to pay more for products that meet their values.

"Being a purpose-led brand always starts with the 'why' behind what we are doing. People will not only buy from but also buy into brands that stand up for their values."

—Javier Quiñones, President and CSO, IKEA US.

3 "E2020 Edelman Trust Barometer Spring Update," Edelman, May 2020, McKinsey Consumer Survey.

Exhibit 4

There is growing evidence that consumers are aligning their purchasing power with businesses' societal commitments

Consumer expectations around societal contributions of businesses have risen …

33%
stopped using a **brand** based on its social actions

71%
will **lose trust in a brand forever** if it places profit over people

57%
believe companies need to **redefine their purpose** to fight the pandemic

62%
believe business is putting **profits before people**

80%
of **Gen Z refuse to buy goods** from companies involved in societal scandals
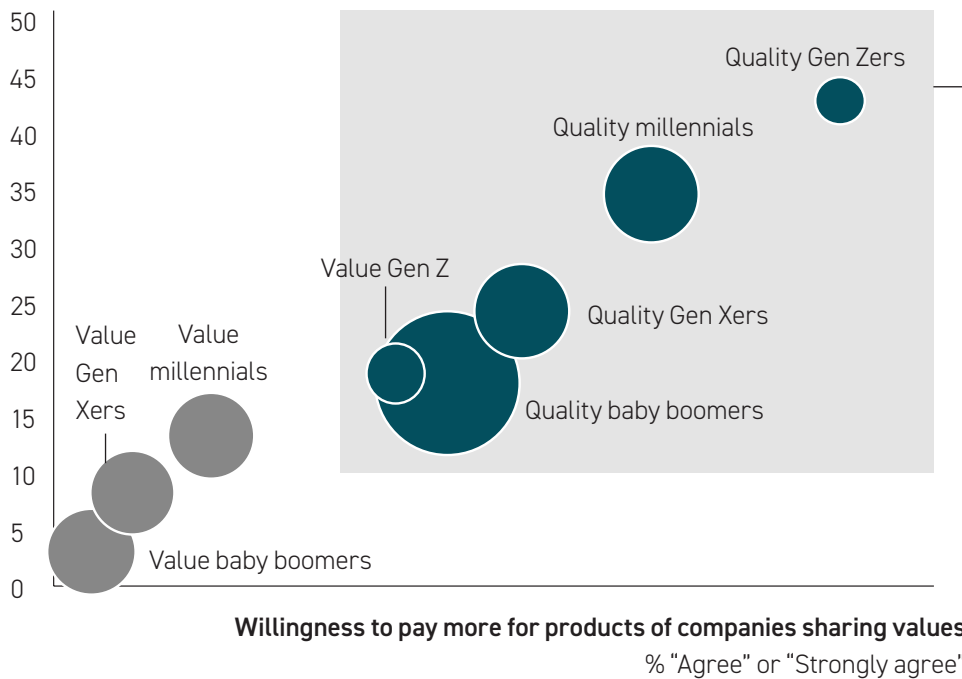
… and consumers are willing to pay more for products that meet their values

Pay more for products with least negative impact on environment
% "Agree" or "Strongly agree"

⬤ Size of spend

Consumers, especially Gen Zers, are **willing to pay more for products that support their values** and have less negative impact on the environment

Willingness to pay more for products of companies sharing values
% "Agree" or "Strongly agree"

Source: 2020 Edelman Trust Barometer Spring Update; McKinsey consumer survey

Beyond consumers, a broader set of stakeholders (including employees, investors, and board members) are applying pressure to companies.

- Employees are the top nonfinancial topic discussed in board meetings, and they are banding together to ensure leadership is aware of their views. For example, Amazon and Google workers walked off the job to draw attention to their demands on climate change. Some retailers have taken steps to provide more support and development opportunities for employees—Bed Bath & Beyond has raised starting wages, and Walmart, which has also boosted its wages, established ambitious reskilling programs to help workers advance in their careers.

