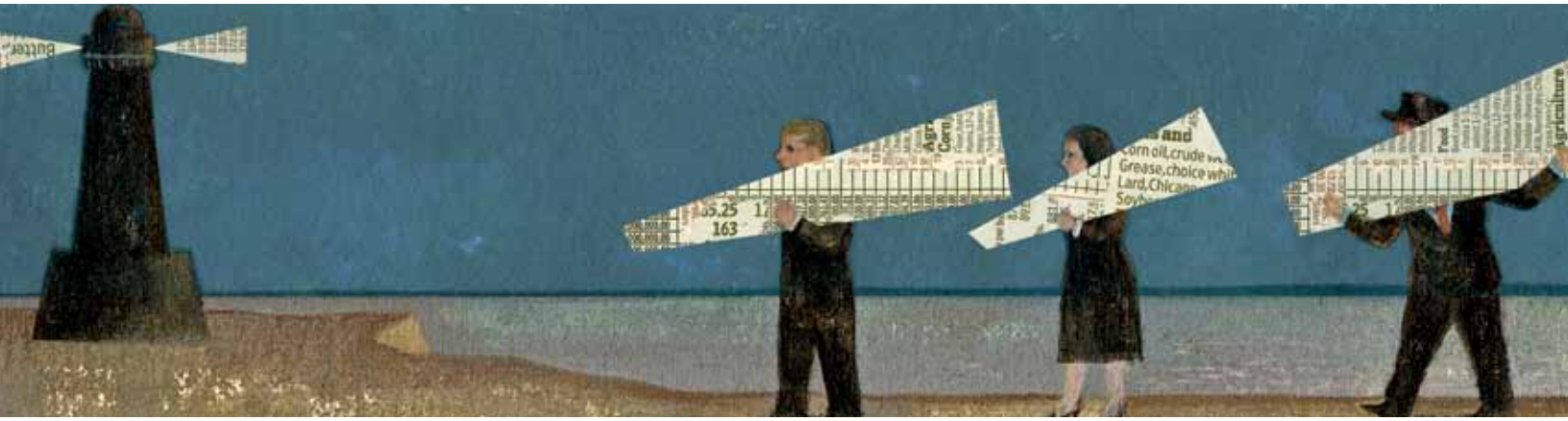


Retail coops: Staying competitive in a changing world

Six global trends are reshaping the retail industry, presenting retail coops with new challenges and opportunities. Now is the time to think through the implications.

Tarek Mansour and Andrea Zocchi

Retail is undergoing a rapid transformation. Consumers' shopping expectations, preferences, and behaviors are evolving—in large part due to the advent of the Internet and new mobile technologies, which are making price and product information ever more accessible. Rapidly expanding middle classes in emerging markets are driving consumption, while developed countries struggle to find growth. Intensifying competition, margin pressure, and volatility in commodity costs are challenging retailers to innovate—or risk being left behind by more flexible and agile players.

These changes present both threats and opportunities to coop retailers. To succeed in this new retail landscape, coops will need to offer a distinctive experience to their members and customers, rethink the role of their physical-store networks, and make deliberate decisions as to whether and how to pursue growth.

The retail sector in 2020

In the coming decade, six global trends will fundamentally reshape the retail sector. These trends—many of which have already begun to upend the traditional retail business—will only intensify.

1. The "all channel" experience

Consumers no longer make purchasing decisions in the same way they did a decade ago. Today,

