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Consumer Packaged Goods and Retail Practices

What matters now in the consumer sector

Sajal Kohli, who leads McKinsey's work in the consumer sector globally, discusses the actions that retailers and consumer-goods companies can take to thrive in the next normal.

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In this inaugural episode of the *McKinsey on Consumer and Retail* podcast, Sajal Kohli, the leader of McKinsey's global Consumer Packaged Goods (CPG) and Retail Practices, describes the state of the industry ("an unpredictable mosaic of fortunes") and the actions that companies can take to thrive in the next normal. An edited version of his conversation with McKinsey executive editor Monica Toriello follows. Subscribe to the podcast on McKinsey.com.

Monica Toriello: Hello, everyone. Thanks for joining us for the first episode of this podcast series. We thought it would be appropriate to start with an industry-wide perspective about what matters now and what matters in the short term, the medium term, and the long term for both retailers and CPG manufacturers. And who better to talk to us about that than the global leader of McKinsey's CPG and Retail Practices. Sajal Kohli is based in the Chicago office, and he's been with McKinsey for 25 years. So he's got lots of experience working with retailers and CPG manufacturers worldwide. Thank you for being here, Sajal.

Sajal Kohli: Thank you, Monica.

Monica Toriello: So before we get into industry talk, tell us a little bit about yourself.

Sajal Kohli: I live in Chicago. I love the consumer sector—anything that looks even remotely consumer facing. I'm married. I have two teenage daughters. And I'm originally from India but have made my professional home in the US.

Monica Toriello: And I know that you've worked with companies on almost every continent. So let's start with a broad question about the industry. We know that in the past four months, certain product categories, like grocery, and certain channels, like e-commerce, are way up in terms of sales and traffic—while others, like clothing stores and restaurants, are way down. Give us an overview of what's happening from your perspective.

Sajal Kohli: It's been pretty unprecedented on multiple fronts. It's a tale of mixed fortunes, if you will. You have food and nonfood on one dimension, you have retail and CPG on the other dimension, and you have discretionary and nondiscretionary spending on another. And then you have the geographic axis: a big part of consumer-facing businesses is the public-policy and health interventions that different countries have been through. So you see this very interesting and unpredictable mosaic of fortunes.

So there's not one global, stereotypical, general description of how this has impacted the consumer sector. It really depends on what the context is. We saw consumer behavior change quite dramatically in 2008 and 2009, but this is a very different crisis. How will consumer behavior really change? We're seeing some pretty interesting differences. We're seeing a massive, massive flight to online. And even consumers who scoffed at online in the past found the power of its convenience when they didn't have any other choice. The real question is, how "sticky" will it be? If you read the tea leaves, it seems to be very sticky.

I think the second question is, what will be the basis of competition—and how will companies actually adapt to this new demand? It's a big deal for CPG companies because suddenly, while DTC, or direct-to-consumer, was an important part of your business, it's now at the forefront of how you need to go to market. And if you were underinvested pre-COVID-19, are you suddenly behind from a competitive standpoint? So I think there are lots of unresolved questions.

Monica Toriello: You mentioned the shift to online looking like it's going to be somewhat sticky. And I think McKinsey articles have said, for example, online grocery, which was at 3 percent penetration in the United States, is expected to go up to 8 to 10 percent this year before settling back down to about 5 to 6 percent. Talk to us specifically about the grocery sector. The economics of online delivery

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and last mile have been tricky forever. How are grocers going to address that, or how should they address that?

Sajal Kohli: Online was always sort of the promise of tomorrow for grocers. And depending on which market you were in, Asia always set the pace in terms of delivery and last mile. If you look at Europe, the UK has always been a prime market for grocery. If you think about online penetration, the US was lagging, outside of the digital disruptors that came in and changed the game. It’s pretty clear that, from a grocery perspective, the online-penetration surge we’ve seen will be very sticky. So the question is, how do companies react?

If you don’t have your own self-distribution supply chain, you will have to partner. I think the whole notion of partnerships and alliances is at the forefront. So if your distribution center and your supply chain were largely configured for large-drop economics—pallets and trucks going to stores—this is now small-drop economics. It’s small orders for consumers in high-density locations. The entire cost structure and the cost profile of that fulfillment mode is quite different. I think you’ll see a lot of grocery operators double down on their investment in online. But as they build up their muscle, they will think about partnerships and alliances in a very different way than they have in the past.