- The biggest institutional investors in the retail industry (such as BlackRock and State Street) are including ESG as priority elements of their investment criteria, with one-third of assets under management allocated based on ESG considerations.[4]

During the past five years, products marketed for their sustainability accounted for just 16 percent of the consumer-packaged-goods (CPG) market but generated 55 percent of the total growth. According to McKinsey research, 70 percent of consumers will pay a premium of more than 5 percent for a green product as long as its quality matches that of a nongreen alternative.

Retailers understand the link between "doing good" and bottom-line impact. Most (80 percent) believe that company actions matter to consumers, and 64 percent believe those actions affect purchase decisions.

Accordingly, leading brands are setting increasingly aggressive ESG goals.

As Alex Gourlay, Co-COO of Walgreens Boots Alliance, observed, "Corporate social responsibility covers a huge range of business activities and has now come of age. Companies now really do walk the walk in their commitment to the communities they serve, the environment, and their people; and take steps to monitor and evaluate their performance and achievements in those areas. This is now a function that is at the heart of every business."

Regarding the environment, Microsoft pledged in 2020 to go carbon positive by 2050 by removing more greenhouse gases (GHG) from the atmosphere than the company has created since 1975. Walmart reinvented supply chain decarbonization and formed industry groups such as the Rainforest Alliance for coffee.

Similarly, Giant Eagle announced a goal of being free of single-use plastics in its operations by 2025 and eliminating single-use plastic bags from all stores. In February 2021, VF Corporation announced its goal to eliminate all single-use plastic packaging, including poly bags, by 2025. Best Buy signed the Climate Pledge, with the goal of being carbon neutral across its business by 2040—a decade earlier than its previous goal of 2050—and offering products to help customers reduce emissions 20 percent by 2030.

Starbucks signaled its commitment to social causes by extending benefits such as upskilling and improved access to higher education, mental health support, and healthcare to part-time employees.

80% of retailers believe company actions matter to consumers, and 64% believe those actions affect purchase decisions.

4 *Report on US Sustainable and Impact Investing Trends 2020,* US SIF Foundation, www.ussif.org.

How to get started

- **Develop a credible purpose story and ESG priorities,** backed by societal commitments across ESG pillars and diversity, equity, and inclusion (DE&I) initiatives to improve the internal work environment, ensure pay equity, and create equitable products. The combination ensures that a company focuses its ESG efforts on areas where it can be distinctive.

- **Take a proactive stand on issues by** tailoring external engagement and communications to highlight the company's values. For example, after the George Floyd protests in 2020, 32 percent of Fortune 1000 companies made statements and collectively promised $64 billion to advance racial equity. Taking a stand will be credible only if backed with real commitments from the organization.

If you're on the journey, how to accelerate

- **Measure the impact of doing good** by setting performance targets and defining metrics aligned with purpose goals (for example, DE&I targets, GHG reduction targets, or number of new purpose-driven products).

- **Establish bold, measurable ESG goals** to guide the company and track progress. Some companies have tied progress to executive compensation—for example, Starbucks and Sodexo on DE&I, and Danone on climate change.

RETAIL INDUSTRY LEADERS ASSOCIATION

Knowledge partner
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Investing for growth

5 Recalibrate talent strategies

Winning the war for diverse talent, next-gen skills, and embracing a fluid workplace will give retailers a performance advantage

The pandemic reinforced that the competitive landscape can change nearly overnight. Therefore, retailers will need to build new capabilities to ensure they can adapt, with a focus on tech-based abilities and strategies. Three imperatives hold the key.

6 Pursue an eco(system)-friendly strategy

Winners will embrace the networked economy to win consumer mindshare and accelerate capabilities

7 Take productivity from foundational to transformational

Analytics and automation will enable the step change in productivity needed to fund the other imperatives

