Retail Practice

The state of grocery in North America 2023

Grocery executives face a host of new challenges, including flat growth and margin pressure. Five trends could point the way to renewed momentum.

This article is a collaborative effort by Bill Aull, Prabh Gill, Dymfke Kuijpers, Nancy Lu, Eric Marohn, and Griffin McLaughlin, representing views from McKinsey's Retail Practice.

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After a tumultuous 2022, grocery executives hoped rampant inflation and snarled supply chains would soon recede, signaling the return to a more traditional landscape. In some ways, they got their wish: inflation has fallen significantly, and supply shortages have moderated. Yet the lingering effects of these trends and consistent pressure on margins have dampened the outlook. Leaders may be wondering when the days of greater predictability and higher profits will return.

Despite their weariness, CEOs should be prepared to act aggressively. As we have discussed in years past, the best-performing grocery retailers are those that consistently focus on innovation and pursue new ways to create value.[1] Indeed, the very constraints that keep executives up at night also contain the seeds to jump-start growth, diversify revenue streams, and achieve greater operational performance.

Our research and analysis identified five trends that hold the key to thriving in 2023 and beyond (see sidebar, "About the research"). They include stronger private-brand offerings and promotions, an elevated omnichannel experience, broader business diversification, the integration of generative AI, and sustainability as a driver of top- and bottom-line results. Grocery retailers that integrate these insights could be better positioned to meet consumers where they are and provide offerings that deepen loyalty—all while keeping pace with an ever-changing industry.

Dominant themes for 2023

After experiencing double-digit growth last year, the grocery industry has experienced a flatter line in 2023 to date. A series of trends paint a picture of the challenges that lie ahead.

Increased economic pressure driven by inflation

The good news for grocery retailers is that inflation fell to 3.2 percent in July, well below its 2022 peak of 9.1 percent.[2] This drop offers executives a respite from having to choose between passing on cost increases to consumers or pushing them toward lower-cost options. Still, the threat hasn't gone away

[1] Bill Aull, Becca Coggins, Sajal Kohli, and Eric Marohn, "The state of grocery in North America," McKinsey, May 18, 2022.
[2] "Consumer Price Index summary," US Bureau of Labor Statistics, August 10, 2023.

About the research

Our team conducted several proprietary research efforts to gain insights into the changing grocery retail industry. The McKinsey Consumer Pulse Survey consists of responses from nearly 4,000 US consumers in late February and early March 2023. In July 2023, the State of Grocery Consumer Survey explored the changing attitudes and preferences of more than 2,000 US respondents. For the 2023 FMI-McKinsey State of Grocery CEO Survey, McKinsey partnered with FMI, the Food Industry Association, to interview 30 grocery and consumer packaged goods CEOs on how they were adapting to persistent change as well as their perspectives on the future. The McKinsey Consumer Loyalty Survey from December 2021 featured a sample of 10,000 respondents who weighed in on their expectations of brands and priorities moving forward.

The authors wish to thank FMI, the Food Industry Association for its collaboration in developing these perspectives and in supporting the engagement of CEOs from leading North American grocery and consumer packaged goods companies. We hope this research offers new insights that can help grocers and those in the broader food industry remain competitive as they continue to operate in a challenging environment.

entirely: food prices still rose 4.9 percent year over year through July 2023, fueled by a 7.1 percent increase in food-away-from-home costs during this period.[3]

These twin trends have had predictable results. In a McKinsey survey conducted in July 2023, two-thirds of consumers reported spending significantly more on groceries in the past two to three months compared with the previous year. Moreover, nearly 60 percent of respondents said grocery spending represented a significantly higher share of their income.[4] Consumers have also adapted their buying habits by trading down to save money. According to McKinsey's Consumer Pulse Survey 2023, 66 percent of consumers have sought out less-expensive goods, an increase of four percentage points from 2022 (Exhibit 1). This shift was particularly pronounced for consumers with incomes below $100,000 in categories such as meat and dairy and shelf staples.

The beneficiaries of this purchasing behavior have been private-brand goods and warehouse club channels. Private brands' share of growth in grocery categories jumped by double-digit percentage points from 2021 to 2023. Meanwhile, McKinsey analysis shows that warehouse clubs have also gained market share at the expense of traditional grocers and supermarkets.