Monica Toriello: Let’s talk about the implications on real estate. Grocery stores, for the most part, have been doing well during the pandemic: they’ve remained open, and people continue to shop at them. But for other types of retailers—clothing stores or specialty stores, for example—what are the implications on real estate? Certain markets, including the US, were already “overstored” prior to the COVID-19 crisis. And now, the pandemic has brought to the fore questions about the role of the store, what people should do in stores, and the contact-free economy. How should retailers think about stores?

Sajal Kohli: It’s pretty clear that it’s going to be a pretty protracted recovery. This is not, “I’m going to try and fix something for the next two or three quarters.” We think this is a multiyear journey that we’re on right now. So you’ll need to fundamentally rethink your bricks and mortar and what the strategic intent of the store is, in terms of how you go to market. If your store didn’t have positive four-wall economics, it will be very difficult for you to actually make that store a viable operating entity.

So one hypothesis is that there will be pretty massive rationalization of the store footprint. And the type of format is going to change quite a bit: for example, things like “buy online, pick up in store” or curbside delivery or home delivery. Consumer-facing businesses have talked about omnichannel for a while. This is the moment of truth on whether you’re ready for omnichannel or not.

You also have to remember from a macro perspective that among developed markets, the US has a higher amount of square footage per capita than any other country. So if you are a retailer that had a big cost gap versus your peer set, or not a very attractive value proposition, and then the COVID-19 crisis hits, you're going to have some pretty significant decisions to make on real estate.

One company, for example, is actually thinking about pulling out of an entire region. And the entire business case of staying or pulling out anchors on the question of what they'll do with the real-estate costs. So it's pretty existential.

Monica Toriello: Are there any cool store technologies that you think will take off in the next few months? Anything experimental out there that could revolutionize the customer experience in stores?

Sajal Kohli: I'll just talk about a few that folks are already experimenting with that might get accelerated or we might see at scale right now. Obviously, we all talk about self-checkout in grocery stores. It's still quite fascinating that even after being at it for six or seven years, the number of consumers using self-checkout machines is not very high. We think that will get massively accelerated. That's one.

Second, if the consumer really wants to minimize the amount of time they're in the store, what technologies will that consumer need to massively reduce their search time in the store? There might be some physical changes; you might lay out the store very differently. Should the store associates have different technology to locate products? Could you imagine going into a store and the store's map pops up on your smartphone, you search the item, and it literally shows you a red dot where the item is located? There will be technologies that will give you a much better real-time sense of where the inventory is—what you're carrying in the store versus what's in the distribution center—so you can let the consumer know when you can get it to them. So I think we'll see a birth of multiple technologies.

And I think the last one is that consumers will value much more the answers to, "How much do you know me? If you have my purchase history, can you give me recommendations and prompts, whether I'm in a store or not in a store, so you can make this much more convenient for me?" I think we're going to see a whole broad spectrum. And the only thing that'll mitigate the acceleration here is if there's less funding for the start-ups that are birthing these technologies.

Monica Toriello: Funding for start-ups is one thing, but I think another important aspect of it all is talent—digital and tech talent. And on the one hand, this big shift to remote working has shown that your talent doesn't have to be based where your company is based, but on the other hand, there's tons of competition for the same kinds of talent. Give some advice to retail and CPG CEOs or executives as they think about attracting and retaining this talent.

Sajal Kohli: You know, what's fascinating to me since the COVID-19 crisis, and I feel this personally, is this very interesting phenomenon that even though you're not spending time with folks in person, there is this very bizarre and counterintuitive sense of intimacy that folks are having via Zoom and Webex meetings.

The other thing that I keep hearing from executives is, they haven't seen a dent in productivity. In fact, they think productivity might have gone up, which is also fascinating. So I think there might be two dimensions here. One is, if where we settle is that certain kinds of talent are actually happier working remotely than working in a corporate headquarters, doesn't that create an unprecedented opportunity for consumer-facing businesses to attract talent that they were not able to attract? This talent will also be even more sought after now, so CHROs [chief HR officers] and chief talent officers need to think very hard about how to retain this talent and make sure that they are satisfied. How do you make sure that their mental health and their well-being is in place while they're working remotely and, on the other hand, incentivize them? So once again, all bets are off. This is a whole new playbook of how you think about prospecting talent, talent retention, talent progression.

And I think the last thing is, consumer-facing businesses are very good barometers of the ethnic makeup of a country because they're distributed workforces. Everybody has diversity and inclusion programs, but this, especially in some geographies like the US, will become a centerpiece: how to maintain diversity and inclusion so that you can reflect the needs of society. And I think consumer companies should really set the pace for the rest of the world.