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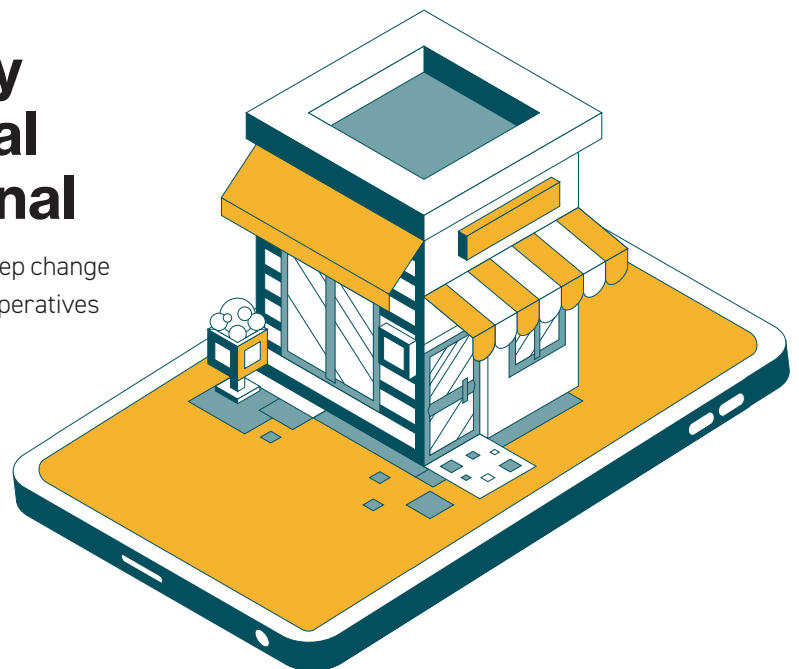
Recalibrate talent strategies

Winning the war for diverse talent, next-gen skills, and embracing a fluid workplace will give retailers a performance advantage

Retailers are short the workforce and capabilities to succeed in the digital-dominated world. To close the skills gap, companies will need to reimagine their strategies for sourcing and deploying talent. Four key themes have emerged.

Elevate your game on next-generation talent

Retailers recognize the magnitude of the gap in digital talent and are planning to increase their digital full-time equivalents (FTEs) by more than 50 percent. Even that rise will be insufficient, meaning that retailers will need to continue to redouble their efforts as the world becomes more analytics-driven.

As retailers evaluate their hiring, development, and retention efforts for digital talent, they should explore the following actions:

- Identify the capabilities and roles required to execute their omnichannel strategies (including deciding whether to make roles domain-specific).

- Reimagine the organizational blueprint and ways of working.

- Build and sustain a culture that can support in-person and virtual work and evolve to support employees.

Acknowledge a more remote world

The quick move to remote work during the pandemic has greatly expanded the available talent pool for retailers. If proximity is no longer a prerequisite, they are in a position to upgrade key positions. When considering remote options, retailers must assess which roles work well in a remote location or office; the importance of human and physical interaction is one important lens. Retailers will need to find ways to access remote talent pools while still maintaining the company culture.

Industry leaders are revisiting their location strategies to help them attract and retain the right talent.

- REI sold its Washington State campus in August 2020 and replaced it with distributed coworking spaces.

- Dollar General is reevaluating its approach to remote work and a return to headquarters. Early in the pandemic, its leaders examined the mix of remote and on-site workers that would make the most sense in a post-pandemic world rather than simply bringing everybody back as soon as it was safe to do so.

- Walmart plans to keep thousands of tech employees working from home postpandemic and reserve office space "primarily for collaboration, to sync up and strengthen camaraderie."

Embed flexibility into the workforce

Retailers can significantly expand their talent pools for hourly and frontline associates by tapping into on-demand labor models such as the gig economy. This independent workforce is large—68 million people, or 27 percent of the US working-age population—and is expected to account for the majority of the workforce by 2027. During the next three years, 70 percent of survey respondents plan to rely more heavily on flexible labor. Industry leaders are already forging partnerships with new marketplaces:

- Walmart partnered with Handy to bring Handy's installation and assembly services to more than 2,000 of its 5,000 US stores.