Resilient e-commerce leads to increased digital engagement

The rapid migration of consumers to e-commerce channels during the pandemic has plateaued. In May 2023, e-commerce stood at 7.2 percent of all grocery spending, more than 35 percent above prepandemic levels (Exhibit 2). Consumers were initially drawn to online grocery out of necessity, but as they have become more familiar with these channels, their preferences have shifted toward e-commerce.[5]

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[3] Ibid.

[4] State of Grocery Consumer Survey, McKinsey, July 7–15, 2023; n = 2,011; sampled and weighted to match the US general population 18 years and up.

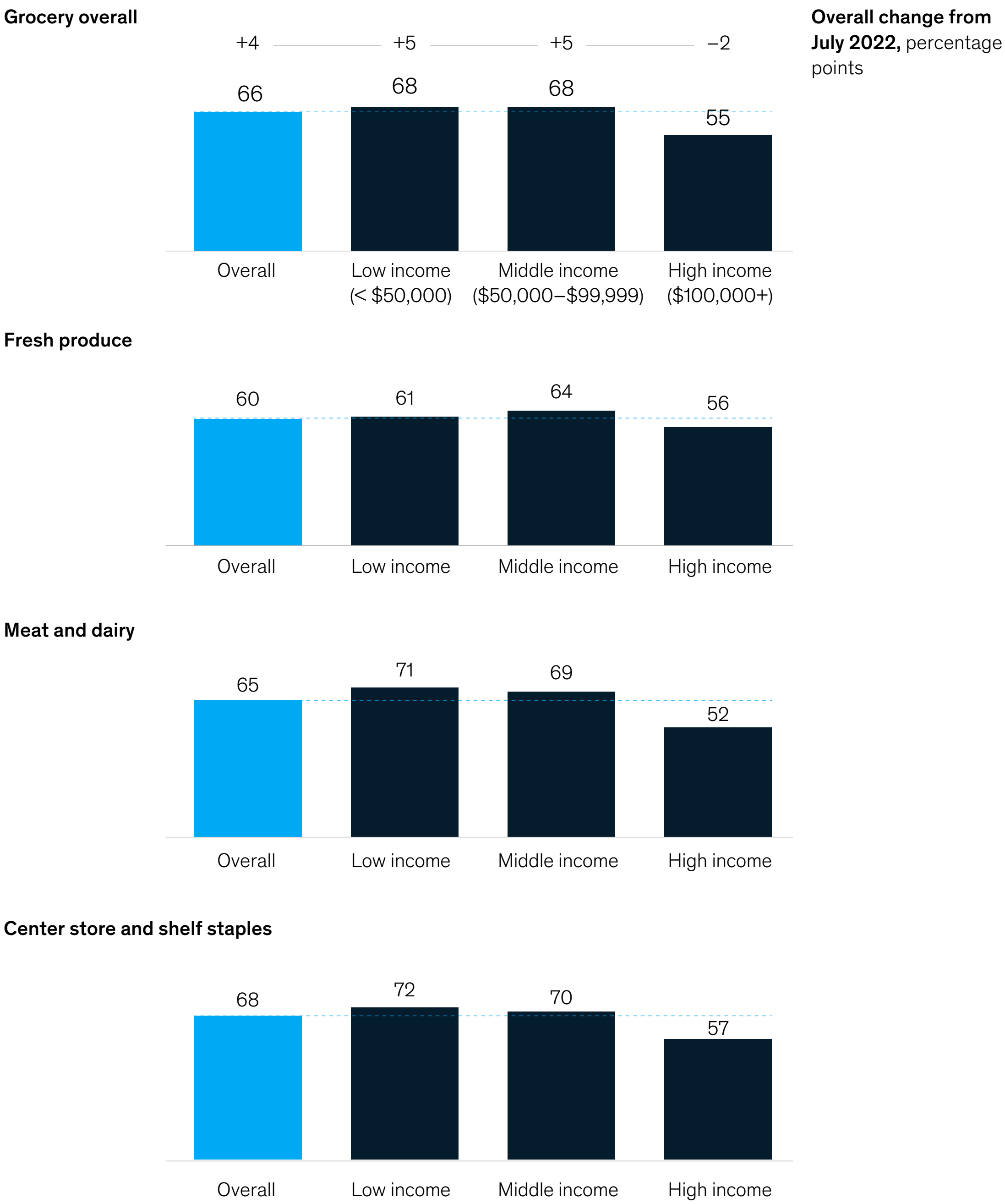
[5] McKinsey Consumer Pulse Survey, February–March 2023.

