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The state of grocery in North America

The emergence of new challenges will force grocery retailers to adapt their strategies and operations. Executives should focus on five priorities in 2022.

by Bill Aull, Becca Coggins, Sajal Kohli, and Eric Marohn

Over the past two years, grocery retailers have had to reassess and adapt nearly every facet of their operations. Changes to the grocery landscape will continue, shaped by both macroeconomic factors (such as supply chain challenges and inflation) and mercurial customer preferences. To keep pace, retailers should focus on a handful of trends: the rise of the value-conscious, healthier-eating consumer; elevated consumer expectations for omnichannel; an increased emphasis on sustainability; strategic workforce planning and investment in tech and analytics; and the growing importance of ecosystems and partnerships.

Looking back on 2021

In our conversations with CEOs, “volatile” was the word used most frequently to describe 2021. Since 2019, the market has grown at an impressive 15 percent,¹ a rise that was the product of increases to both prices and volumes. But these top-line numbers belie the roiling retail landscape beneath. Significant shifts in share of stomach, supply and labor shortages, unprecedented investments in e-commerce, and rising inflation created widespread disruption for grocers.

Acceleration of pandemic-related consumer trends

According to recent McKinsey consumer insights, the trends that took hold at the start of the pandemic have gained momentum. Total e-commerce sales have grown nearly 60 percent since the beginning of the pandemic, though penetration rates have leveled off. At the same time, consumers are making fewer

trips and visiting a smaller number of stores: they are 20 percent more likely to go to just one grocery store a week. As such, consumers are increasingly seeking out one-stop shops and have expressed an interest in buying everything in one place even more frequently in 2022.

Meanwhile, the food-at-home market, which had been slowly losing share to food away from home before 2020, has surged 8.7 percent, four times its historical growth rate. The move to food at home coincides with a growing emphasis on healthier eating.

Together, these trends suggest consumer behaviors have fundamentally changed—and grocers should take notice.

A steadying but still-fragile supply chain

Disruptions to supply chains during the pandemic have increased out-of-stock rates by upward of 15 percent, compared with historical rates of 5 to 10 percent.² Issues over the past two years have been attributed to a host of factors, including bottlenecks at ports, labor shortages, and huge, unanticipated spikes in consumer demand. The good news is that some of these challenges, such as overseas vessel delays and container shortages, will pass. Others—such as labor shortages and the ongoing shift toward automation—have been a long time in the making and will require a sustained commitment to resolve.

Significant shocks to the labor market

The grocery industry employs nearly three million people in the United States.³ Every aspect of the industry’s people model—

¹ Total grocery sales across traditional grocery, supercenters, mass market, drug stores, convenience stores, clubs, discounters, and online channels inclusive of drug spending; Kantar LLC, Copyright 2022. All rights reserved 2022.

² Kelly Tyko, “Grocery stores still have empty shelves amid supply chain disruptions, omicron and winter storms,” *USA Today*, January 12, 2022.

³ “Supermarkets & grocery stores in the US - Employment statistics 2002–2027,” IBISWorld, updated December 29, 2021.

corporate, in-store, and across every part of its operation—is experiencing an upheaval caused by a rise in absenteeism and attrition as well as by employee demands for flexible labor scheduling. The workforce participation rate plunged dramatically during the pandemic; as of August 2021, it was still 1.6 percentage points below prepandemic levels. The accelerating adoption of automation (such as the increased use of self-checkout, image technology to perform in-stock checks, and automated picking in warehouses) is also changing the workforce dynamic.

Emergence of unprecedented inflation

At the beginning of 2022, inflation exceeded 7 percent, fueled by historic rises in labor, freight, and commodities costs during the latter half of 2021. Today’s inflationary environment continues to stem from a blend of cyclical, structural, and global supply chain issues. The recognition of supply chain

challenges among suppliers, retailers, and consumers has increased these groups’ receptiveness to higher prices—a fortunate development for retailers because no single player can absorb the full magnitude of price increases and remain profitable. In 2021, grocery retailers raised prices even while doing their best to mitigate costs. One CEO noted, “Inflation is exceeding customer income growth. If cost increases are just passed through, it will lead to lower sales and profits and a greater migration of customers to EDLP⁴ grocers. It will be critical to balance when to absorb the cost inflation versus passing some or all of it through to optimize business performance and retain customers.”