- Meijer engaged Hyer to help meet its workforce needs in real time across the supply chain, from distribution centers to in-store needs, to manage rapid changes in demand.
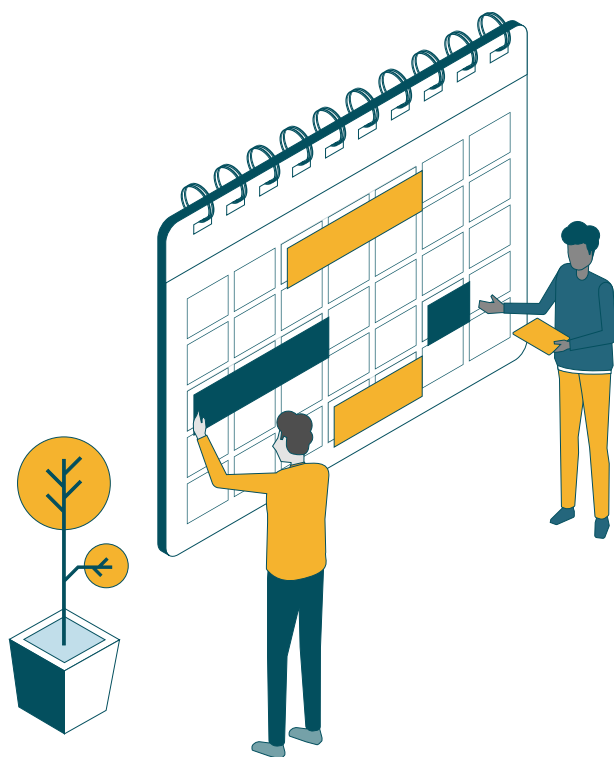
- IKEA acquired TaskRabbit in 2017, accessing its more than 60,000 independent workers to help customers pick up, assemble, and install IKEA products.

- ShopRunner partnered with a number of apparel and skin-care retailers, such as American Eagle, Bloomingdale's, Kiehl's, and Under Armour, for last-mile delivery.

However, this flexibility comes with risks, including an erosion of brand identity and company culture, legal and regulatory issues, and an uneven customer experience. Retailers that go down this road must consider the uncertainty and potential drawbacks and implement the appropriate quality-assurance and culture initiatives. Notably, using a flexible workforce doesn't alleviate the need to invest in reskilling in-store and other workers to adapt to a new omnichannel strategy; in some circumstances it can further complicate the training picture.

Build a diverse workforce

Diversity and inclusion (D&I) looms especially large in the consumer-facing retail industry. Missteps at any of its many customer touchpoints can seriously damage corporate reputation and sales, as demonstrated by the willingness of three-quarters of Generation Z consumers to abandon companies that run ad campaigns seen as misogynistic, racist, or homophobic.

Leading retailers are making commitments to increase workforce diversity and reflect the country's diversity with the products they sell.

- Gap pledged to double the number of its Black and Hispanic/Latino employees by 2025.

- Target announced plans to increase representation of Black team members across the company by 20 percent over the next three years.

- Ulta Beauty has committed to doubling the Black-owned brands in its assortment by the end of 2021, stepped up employee training to make stores more welcoming for all customers, and doubled D&I trainings across the enterprise.

But increasing diversity in the retail industry will be challenging. COVID-19 has accelerated the industry's use of automation and artificial intelligence (AI), and these advanced technologies bring the threat of workforce displacement. In addition, more diverse talent pools can lack access to employer-sponsored upskilling, external certification programs, and technology needed to ensure their qualifications are in line with job opportunities in an evolving job market.[5]

Retailers committed to strengthening D&I in their talent strategies will need to understand their starting points by analyzing data and the voices of employees and customers to see how their companies perform on role and location metrics and reviewing core processes to locate risks and biases (for example, hiring and selling practices). They must also balance short-term initiatives and longer-term programs—for example, engaging store managers and associates in developing action plans, holding managers accountable for making store operations more inclusive, and establishing collaborative partnerships with external resources (such as Target with the Hispanic Association on Corporate Responsibility).

5 Bryan Hancock, James Manyika, Monne Williams, Jackie Wong, and Lareina Yee, "Race in the workplace: The Black experience in the US private sector," February 21, 2021, McKinsey.com; Kelemwork Cook, Duwain Pinder, Shelley Stewart, Amaka Uchegbu, and Jason Wright, "The future of work in Black America," October 4, 2019, McKinsey.com.

How to get started

- **Develop a road map to close major talent gaps.** It should include clear metrics to ensure accountability and transparency and an execution plan.

- **Provide attractive development opportunities,** clear career paths, and competitive salaries and benefits (even for part-time employees) on par with top tech competitors.