According to McKinsey's Consumer Pulse Survey 2023, 66 percent of consumers have sought out less-expensive goods, an increase of four percentage points from 2022.

Exhibit 1

Facing higher food prices, consumers have been trading down more across grocery categories to save money.

Share of respondents who traded down on groceries in the past 3 months,[1] %



[1]Question: Within the past 3 months, have you done any of the following when purchasing a product? Trade-down behavior includes one or more of the following answers: shopped from a lower-priced retailer, shopped from lower-priced brand, bought private brand, bought a brand for which you had a coupon, used buy-now-pay-later, delayed a purchase, bought a larger-size pack for a lower price, bought smaller size or quantity, and made more shopping trips in search of discounts.
Source: McKinsey US Consumer Pulse Survey, Feb 24–Mar 1, 2023 (n = 3,973, sampled and weighted to match the US general population aged 18 years and older)

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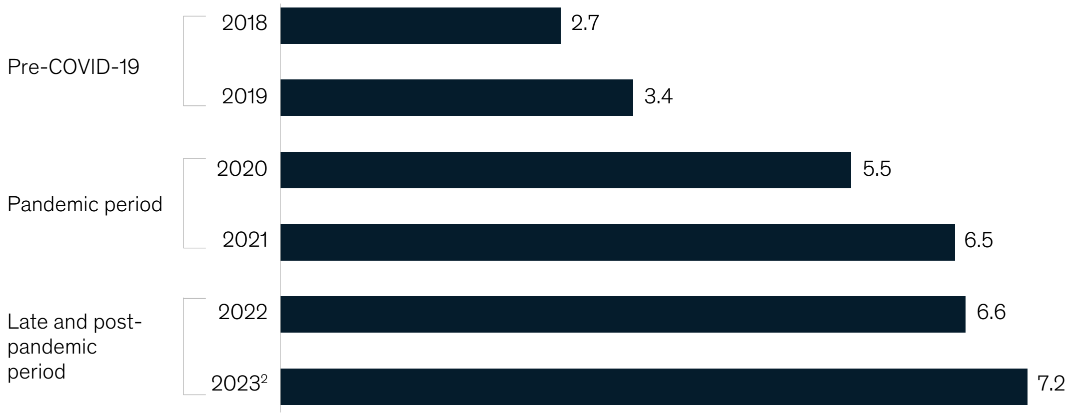
Exhibit 2

The proportion of online spending for grocery has increased since the onset of the pandemic.

Proportion of grocery spending done online,[1] %



[1]Grocery is defined as food and nonalcoholic beverage sales, including canned goods, produce, etc. Does not include restaurant sales.
[2]Forecast.
Source: Forrester, US Online Retail Forecast, 2023 to 2028, July 2023

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Our grocery consumer survey found that convenience—in the form of time savings, delivery, and ease of price comparisons, among others—was the overwhelming draw for online channels.[6] But in addition to the advantages of online shopping, consumers cited several obstacles, including high delivery fees and a preference for personal contact with products in store. Grocery retailers would likely need to enhance the online experience to boost e-commerce penetration further.

Accelerating pressures on profitability

To cope with the pandemic's upheaval, grocers dramatically increased their capital expenditures: from 2020 to 2022, these expenditures rose at a CAGR of 7.5 percent. Our CEO survey found much of this investment went to stabilize supply chains. The top three categories for capital expenditures were forecasting capabilities (80 percent of respondents), inventory management (77 percent), and supplier base diversification (70 percent).

In 2022, executives cited supply shortages as their top impact theme. What a difference a year makes. Possibly because grocers have acquired additional capabilities and flow of goods has increased, supply shortages have now fallen to the middle of the pack of concerns.