Greatly increased capital investment

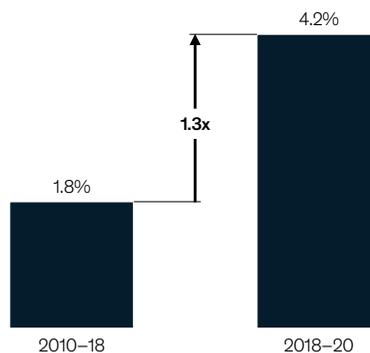
The grocery ecosystem has begun to change dramatically as new partnerships and entrants have challenged the status quo. Grocers increased their capital

⁴ Everyday low pricing.

Exhibit 1

Grocers significantly increased their capital spending to keep pace with a changing ecosystem.

Capital expenditure CAGR,¹ %



¹ For a collection of 16 publicly traded hypermarkets and super centers, food retailers, and general merchandise stores. Source: McKinsey analysis of annual reports from grocery retailers

expenditures at an amount 1.3 times their historical levels thanks in part to an influx of funding (Exhibit 1). Consider that venture-capital firms raised \$10 billion for grocery start-ups in the first six months of 2021 alone. As investments continue to pour in, we expect these enhanced capabilities to disrupt the food ecosystem.

What's ahead for 2022

Grocers will face five trends that can broadly be described by changing consumer tastes and the responses necessary to keep pace with them.

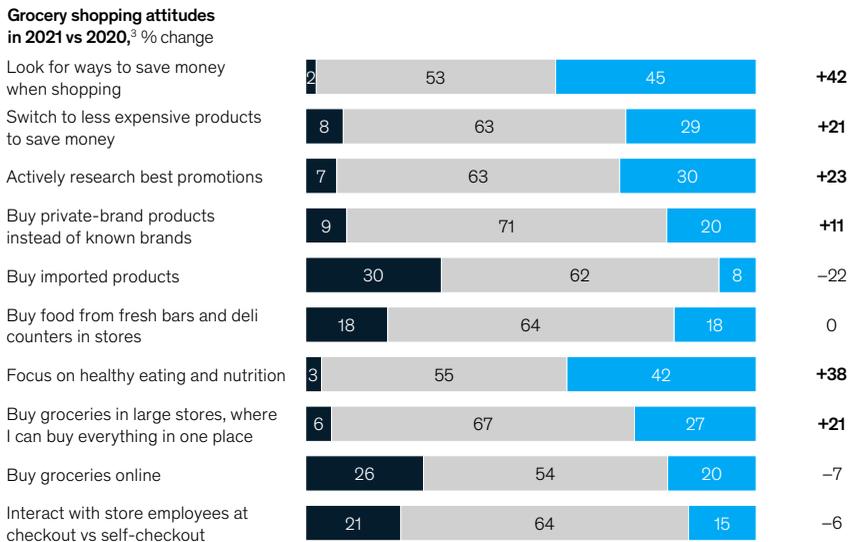
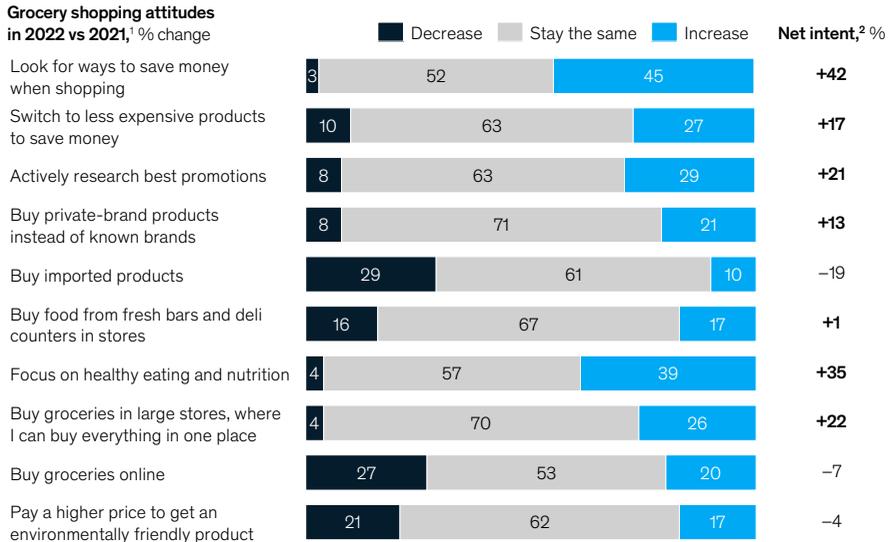
1. Rise of the value-conscious, healthier-eating consumer