- **Define and commit to a bold D&I aspiration,** both internally and externally.

If you're on the journey, how to accelerate

- **Build capabilities that provide access to upskilling opportunities** and technical development for the existing workforce while preparing employees for an influx of external hires.

- **Consider how (or if) your organization could take advantage of on-demand labor models** and remote working to augment full-time, in-house staff.
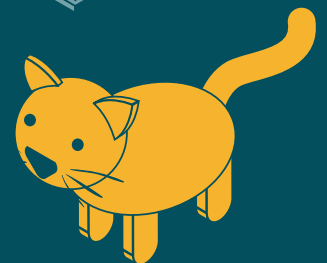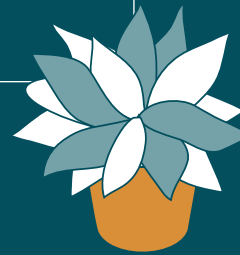
Pursue an eco(system)-friendly strategy

6

Winners will embrace the networked economy to win consumer mindshare and accelerate capabilities

Six of the seven global companies with the highest market caps participate in ecosystems—interconnected sets of services that enable users to fulfill a range of needs in one integrated experience. We expect the development of ecosystems, especially those convened by retailers, to accelerate. McKinsey analysis suggests that ecosystems across a dozen sectors will collectively function as a $60 trillion economy by 2025.[6] That makes developing an ecosystem strategy an imperative for survival: even if retailers aren't positioned to establish their own ecosystem, they will have to figure out how to compete, participate, or coexist.

Our research identified five platform archetypes, which vary based on where they focus in the value chain (Exhibit 5). Further, some industries are a more natural fit for certain archetypes. A retailer considering an ecosystem position must define the role it is well suited to play based on its business strategy, ambition, risk appetite, financial resources, and existing capabilities.

6 of the 7 global companies with the highest market caps participate in ecosystems.

Exhibit 5

There are five platform archetypes to win in an ecosystem

		Description	Types	Depth of value creation					
				Content and listings	Lead gene-ration	Con-version	Transac-tions and payments	Fulfill-ment	After-sales
1	Aggregator	Present information from various suppliers in a consolidated view to the end customer	Media and content Products or services Search		○→				
2	E-commerce	Fulfill classic retail function digitally and offer value-added services to suppliers	Single vertical (food, fashion, and electronics) Multivertical (eg, department stores) Niche vertical (eg, razor blades)	○	○	○	○	○	→
3	Marketplace	Connect customers to third parties in a single integrated customer experience	Managed vs unmanaged Horizontal, single vertical, multivertical		○	○	○	○	→
4	Super app	Consolidate multiple apps and functionalities into one overarching and ever-expanding app	Inter-ecosystem Intra-ecosystem		○	○	○	○	○→
5	Service provider	Provide critical functions to the platforms and the overarching ecosystem	Manufacturing Marketing and sales Payments and fulfillment Aftersales	○→	○	○	○	○	○

Source: McKinsey; Web research

6 Violet Chung, Miklós Dietz, Istvan Rab, and Zac Townsend, "Ecosystem 2.0: Climbing to the next level," September 11, 2020, McKinsey.com.

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Companies that participate in ecosystems shift from operating "pipeline businesses" (creating products and services that meet specific customer needs) to operating "platform businesses" (matching customers with exchanges of goods, services, and social currency). Ecosystems enable large-scale automation and collect massive amounts of valuable information, ranging from logistics data to behavioral data. By developing an ecosystem, traditional retailers have the potential to transform and leapfrog the competition, counter challenges from digital rivals, and engage with customers in new ways.

The leading Chinese retailer Suning is a case in point. In the late 1990s, Suning achieved offline market leadership in home appliances. From 2010 to 2015, Suning established and scaled an online presence and began building an e-commerce ecosystem with expanded categories (grocery, books, and apparel) and a marketplace model that attracted third-party merchants. By 2019, Suning qualified as a full-category omnichannel retailer.