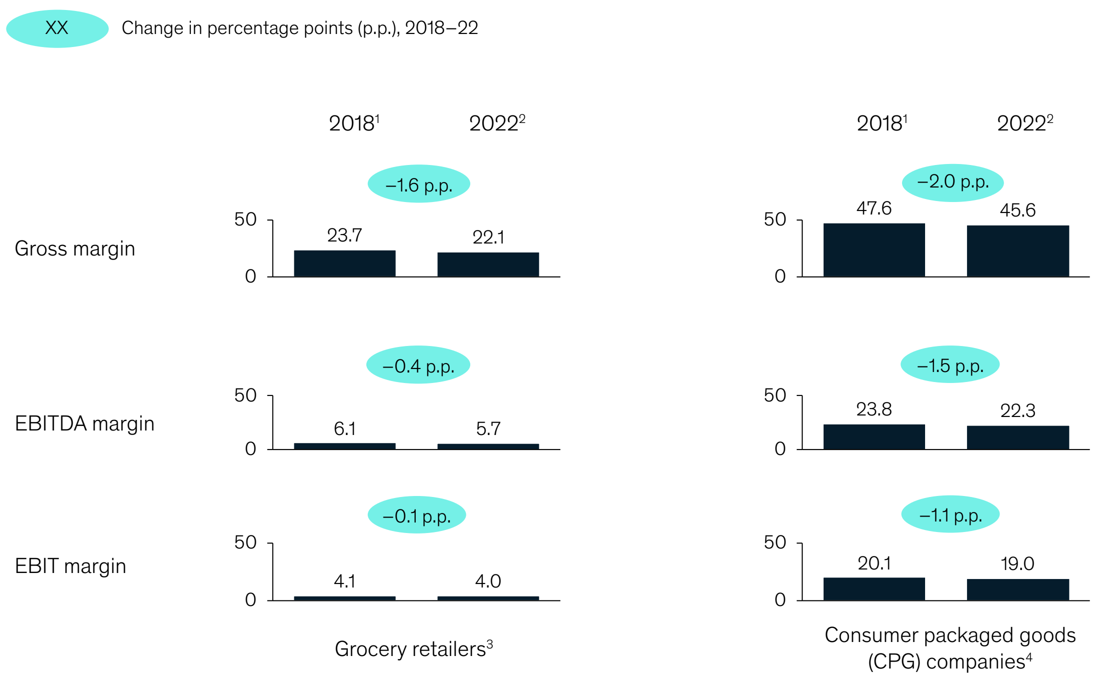
However, rising capital expenditures have also contributed to margin pressure for both grocery retailers and consumer packaged goods (CPG) companies. Over the past decade, this increased spending has outpaced revenue growth. The capital expenditure–revenue ratio was 23 percent lower in 2022 than in 2012, highlighting the divergent paths of these metrics. From 2018 to 2022, EBITDA margins for grocery retailers and CPG companies decreased 0.4 and 1.5 percentage points, respectively (Exhibit 3).

[6] State of Grocery Consumer Survey, McKinsey, July 7–15, 2023.

Exhibit 3

Even with increased prices, grocery retailers and consumer packaged goods companies face downward margin pressure.

Comparative margins, %



[1]2018 denotes the fiscal year that starts in 2018, regardless of how companies themselves define their fiscal years.
[2]2020 denotes the fiscal year that starts in 2020, regardless of how companies themselves define their fiscal years.
[3]For a collection of 15 publicly traded hypermarkets and supercenters, food retailers, and general-merchandise stores: Big Lots, Casey's Retail Company, Costco, Dollar General, Dollar Tree, Ingles Markets, Kroger, Natural Grocers by Vitamin Cottage, PriceSmart, Sprouts Farmers Market, Target, Tuesday Morning Corporation, Village Super Market, Walmart, and Weis Markets. Aggregated figures shown.
[4]For a collection of 15 publicly traded CPG companies: Campbell Soup, Clorox, Coca-Cola, Colgate-Palmolive, Conagra, Constellation Brands, Dr Pepper, General Mills, J.M. Smucker Company, Kellogg, Keurig, Kraft Heinz, Mondelez, P&G, and PepsiCo. Aggregated figures shown.

