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Interview

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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