Among US retailers, Amazon has excelled in using the ecosystem approach to diversify its business by building an ever-expanding, self-reinforcing network of businesses, including retail, cloud computing, devices, advertising, logistics, finance and payments, healthcare, and more. Amazon famously started as a bookseller, became a market leader in cloud services and advertising (the third largest for digital), and is now attempting to do the same for healthcare and pharmaceuticals. The company continues to see a gap, fill the need,

create new products, and expand as an ecosystem.

Other retailers are following suit. Mass retailers now all have marketplaces, which will give them a captive audience for the suite of services they are rolling out, as well as the scale to expand. In recent years, Target has been on a path to transform itself from a pipeline to platform business through a stores-as-hubs strategy that places stores at the center of its omnichannel platform. Target has made significant strides in building out its media network (Roundel), investments in delivery capabilities and technologies (Shipt, Deliv), and partnerships with other national brands (for example, store-in-store partnerships including Starbucks, Disney, Apple, and Ulta Beauty; the Ulta Beauty partnership will roll out to more than 100 Target stores starting this year).

Retailers considering an ecosystem must define the role they are well suited to play.

How to get started

- **Explore nontraditional retail partnerships** by joining forces to enter new geographies and marrying the best of physical and digital. Reliance has helped Facebook expand its reach in India, and Oracle and Walmart's proposed partnership with TikTok offers the retailer the ability to meet consumers where they spend their time.

- **Analyze and learn from successful ecosystem players.** Beyond learning from operating practices, retailers must also understand the type of talent needed and the necessary investments in technology and infrastructure. More holistically, it is important to cultivate the culture of innovation and disruption these ecosystem players foster.

If you're on the journey, how to accelerate

- **Decide what role the company will play in the ecosystem**—orchestrator, service provider, or participant. Some retailers may design their business and operating model so services can be used by other retailers—think Amazon Web Services or Target's Shipt.

- **Choose a business model that will create shareholder value without compromising the brand's integrity.** This exercise involves scenario analysis to understand the full financial rewards of different outcomes and the impact on valuation. When Walmart opened full-service clinics to expand its healthcare reach, the reward was an improved valuation.

Take productivity from foundational to transformational

Analytics and automation will enable the step change in productivity needed to fund the other imperatives
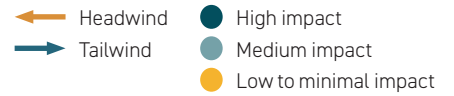
Executing the previous six imperatives requires meaningful investment in talent, capabilities, and capital. Retail as a sector has achieved outsized productivity growth. Going forward, the typical levers have little mileage left. Thus the next phase will require deploying analytics and automation across the P&L (Exhibit 6).

Exhibit 6

Transformational productivity improvements are required to reshape P&L and enable investment

Legend:
- ← Headwind
- → Tailwind
- ● High impact
- ● Medium impact
- ● Low to minimal impact

Affected P&L line items		Description of impact	Impact on retail subsector		
			Food retail	Hardline	Apparel
Product cost	←	Rising supply costs in key sourcing markets (eg, China)	Low	High	High
	←	Inventory risk driven by decentralized fulfillment to meet increasing delivery expectations (eg, carrying more inventory across stores to prevent stockouts)	Low	High	High
	←	Rising expectations for more ethically sourced products	Medium	Medium	Medium
	→	Shift to value provides opportunity to increase private-label assortment	Low	High	High
L&D	←	Increase in employee training and upskilling costs to meet new capability needs (eg, next-generation data analytics)	Medium	Medium	Medium
Labor expense	←	Store labor: increasing wages and extending benefits to part-time employees to attract and retain talent	High	Medium	Medium
	→	Store labor: growth of on-demand gig labor to provide additional capability needs from shifting role of the physical store	Medium	Medium	Medium
	→	Corporate HQ: growth of remote workforce and AI/automation to bridge next-gen skills gap and relieve cost pressure	Medium	Medium	Medium
Operational expense	←	Increasing supply-chain fulfillment costs from overall accelerated e-commerce growth	Medium	High	High
	←	Rising expectations for faster delivery of online orders	Medium	High	High
Net rent	←	Selective store closures and investment cost to retrofit stores to enable fulfillment	Medium	High	High
	→	Fewer leased office spaces from overall reduced need for in-person workforce	Medium	Medium	Medium

Cost pressures on P&L from rising table stakes require retailers to make transformational productivity improvements through automation and AI

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Retailers will need to prioritize investments that are truly transformational. Our research uncovered five areas that hold particular promise.