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Upheaval in the labor market

The Great Resignation was one of many striking developments during the pandemic. While the overall workforce has largely rebounded, grocery retailers continue to struggle with talent attraction and retention. In early 2023, 44 percent of frontline retail workers were considering leaving their jobs in the next three to six months.[7] Even though the quit rate has fallen sharply since then, CEO survey respondents cited labor shortages as the biggest challenge (along with inflation) for the grocery industry in 2023 (Exhibit 4). Today, the retail industry has approximately four million more open positions than candidates searching for work.[8]

Sustainability as part of core business operations

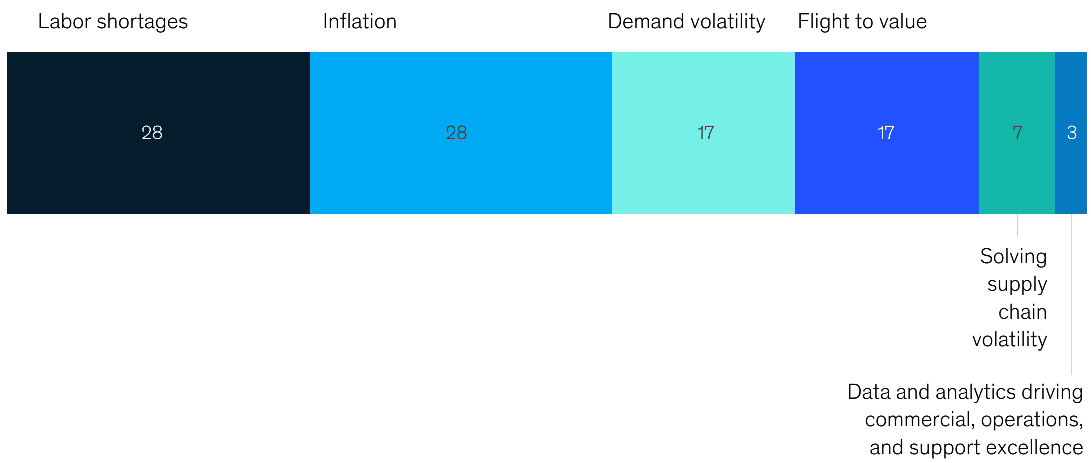
Our 2022 survey found that grocery retail CEOs expected consumers to prioritize sustainability in their purchasing behavior.[9] They proved prescient, as events within and beyond the industry have kept the issue in the spotlight. Other stakeholders—regulators, investors, and nongovernmental organizations (NGOs)—are also

[7] McKinsey Talent Trends Survey, January 2023 (n = 15,366).
[8] Bureau of Labor Statistics Job Openings and Labor Turnover Survey, June 2023.
[9] "State of Grocery Europe 2022: Navigating the market headwinds," McKinsey, March 31, 2022.

Exhibit 4

CEOs cite labor shortages as one of the biggest challenges for the grocery industry in 2023.

Biggest challenge for the grocery industry in 2023,[1] % of respondents



[1]Question: What do you think will be the single biggest challenge and the single biggest opportunity for the grocery industry in 2023?
Source: 2023 FMI-McKinsey State of Grocery CEO Survey, February 18–March 15, 2023 (n = 30)

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elevating sustainability in grocery. For instance, the regulatory environment for grocers is set to become more complex: by 2030, more than 15 sustainability-related regulations are expected to go into effect, and they will complicate the business and operating environment. The majority of the regulations are related to food waste (for example, ensuring food waste doesn't end up in landfills), packaging (such as the phaseout of single-use plastics), and increased restrictions on labeling. These measures could force grocery retailers to adapt their operations.

Similarly, investors are engaging in shareholder activism to demand that food companies actively work to meet climate goals. Instead of divesting from such an essential industry, investors have adopted tactics such as exclusion (barring a company's securities from being added to an investment portfolio) to push sustainability initiatives further. NGOs have also sought to exert their will: several are lobbying regulators to extend the US carbon tax to food. NGOs are also important forces in facilitating corporate shifts toward sustainable initiatives.

Trends shaping the grocery market in 2023 and beyond

Our CEO survey found that grocery executives are distinctly pessimistic about growth prospects in

2023. Indeed, two out of three CEOs believe growth will be slower this year than in 2022. Similarly, in our conversations, CEOs described the industry as “volatile,” “challenging,” “uncertain,” and “competitive”—sentiments that indicate the difficult road ahead. Top of mind for executives are the labor shortage and demand volatility.

Based on our consumer research, CEO survey, and market analysis, we believe five trends will shape the grocery landscape in the years to come.