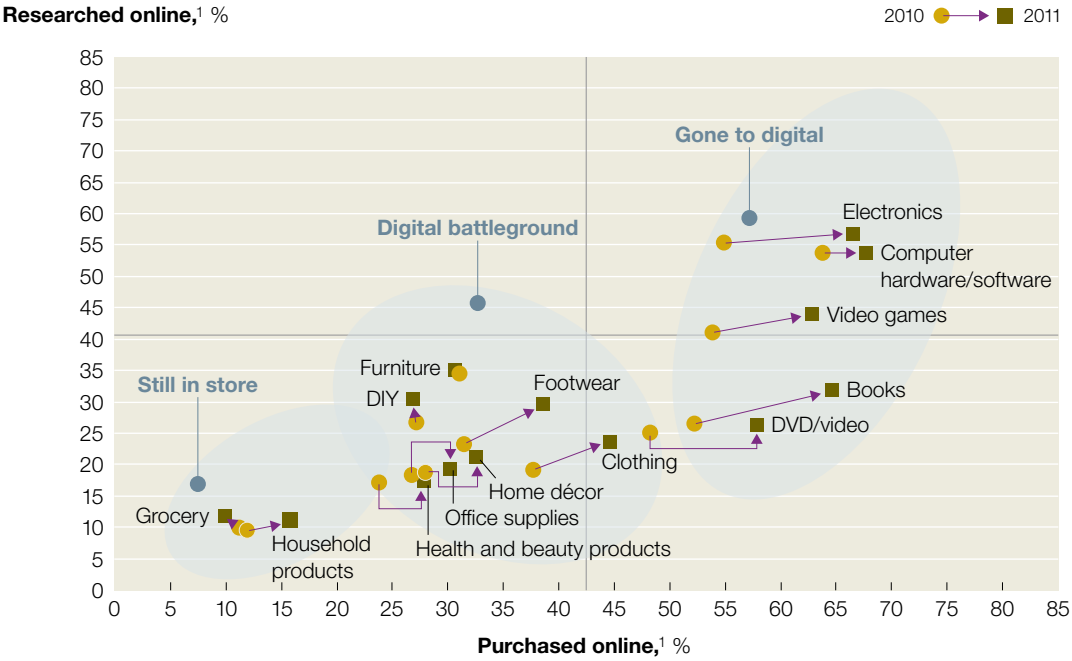
the Internet has become an entrenched part of daily life, and it is changing how and what people buy. In the United States, for example, online and online-influenced sales accounted for 46 percent of total retail sales in 2011, up from 22 percent in 2006.[1] This shift into the digital battleground isn't confined to a handful of product and service categories—it's almost universal (Exhibit 1).

Consumers will increasingly use multiple channels—including brick-and-mortar stores, the Internet, social media, and mobile devices—simultaneously and in sequence at each stage of their purchasing journey. Winning retailers will capitalize on all of these customer touch points and ensure that these channels integrate with and complement one another. Channel boundaries will blur; retailers will seek to engage customers across all channels, not only to achieve business results but also to develop a deeper understanding of—and deeper relationships with—their customers. Consumers will come to expect a personalized, seamless all-channel experience—and the best retailers will meet this expectation.

[1] According to McKinsey analysis based on Forrester Research data.

Exhibit 1

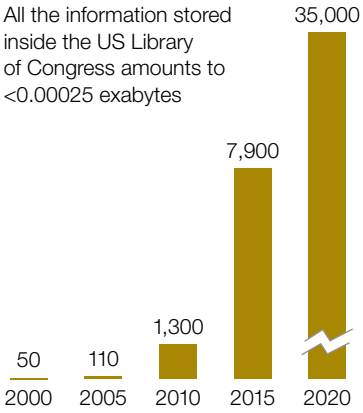
Many product and service categories are transitioning, or have already gone, to digital.

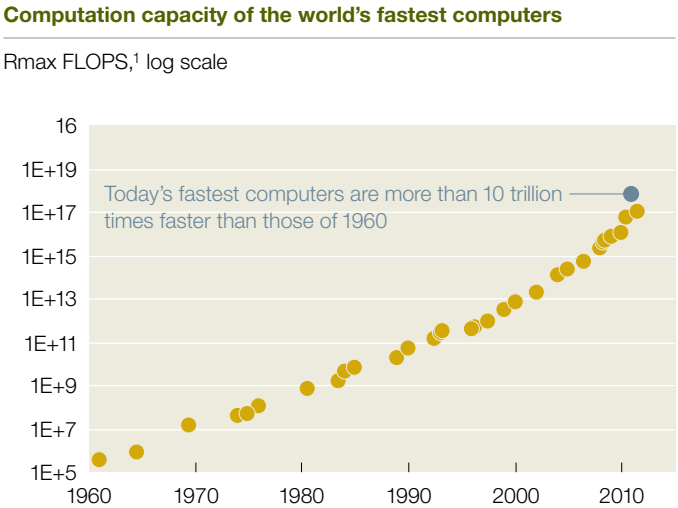


[1] As a % of those who bought a product in the respective category in the prior six months.
Source: iConsumer 2011

Exhibit 2

Businesses will leverage the explosive growth of available data and computational capacity.





Available data will be characterized by their scale, distribution, diversity, and timeliness

- **Scale:** data sets will be massive (>1 multipetabyte (1 million gigabytes)) and built to be easily scaled up
- **Distribution:** data will come from and be distributed both within and outside the organization
- **Diversity:** data will be semistructured, unstructured, or a combination of different types
- **Timeliness:** data will be captured and analyzed in real time, allowing for immediate response

[1] Floating-point operations per second; measurement based on achievable (as opposed to theoretical) throughput.