Enable stores with tech

Technologies such as self-checkout have become commonplace in the industry. In the past 12 months, we have seen an acceleration to extend similar capabilities across stores. Automated inventory management through real-time image processing improves both productivity and in-stock positions for customers. Digitizing administrative activities, through tools such as AI-enabled labor scheduling, advanced insights platforms (in lieu of scorecards), or digital compliance tools enables managers to get out of the back room and onto the sales floor. IoT sensors help preemptively address hardware issues in cooler doors or point-of-sale systems to prevent costly downtime. Together, we believe advanced levers like these can increase profitability by about 300 basis points over time.

Automate the supply chain and invest in solutions to increase visibility

With e-commerce forecast to reach more than 20 percent of sales (some segments and retailers have already exceeded this threshold), many retailers are still operating fulfillment networks built for penetration of less than 10 percent. As retailers scale their fulfillment networks, supply-chain automation can help address consumer demand for speedy delivery while reducing cost per order. In particular, we see adoption of more flexible technologies such as goods-to-person AGVs (automated guided vehicles) and person-to-goods picking robots (and "cobots") that can be operated in smaller-scale facilities. These technologies can speed processing of consumer orders by 300 percent and provide a positive ROI for retailers. Automation of the distribution center alone could boost profitability by 300 to 700 basis points.

In addition, retailers are investing in delivery experience management technologies to improve the consumer experience and provide visibility across all points in the supply chain, from distribution center processing times to delivery location and returns processing. These investments have helped retailers improve customer satisfaction scores by up to 10 percent while enabling incremental revenue capture.

Launch tech-enabled, business-backed indirect spending optimization

Leading retailers recognize indirect third-party spending, typically amounting to 10 to 12 percent or more of revenue, is a critical driver of profitability and shareholder value. To distance themselves from competitors, they are launching ambitious efforts to dramatically reduce spending by empowering their procurement organization with two game changers. First, leaders are introducing tech-enabled, advanced-analytics approaches to identify and unlock more sophisticated levers through negotiations. Second, they are partnering more closely with business functions and using granular data, analytics, and design thinking to challenge what and how goods and services are being purchased and identify inefficiencies. Through these efforts, retailers are capturing bottom-line impact of 100 to 140 basis points or more.

Boost private-brand innovation and sourcing excellence

Private brands have evolved from lower-cost alternatives to A-level brands to competitive weapons for retailers. They provide an opportunity to strengthen customer loyalty through a differentiated, innovative offering and to increase margins. Leading retailers are using product design and development in collaboration with suppliers to support innovation, penetration, and growth. They are also using next-generation sourcing tools to completely change the way they negotiate with vendors: from a retail-backed target costing to hit a certain initial markup to

Automation of the distribution center alone could boost profitability by 300 to 700 basis points.

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"The days of only one function driving any successful initiative are behind us. Everything we do requires strong coordination of cross-functional teams—from digital to store operations to merchants and more, everyone plays an integral role. And it all starts with a clear understanding of consumer expectations and the right prioritization."

—Brian Cornell, Chairman and CEO, Target

a cost-forward approach, by developing deep expertise in costing engineering, competitive sourcing, and advanced fact-based negotiations. In this way, retailers are achieving 10 to 20 percent growth in private-brand sales while improving margins in this category by 500 to 800 basis points.

Automate business support functions

Automation and analytics have the dual benefit of boosting profitability while also freeing up resources to focus on the tasks that matter (such as new growth opportunities). In our experience, merely automating repetitive tasks can free up 20 to 30 percent of time across functions such as finance, HR, IT, procurement, and legal. However, few retailers currently have the capabilities or tools required to unlock this productivity. To achieve these results, retailers must consider the true long-term cost of not investing in productivity improvements. Too often, retailers overestimate their business-as-usual performance or the initial investment needed to achieve benefits from automation. The reality is that available technologies, when

applied to simplify core business processes, can capture a large proportion of this benefit. For instance, up to 40 percent of tasks in finance functions can be automated based on available technologies in a short period of time.