1. Ongoing pressure to deliver value to consumers

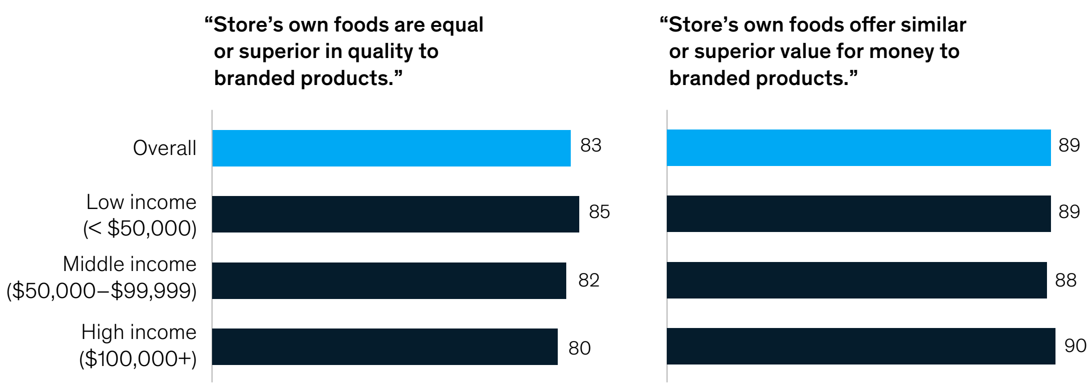
Reducing spending remains a top priority for shoppers in all income groups. Indeed, nearly 60 percent of consumers are looking for ways to save money, an increase of 13 percentage points from 2022. This search for savings means private-brand offerings could take on added importance. In 2023, 44 percent of consumers are planning to buy more private brands, nearly double last year’s percentage. Even if market conditions improve, consumers might continue buying private brands: 83 percent of consumers believe the quality of private-brand goods is equal or superior to that of branded products (Exhibit 5).

Consumers’ quest for savings also extends to a heightened interest in discounts, a pattern that holds true even among high-income shoppers (Exhibit 6). Seventy-three percent of consumers report that discounts for grocery items have become more important in their shopping decisions compared with a year ago. Other factors, including the continued consolidation of the grocery market through M&A and persistent inflation, will further push grocers to offer competitive low-price options.

Exhibit 5

Most consumers across income groups perceive private brands as equal or superior in quality and value to national brands.

Attitude toward store’s own brands compared to national brands,[1] % of respondents



[1]Question: We would like to ask you a few questions about store’s own brand foods (ie, food products sold under the label of the grocery retailer). In each line, please select which statement you agree with the most.
Source: McKinsey State of Grocery Consumer Survey, July 7–15, 2023 (n = 2,011, sampled and weighted to match the US general population aged 18 years and older)

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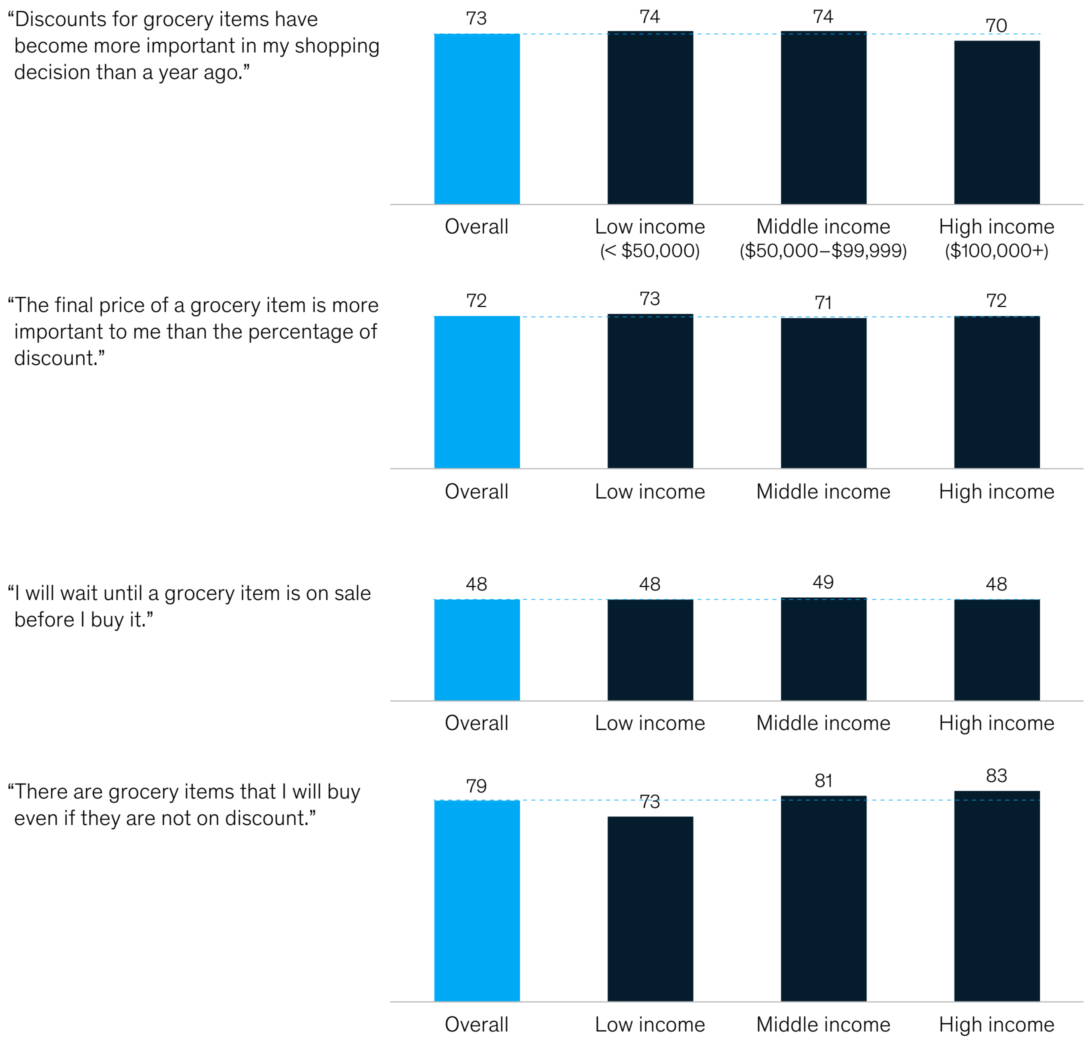
Exhibit 6