With continued uncertainty around the COVID-19 pandemic and grocery inflation the highest it has been in ten years, consumers have become more focused on shopping for the best value in an effort to stretch their dollars (Exhibit 2). Moreover, 90 percent of CEOs expect increasing pricing pressure from consumers to continue in 2022. When choosing where to shop in the year ahead, 45 percent of consumers indicate they plan to explore more ways to save money, a level virtually

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Exhibit 2

In 2022, consumers will look for ways to save money while focusing on healthier eating and nutrition.



¹ Question: Think about 2022. Are you planning to do more, less, or about the same of the following?

² Question: Which of the following statements best describes your attitudes toward grocery shopping in 2021 as compared with 2020?

³ Net intent is calculated by subtracting the percent of respondents stating decrease from the percent of respondents stating increase. Source: State of Grocery Consumer Survey, November 19–December 7, 2021 (n = 3,007) and January 13–25, 2021 (n = 4,691); sampled and weighted to match the US general population over 18 years old

unchanged from the year before. In contrast, 29 percent intend to actively research the best promotions more frequently.

Consumers are balancing their emphasis on value with an interest in healthier foods. About 40 percent of consumers expect to increase their focus on healthy eating and nutrition. Consumers intend to purchase more regional and local goods (41 percent), high-protein options (34 percent), and offerings that are free from certain ingredients (33 percent), along with other naturally healthy options (Exhibit 3). This combination of saving money and eating healthier, more nutritious foods is more prevalent among millennial and Gen Z consumers, in part because they are still waiting for their finances to return to normal.

The emergence of this younger, value-conscious, and healthier eater in 2022 creates opportunities for grocers to tailor their value-priced private-label products to include healthier offerings.