Getting started

Revisit the brand promise
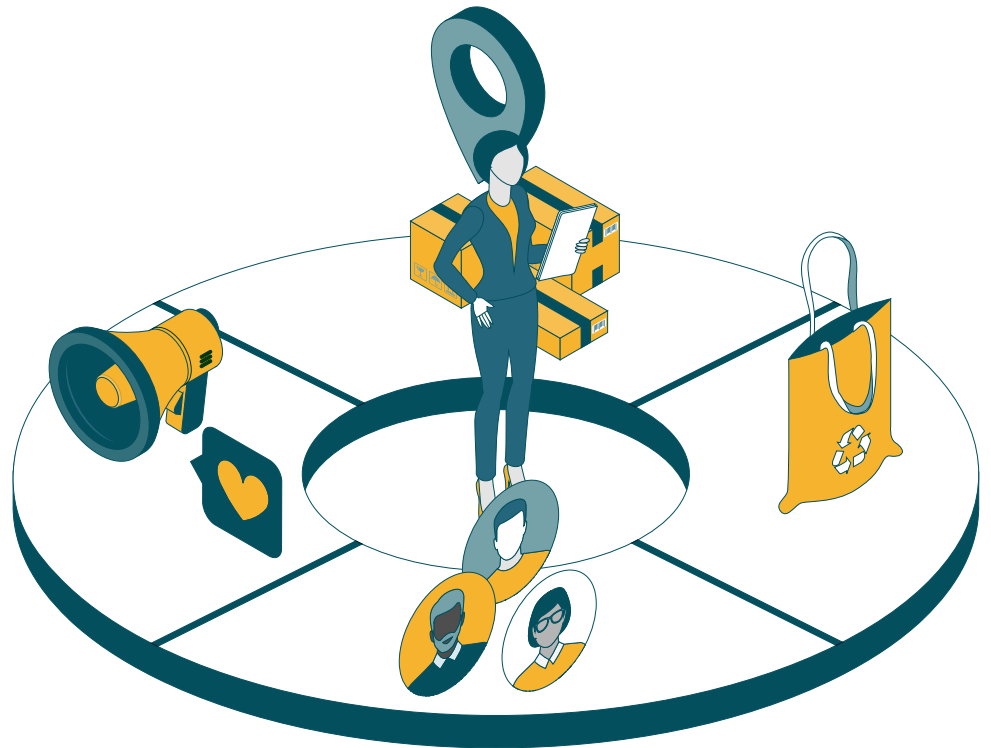
Few if any retailers will be able to address all of these imperatives at scale and at the same time—the overall cost and complexity will be too high. Therefore, the first step will be to set priorities. Some imperatives, such as prioritizing ESG principles and attracting next-generation talent, are related and may make sense to tackle in tandem. However, retailers will need to balance a range of trade-offs, such as the tension between speedy delivery (send lots of boxes), sustainability efforts (reduce the number of boxes shipped), and the challenge of offering a broad assortment and personalizing the shopping experience.

The key to striking the right balance is fidelity to the retailer's brand promise.

In the words of Kevin Holt, CEO of Ahold Delhaize USA, "How well you create a value proposition is the cornerstone of the brand's ability to survive." The postpandemic environment will require actions on the imperatives tailored to the individual brand promise's DNA. What does the retailer want the brand to stand for, and how can embracing the imperatives strengthen the retailer's ability to deliver that brand promise?

For example, a retailer committed to fulfilling digital demand might prioritize developing an assortment that enables more efficient logistics to offset the higher operational costs associated with digital fulfillment.

> ## "How well you create a value proposition is the cornerstone of the brand's ability to survive."
>
> **—Kevin Holt, CEO, Ahold Delhaize USA**

During the past year, many retailers shifted course and innovated at a speed they once thought impossible. Now is not the time to slow down. Retailers that can accelerate their progress with targeted investments, embrace new approaches to talent and ecosystems, and free up resources to support promising ventures have the potential to become leaders in the industry for years to come.

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