Source: IDC digital universe study, 2011 and 2010; McKinsey Global Institute; Martin Hilbert and Priscila López, "The world's technological capacity to store, communicate, and compute information," *Science*, February 2011; vetta.org; McKinsey analysis

2. Strategies and execution driven by big data

Between 2010 and 2020, the amount of data generated worldwide is expected to increase by a factor of 30, accompanied by similarly rapid growth in computation capacity (Exhibit 2). By harnessing the power of big data—large, complex data sets too big to manage with standard database-management tools and systems—retailers will be able to make better management and planning decisions, improve operations, and more precisely tailor their products, services, prices, and marketing to various consumer segments. The demographic markers (such as age, gender, and ethnic or linguistic group) traditionally used for customer segmentation will become less relevant, as big data enables the creation of more precise behavioral markers regarding purchasing and usage.[2]

Retailers have started—and will continue—to make substantive investments in data, analytical tools, and processing centers, as well as in the talent to lead data-mining efforts: data analysts, IT specialists, statisticians, and marketers will be in high demand. We estimate that by 2018 the supply of talent in sophisticated data analytics will be approx-

[2] For more, see "Big data: The next frontier for innovation, competition, and productivity," McKinsey Global Institute, May 2011 (mckinsey.com). Also see Jacques Bughin, John Livingston, and Sam Marwaha, "Seizing the potential of 'big data,'" mckinseyquarterly.com, October 2011.

imately 30 percent less than the demand, thus driving intense competition for these skills.[3]

3. Power to the people

Gone are the days when a convenient location, high in-stock rates, and adequate staffing were surefire ways for a retailer to ensure that a customer entering a store would actually buy something there. In 2012, 44 percent of respondents to our proprietary iConsumer survey reported conducting product research on their mobile device while shopping in a store.[4] Consumers are constantly seeking and receiving a variety of signals—such as user reviews, price comparisons, and product ratings—that influence their buying decisions on the spot, thus diluting the power of the information that a retailer provides both in stores and online.

This price and product transparency makes it imperative for retailers to develop, consistently execute, and "get credit" from the consumer for truly distinctive product-price-service offers. Retailers will increasingly look to differentiate themselves through unique offerings such as private-label products, specially sourced items, and exclusive designer lines.

4. Growth in emerging markets

Many developed economies are still struggling to recover from the global economic crisis. Discretionary spending has not returned to pre-crisis levels, and newly (perhaps permanently) price-conscious consumers are tamping down prices. Consumers have just begun a slow process of deleveraging that could drag down consumer spending and retail growth for years to come.

Growth in emerging markets, by contrast, is expected to be strong and sustained, with the burgeoning middle class driving the bulk of consumption. By 2020 the number of middle-class households in emerging markets will double to more than 300 million, and emerging markets will account for more than half of the world's retail-revenue growth between 2010 and 2020. By 2020, more than a third of the world's retail revenue will come from emerging markets. It remains to be seen whether leading retailers from the developed world will overcome restrictive regulation and cultural differences to succeed in emerging markets or whether homegrown mega-retailers will dominate these markets.

5. Pressure on margins and capital productivity in developed economies

Amid slow growth in developed markets and intensifying competition worldwide, retailers face tremendous margin pressure. At the same time, they will need margins to fund their battle for market share.

[3] US Bureau of Labor Statistics; US Census; Dun & Bradstreet; company interviews; McKinsey Global Institute analysis.
[4] For more, see our iConsumer reports on mckinsey.com.

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To remain competitive, retailers will need to increase operational efficiency through both technological and nontechnological means. New technologies (electronic shelf labels, for instance, or mobile points of sale) could lead to significant cost savings and service improvements, but continued optimization of large investments—such as smart pricing and promotions—will generate significant value.

Furthermore, a major transformation in physical retail space will be necessary to drive capital productivity. Retailers will experiment with new, more capital-efficient formats (such as smaller, denser, and leaner stores) and actively manage the size and design of their store network so that it works in tandem with digital channels and helps deliver a seamless all-channel experience.