2. Elevated consumer expectations for omnichannel

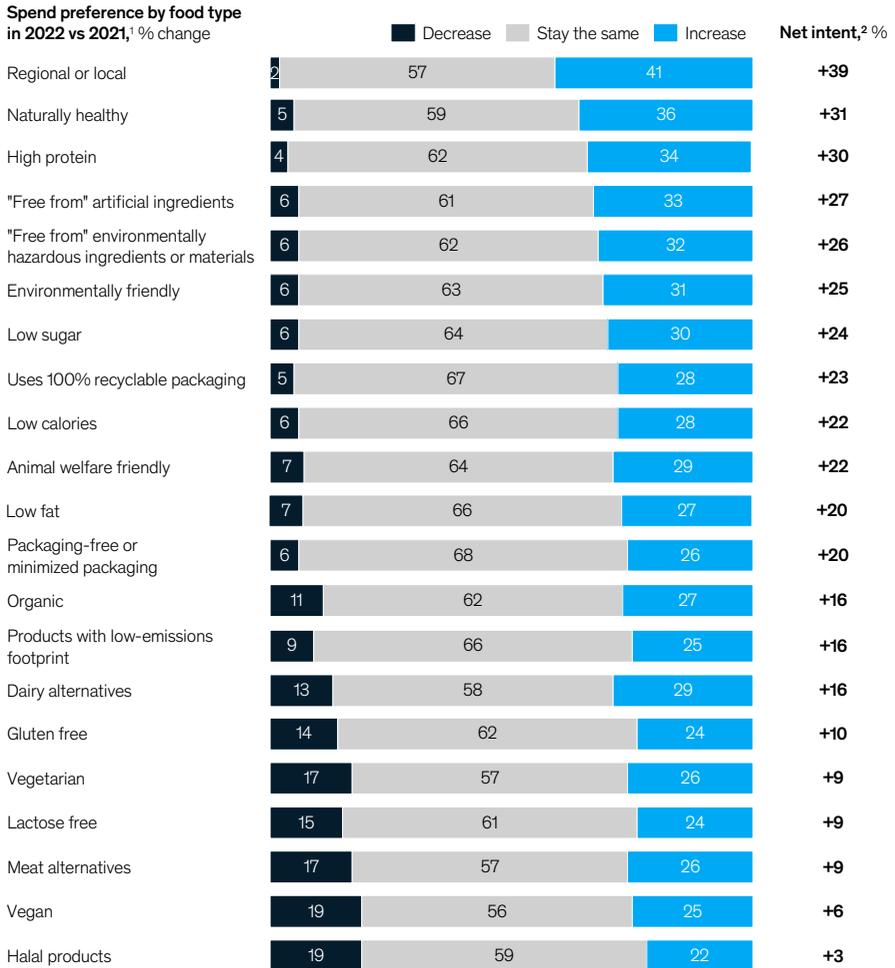
Online buying is here to stay. Customer preference for online and delivery orders increased by around 50 percent during the pandemic and is expected to rise further in 2022 (Exhibit 4). Consumers continue to be drawn to the convenience and relative safety of online shopping, an attraction that becomes even more appealing as delivery costs decline and promotions increase.

The main barriers to online shopping are consumer preferences for personal contact in stores and expensive delivery charges,

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Exhibit 3

Consumers expect to spend more money on food with specific attributes, such as high protein and natural ingredients.



¹ Question: Thinking about 2022, do you expect that you will spend more, the same, or less on following types of food products as compared to 2021?

² Net intent is calculated by subtracting the percent of respondents stating decrease from the percent of respondents stating increase.

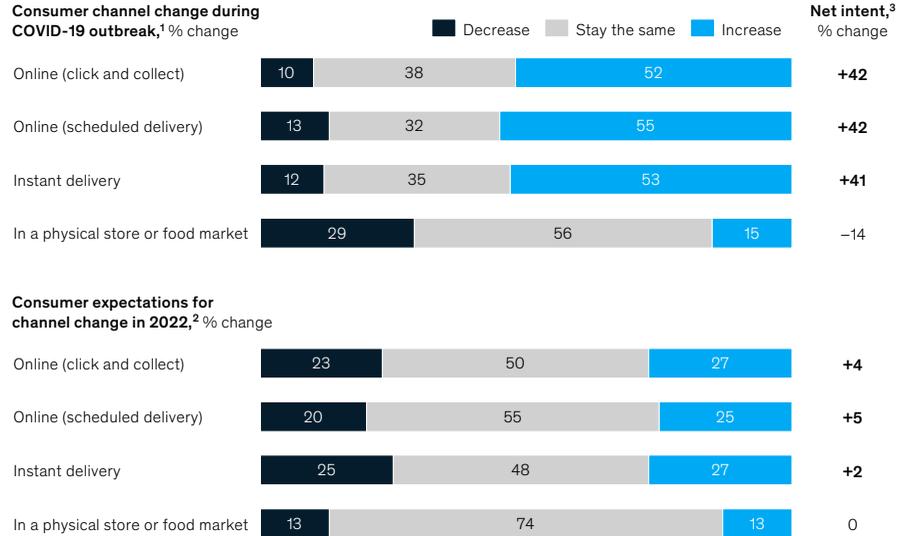
Source: State of Grocery Consumer Survey, November 19–December 7, 2021 (n = 3,007) and January 13–25, 2021 (n = 4,691); sampled and weighted to match the US general population over 18 years old

though consumers are less concerned about these issues today than they were in 2020 (Exhibit 5). Consumers also prefer home delivery when grocery shopping online, marking a change from the preference for click and collect in 2020.