Monica Toriello: That's interesting. How do you think automation plays into that? We've got this confluence of trends—there's automation on the one hand, diversity and inclusion on the other, and massive unemployment in certain parts of the sector. How does all of that play into how a CEO ought to think about labor and talent and automation?

Sajal Kohli: MGI [McKinsey Global Institute] did a piece of work that found that 55 percent of a grocery store, the way we know it today, could be automated. Let's talk about the countervailing forces here: automation holds massive promise when it comes to SG&A [selling, general, and administrative] costs and resetting the cost structure from a labor-cost standpoint for organizations. But it comes with a pretty heavy burden: What happens to these displaced workers? And when you look at the kinds of roles that'll impact future-of-work technologies, you break it out into two or three buckets.

The first one is, some roles, the way we know them today, might not exist. They may just go away. There is a second set of roles that, while we might call them the same thing, will change materially. But then there's a third bucket, which includes all these new roles that will emerge. Think about robot maintenance: How many retailers have robot maintenance on their payroll today? So you've got to think about all three of these. What's your workforce strategy going to be in light of these new technologies?

Imagine you get to that answer—and every organization will decide for itself where their workforce fits into those three buckets. The real question then is, since there's a massive premium on reskilling, who's going to reskill this workforce? That's a public-policy question and also an organizational question. CHROs and chief talent officers will have to think very hard about how to reskill and retrain folks who are going to stay with them. Should there be public–private partnerships between policy makers and governments and private institutions on how to take on this whole reskilling challenge?

This is actually agnostic of COVID-19. This was a trend that we'd seen pretty strong and loud and prominent pre-COVID-19 as well. I think it will just get accelerated much more right now.

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Monica Toriello: Speaking of trends that were already accelerating pre-COVID-19, sustainability is one of them. And some observers think maybe sustainability will take a back seat for now. What is your thought on sustainability? Is that something that consumers will continue to care about or will maybe even care about more?

Sajal Kohli: You have to separate out the two sectors: CPG versus retail. In CPG, sustainability has been an area of focus for a while, and it is now a "table stake." I think, on the retail side, it was much more mixed. There were some retailers, if you think about apparel and discretionary spend, that were really trying to make that their point of differentiation and their value proposition. There were other larger retailers, for example, where this was a part of what they wanted to do—it was a part of the values of the company. So I think there are many different perspectives on this. But I think our sense is that it's going to get amped up across both sectors.

I think the real question for me is, where will companies actually focus? Which part of sustainability will they anchor on? Because I also feel, other than just the societal and climate-change impact, in all the places where you've seen traction, it has to connect back to what the business strategy is. I think if it's a parallel universe, it doesn't really get enough attention in any organization. So I think organizations are going to need to figure out which part of sustainability they stand for and how they'll contribute.

Monica Toriello: I think much of that is driven, too, by millennials and Gen Z consumers, right? Talk to us about that younger demographic. How should consumer companies think about millennials and Gen Zers?

Sajal Kohli: The younger generation, whether millennial or Gen Z, is pretty fascinating. We've been doing the Consumer Sentiment Survey during the COVID-19 crisis in about 42 different countries, and we take a pulse every week. In general, across regions of the world, it's a much more optimistic cohort. So that's one thing: they're quite different compared to older cohorts.

I think the second is the question of who a millennial is. We just did some proprietary research last year where we looked at millennials as a cohort, and what's fascinating is, there are actually five or six segments within the millennial group as we know it. And a couple of them actually behave like baby boomers in terms of their buying behavior. And then there's a big spectrum of age within that group as well—for example, some don't find stores attractive at all, and they do everything online, whereas there are others who like the artisan value of stores and the curation, and they like to touch and feel the product. So I think you have to think about which millennials we are really talking about and who we are actually catering to. It's a pretty broad spectrum, and it's a pretty broad population cohort.

But some things are pretty consistent. They care about the environment. They care about what the organization stands for and how they'll give back to society, which I think are going to be pretty important table stakes for companies going forward. And the reason I say that is, in the next four to five years, millennials are going to have much more discretionary power as a cohort than baby boomers did. They might not have it on a per capita basis, because they're still in early parts of their career, but that's a pretty big shift.

So when CPG companies and retail companies look forward over the next ten years, the questions may be, who are you really designing the store for? Should your website experience be much more millennial oriented? These are glacial macrotrends that impact these longer-term decisions that companies are going to make. Where should I put a store? Should it be in an urban location? Should it be in a suburban location? And where is the population shift going to be? Where's the discretionary spend?