6. Volatility in input costs

Volatility in commodity input costs will continue to challenge retailers. From 1990 to 2010, the implied annual volatility of wheat, maize, and soybeans increased from about 10 percent to more than 30 percent; in 2010 and 2011, volatility in cotton prices was the highest it has been in decades. The structural factors that drove this volatility are still relevant and show no signs of abating: rising demand from China and India coupled with tight supply conditions, an influx of money from speculators, exchange-rate volatility, and—in the case of food—climate variability. Retailers must continue to improve their corporate risk-management practices, carefully consider diversification strategies, and prepare to manage through volatility cycles.

Implications for retail cooperatives

These trends will affect all retailers regardless of ownership structure, but they have additional implications specific to coop retailers. Because of the variety of cooperative retail models (client-owned, employee-owned, and merchant-owned) and the variability of the subsectors in which they operate, there is no single strategy that coops should pursue in the face of these trends. There are, however, some common questions for senior executives of coop retailers to consider. In all cases, the answers to these questions should be formulated in the context of local legal and regulatory requirements.

1. How can coops keep their physical-store networks relevant?

The e-commerce boom has made consumers less likely to visit brick-and-mortar stores. Retailers' physical-store networks have thus become less central to the customer relationship. This shift disproportionately affects coops, which have historically relied on their stores as crucial links to the communities they serve.

Coops will have to find a way to preserve the advantage of geographic proximity, even as they

provide an acceptable multichannel experience. How can coops give customers compelling reasons to enter their stores? Options might include in-depth expertise, convenience, or new, high-quality services. Coop retailers must also consider how to leverage the local knowledge and entrepreneurial nature of store owners and store managers. If given enough flexibility, store owners or managers could introduce locally sourced products into the assortment, tailor their offerings to local tastes and preferences, and even identify the optimal store formats for their respective communities.

2. How can coops maintain an edge in customer satisfaction?

Compelled by their mission, governance, and incentives, coop retailers tend to prioritize customer service—but they should prepare to face tougher competition in that dimension. As leading retailers integrate all their channels and leverage new technologies, they will redefine the customer experience and up their game in customer service.

Cooperative retailers should arm themselves against the threat by first identifying the key elements that members and consumers truly care about when it comes to customer service. What investments should they make to maintain their edge in customer satisfaction? And how can they make shopping in a cooperative a distinctly differentiated experience? Cooperative retailers will need to make deliberate choices—for instance, they may opt to rely mainly on technology and big data, or they may prioritize investing in the local workforce and in their physical network—while containing costs.

3. Can coops use the Internet and social media to improve member relations?

Coops have traditionally relied on their physical presence at the heart of the communities they serve to engage not only customers but also members. Given the rise of online and multichannel retailing, coops' ties with members could potentially weaken. How should cooperatives harness the power of digital channels to strengthen, rather than dilute, their proximity advantage? Can they use social media and online applications to revitalize the democratic dimension of cooperatives—for instance, by letting special committees interact via social media? Could digital

channels facilitate a broader reach and a more engaged member base?

4. How will coops grow?

Cooperatives should decide how aggressively they will pursue growth—particularly in saturated markets and, in some cases, recessionary environments. Healthy growth is essential to the cooperative business model and to continuing to fulfill the cooperative mission to their members. (For a more detailed look into coop growth, see "How cooperatives grow," page 4.)

Will cooperatives seek growth internationally or in their home markets? What will such growth entail, and what innovations will help them capture it? In certain markets, growth may come as a result of expansion into adjacent products or services; in others, it might consist of taking share from competitors by offering better customer service.

5. Are there opportunities for alliances among noncompeting cooperatives?

Many retail cooperatives face larger, more powerful competitors that enjoy economies of scale. While coops may not wish to grow quite as big as their competitors, they could potentially access the benefits of size through alliances or joint ventures.

Similar but noncompeting retailers can consider avenues of collaboration within their current lines of business, again within the local legal and regulatory context. For example, pooling purchases could increase their bargaining power; a joint private label could be more cost-effective and create a stronger brand than a product line launched by a single coop. Alliances could also be beneficial when it comes to identifying and sharing best practices, establishing academies for employee training, educating policy makers, or entering new markets. By thinking carefully about such opportunities and ensuring that any alliances are structured and executed in a sustainable way, coop retailers can exploit synergies, promote their common agenda, and create competitive advantage.

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Major structural forces are redefining the retail sector and will continue to do so over the next decade. As leaders of retail cooperatives react and adjust to these forces, they should give careful thought to how the distinct characteristics of their organizations can help them gain a competitive advantage and better fulfill their mission in the long run.

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