To shift more spending to online, successful grocers will invest to create a more seamless, personalized experience. Here are four key trends to keep in mind:

Exhibit 4

Online and delivery orders increased by about 50 percent during the pandemic and are expected to rise further in 2022.



¹ Question: How did your preference to shop across the following channels change during the COVID-19 outbreak?

² Question: In the next 12 months, do you expect to shop more, less, or the same in the following channels?

³ Net intent is calculated by subtracting the percent of respondents stating decrease from the percent of respondents stating increase.

Source: State of Grocery Consumer Survey, November 19–December 7, 2021 (n = 3,007) and January 13–25, 2021 (n = 4,691); sampled and weighted to match the US general population over 18 years old

Customers expect a consistent value proposition across online and in-store channels. Shoppers are engaging in omnichannel across a variety of shopping missions—weekly grocery shopping and midweek top-ups, for example—and they expect similar assortments, pricing, and promotions, among other factors, across channels.

User experience on apps is becoming more important. Consumers increasingly value the ability to search for products quickly and build their baskets while shopping online. Winning grocers have responded by investing in their e-commerce capabilities and forging partnerships with tech companies (for

example, Albertsons with Google) to improve user experience.

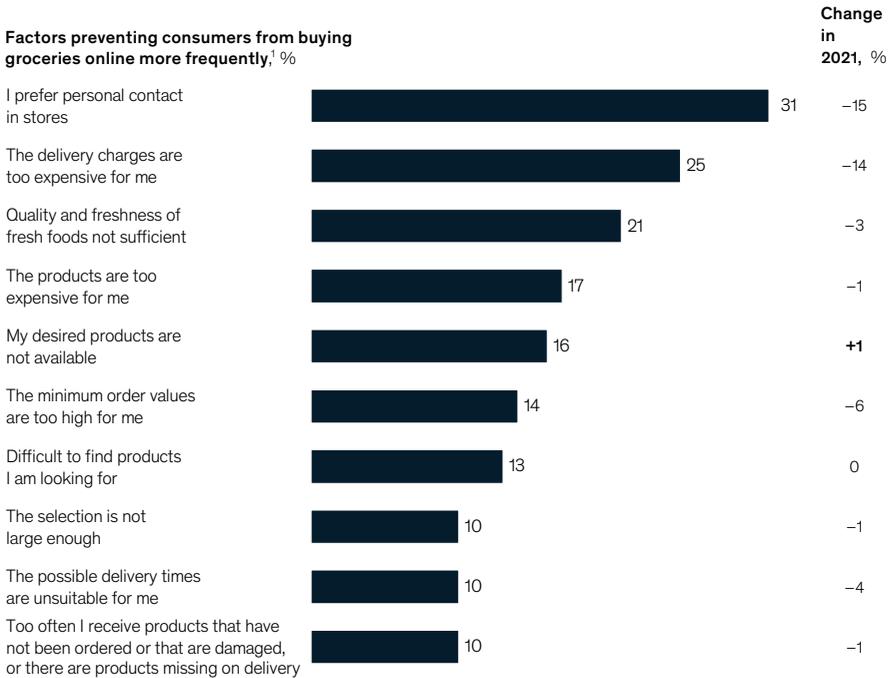
Loyalty and personalization are more important than ever. Grocers are improving their share of wallet with omnichannel shoppers by expanding their capabilities in personalized promotions and product recommendations.

Grocers are also experimenting with shopper engagement in omnichannel. For example, some are using mobile product scanning to get product information. In addition, scan-and-go commerce is changing the way shoppers interact with grocers both in stores and on apps.

Exhibit 5

Cost, quality, and merchandising authority are keys to increasing grocery e-commerce.