And we're seeing all these things play out at the same time. I don't think there's any clear trend yet. And the COVID-19 crisis obviously is an overlay on what we were seeing before. So we have to let things settle a little bit before we see how they tip their hand, so to speak.

Monica Toriello: CEOs are grappling with all of these trends at the moment. There's a lot to think about and a lot to do. What are the two or three most important priorities for a consumer-facing company CEO today?

Sajal Kohli: There is so much context—what categories you're in, what geographies you're exposed to—it's tough to have a standard list of things I would say executives need to focus on. But at least two or three things are emerging.

It is absolutely clear that the actions you take now will actually define whether you win the recovery or not. It is strategy under uncertainty. So you're going to want the perfect set of facts and all the trend analysis, and you're just not going to have it. Calming the waters while not having perfect data, but moving toward whatever your "North Star" is will be super important. I think that's one.

The second is challenging a lot of assumptions. Why shouldn't we partner with folks outside of the industry if they can do something better than we can? Should we share data between our customers and ourselves? Should a CPG company share data with retailers, and vice versa, to serve the consumer better? Should you think about sourcing quite differently as you think about geopolitical tensions? Everything's on the table. You have to start thinking about how to reset your cost structure to be "fighting fit." Those assumptions should be on the table as well.

Speed is going to, once again, become the basis of competition. So one other thing that executives should think about is the operating model in the company. Do we need to have all of these layers? Do we need to have all of these multiple handoffs? Should we organize differently for speed?

When I step back, I'd say, take all of the wisdom you've accumulated through your career. Now put it all into a box and then shake up the box; open it up, and you'll see a bunch of broken pieces. You'll see some pieces that'll stick to the corners. It's going to be a very different mosaic.

Monica Toriello: Can you think of any examples of management teams that are doing this kind of thing—whether it's rethinking their operating model or redesigning themselves for speed—that you feel could be an example to other companies as well?

Sajal Kohli: One is a global company, and it is quite amazing how they have fundamentally challenged the way their supply chain is configured. They've decided to run their own distribution centers, which they previously valued as one of their sources of competitive advantage. They're fundamentally changing where they source from. These are pretty fundamental pivots away from what's driven success for the company.

Another retailer basically decided that they are going to take four layers out of their corporate headquarters, not because of cost—they're actually doing quite well—but because they want to flatten the organization. And they have collapsed six or seven functions into customer-facing functions. So for example, part of the corporate center says, "This is the millennial organization," and all they do is from a marketing perspective, an assortment perspective, a branding perspective—that's the millennial crowd, and that's all they obsess about. It's a lot like how digital disruptors are organized. They've used the crisis to actually reinvent themselves.

Another fascinating example is a food retailer that actually went dark. And I don't mean that in any ominous way, but they just went dark because they're on a pace to turn 40 or 50 percent of their brick-and-mortar operation into dark stores. Basically, they've said, "I have 10 to 15 percent online penetration. I anticipate 50 to 60 percent online penetration going forward. So I'm going to repurpose my brick-and-mortar stores as dark stores and make them fulfillment centers." They'll be like delivery centers. Which, by itself, is not surprising, but the pace at which they're doing it is quite amazing. So you could imagine they'll look dramatically different versus their peer set in three or four years if they move at this pace.

Monica Toriello: Those are great examples. As we wrap up this podcast, just give our listeners one parting thought. What's the one thing you would tell a CEO to keep in mind as they navigate the consumer industry's next normal?

Sajal Kohli: The amount of acceleration we've seen on several parts of consumer-facing businesses, whether it's online penetration, et cetera—we've covered decades in four months. And that should be the new heuristic for the pace of change. I think you ought to come to terms with that reality because that means that the entire time horizon of how you made decisions, et cetera, will materially change with imperfect data in times of uncertainty.

So what does that really mean? That means high tolerance for ambiguity. That means a ton of grit. But I think it also means there will be a massive premium on what a CEO does really well, which is bring calm to the troops and bring them along. How do you bring folks along on the journey? It's very visceral. It's very existential. It's very human. But I think that's going to make a big difference.

Monica Toriello: Very human indeed. I think we'll end on that note. Thanks again for talking to us today, Sajal.

Sajal Kohli is a senior partner in McKinsey's Chicago office; **Monica Toriello** is an executive editor in the New York office.

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