Quality and freshness of food remain obstacles for consumers in online grocery shopping



¹ Question: What prevents you from buying groceries online more frequently? Indicate all applicable reasons. Source: State of Grocery Consumer Survey, November 19–December 7, 2021 (n = 3,007) and January 13–25, 2021 (n = 4,691); sampled and weighted to match the US general population over 18 years old

Grocers are also starting to see the upside from omnichannel; the omnichannel shopper spends two to four times more than the in-store customer. Now the focus has shifted from protecting in-store sales to supporting business both online and in stores through omnichannel excellence.

3. Increased emphasis on sustainability

Several developments—the success of the UN Climate Change Conference (COP26) in Glasgow, the dip in emissions at the beginning of the pandemic, and the uptick in climate-related natural disasters—have

made many consumers more aware of the consequences of their purchasing behaviors. This emergence of socially conscious consumers is forcing Fortune 500 companies to act.

Companies beyond those known for their environmental, social, and governance (ESG) policies—such as Ben & Jerry’s, FedEx, and LEGO—are increasingly making more decisions based on social and environmental issues compared with 2020. In our survey, grocery CEOs largely expect consumers in 2022 to place a

greater emphasis on sustainability across all dimensions (for example, packaging and supply chain) and make different choices because of it.

The industry has experienced a groundswell of interest and activity (Exhibit 6). Five years ago, Walmart was the only retailer with ESG targets based on public science; today, grocers, apparel manufacturers, quick-service restaurants, and stores of all formats are seeking assistance with their ESG strategies. For example, Kroger aims to end hunger and

eliminate waste in its communities by 2025, and Albertsons has committed to making 100 percent of its Own Brands packaging recyclable, reusable, or industrially compostable by 2025.⁵ Many retailers recognize the connection between Scope 3 emissions (the result of activities from assets beyond a company's operations, such as vendors) and a global supply chain and are, accordingly, reevaluating operations and ESG simultaneously to enhance resilience while decreasing their carbon footprint.

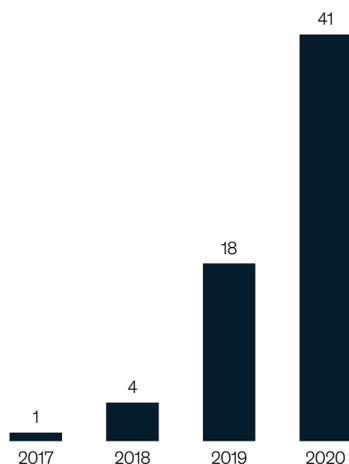
⁵ "Kroger celebrates zero hunger | Zero waste momentum in 2020," Kroger, April 20, 2021; "Plastics & packaging," Albertsons, accessed May 5, 2022.

Exhibit 6

The emergence of socially conscious consumers is compelling Fortune 500 companies to act.

Companies are engaging with the public on environmental, social, and governance (ESG) factors at scale

Global retailers with public science-based targets, number of retailers



>75%

of global GDP is generated in countries with net-zero carbon mandates in law or policy development



44%

of Fortune 500 companies are integrating ESG into core business strategy



76%

of consumers buy or boycott brands based on values



\$30 trillion

sustainably invested globally, up 10 times from 2004

Source: McKinsey analysis

4. Strategic workforce planning and investment in tech and analytics

Automation and AI will affect millions of jobs in the coming years, and retail is one of the most susceptible industries: for example, 54 percent of current work activities in retail can be automated. By 2030, estimates suggest retail could capture 35 percent of this automation potential, resulting in the displacement of approximately six million full-time employees.⁶

Leading organizations have already made bold bets to keep pace with changing workforce requirements. Several organizations are leading the way in efforts to reskill their employees:

Kroger has a tuition reimbursement program that offers up to \$21,000 to part- and full-time associates. More than 6,000 associates have benefited from this program.⁷

Giant Food Stores partnered with Central Penn College to offer a \$1,000 scholarship for its employees to attend the college. Giant also provides \$5,250 a year in tuition reimbursement to full-time associates.⁸

Publix offers varying levels of tuition reimbursement for education options that enhance an employee's ability to perform in a current or future role, ranging from \$4,400 for two-year community colleges to a total of \$16,000 for four-year colleges and universities.⁹

Walmart has invested \$5 billion in a range of upskilling initiatives. For example, employees can earn college credits online through the company's Live Better U program. Tenured employees can take part in the Walmart Academy—dedicated locations near Walmart Supercenters that offer two to six weeks of training to support career advancement. In fiscal year 2021 alone, 95,000 associates were trained via the Walmart Academy. In addition, Walmart and the Walmart Foundation have invested more than \$100 million in the broader “retail opportunity” ecosystem.¹⁰

Amazon provides free education to employees through its Career Choice program—part of the company's \$1.2 billion commitment to upskill more than 300,000 employees for in-demand fields through its AWS Grow Our Own Talent, Surge2IT, and the User Experience Design and Research Apprenticeship programs, for example.¹¹

5. Growing importance of ecosystems and partnerships

Margin pressure for grocers will likely continue through 2022, forcing business leaders to search for growth beyond the core. Grocers have significant loyalty from their core customers and a treasure trove of customer data. They can use these advantages to build broader ecosystems that improve the overall financial profile of their business. We expect grocers to pursue three main ecosystem strategies in 2022:

⁶ McKinsey Global Institute analysis.

⁷ “The Kroger family of companies to hire 10,000 associates,” Kroger, June 7, 2021.

⁸ “Giant Food Stores partners with Central Penn College,” Central Penn College, October 7, 2019.

⁹ “Tuition reimbursement,” Publix, accessed May 5, 2022.

¹⁰ *PrepScholar blog*, “Walmart's Live Better U: Reviews and requirements,” blog entry by Ashley Robinson, College Entrance Examination Board, November 14, 2021; “What is a Walmart Academy? How they're building confidence and careers,” Walmart, April 17, 2017; *2020 Environmental, social and governance report*, Walmart, 2020.

¹¹ “Amazon boosts upskilling opportunities for hourly employees by partnering with more than 140 universities and colleges to fully fund tuition,” Amazon, March 3, 2022.

Partner with tech companies to modernize operations and enhance capabilities.

For instance, microfulfillment center technology players such as Swisslog and Takeoff Technologies are collaborating with grocers Ahold Delhaize and H-E-B, respectively. Google and Microsoft are also forging partnerships with grocers to introduce AI in replenishment and commerce (for example, implementing online tools to enable consumers to build grocery shopping lists).

Join forces with delivery companies for cost efficiencies and e-commerce reach.

Beyond Instacart, Shipt is expanding its engagements with grocers, while DoorDash has partnerships with Smart & Final, Meijer, Fresh Thyme, and Albertsons, among others.

Create new and innovative value propositions to customers.

In Europe, Morrisons has partnered with Deliveroo to offer a ten-minute grocery delivery service called Deliveroo Hop, while Albert Heijn is expanding its “to go” format across BP retail sites. In the United States, Kroger is doubling down on prepared meals through its partnership with Kitchen United.

Ecosystems are not only for the largest grocers to pursue; midsize and regional grocers can also participate by taking a nonleading role or finding a niche to own.

Priorities for 2022

The year ahead is already full of challenges. Leading grocers will be defined by the differentiation, innovation, and defensibility of their strategies. As executives consider

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their course and priorities for 2022, they should address several questions:

1. Changing consumer habits are here to stay. How will you pivot—and continue to pivot—to cater to these evolving needs?
2. Omnichannel is table stakes. How will you continue to build your digital and advanced-analytics capabilities to achieve omnichannel excellence?
3. ESG is gaining importance, and consumers are voting with their feet. Where are you with your commitments?

4. Talent will remain under pressure. Do you have a model in place to attract and replace those leaving the industry?

5. Forward-thinking partnerships are proliferating. Are you creatively looking to push capabilities in the face of new competitors?

Grocery executives that can successfully navigate these five issues will be poised for better performance in the years ahead.

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