Across income groups, discounts have become more important to grocery shoppers.

Attitude toward discounts,[1] % of respondents



[1]Question: To what extent do the following statements apply to you? Percent shown is the sum of responses "probably applies to me" and "definitely applies to me."
Source: McKinsey State of Grocery Consumer Survey July 7–15, 2023 (n = 2,011, sampled and weighted to match the US general population aged 18 years and older)

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Grocers will have to find ways to deliver increased value to consumers. However, attempting to win on price against national brands is a tough path, putting grocers under rising pressure to develop compelling private-brand offerings comparable to those of other national brands. About 80 percent of food retailers and manufacturers plan to moderately or significantly increase their investments in private brands over the next two years, with a focus on value and price as a top area for innovation.[10]

Private-brand products are attractive because they typically have higher margins than branded products. In US grocery stores, for example, private brands' share of dollar volume increased by 10.3 percent in the first quarter of 2023 compared with the previous year, nearly twice the 5.6 percent rise of national brands during the same period.[11]

H-E-B has invested heavily in its private-brand strategy to capitalize on its brand recognition among consumers. These goods made up nearly 27 percent of the company's revenues in 2022.[12] One shopper commented, "I love [H-E-B] because of their store brand and all of the different things they make and have to offer. They truly put pride in their work."[13] As one of the fastest-growing US retailers, H-E-B has demonstrated the ability of successful private-brand products to significantly increase profits.

In addition, retailers that create unique experiences and provide greater convenience will be positioned to compete on more than price alone. Identifying what consumers value most and offering flexibility (for example, options for smaller pack sizes) will be critical to this effort.

2. Elevated personalized experience across channels

Consumers have come to expect a consistent, seamless, personalized experience across the entire journey, making omnichannel no longer a "nice to have" but a critical offering. The nature of omnichannel retail has changed dramatically over the past several years. During the pandemic, grocery shopping shifted from primarily an in-person exercise to engagement across channels. In response, retailers expanded services such as "buy online, pick up in store" and relied on partners such as Instacart and Shipt for personalized shopping and delivery. The shifting landscape had a pronounced impact on loyalty: consumers were increasingly open to trying new brands and store formats to suit their preferences.

So how can grocery retailers reel consumers back in and strengthen loyalty? More than ever, personalization holds the key. Our 2022 consumer loyalty survey found that 80 percent of consumers are more likely to make a purchase when offered a personalized experience. Over the past two to three years, retailers that emphasized personalization have raised the bar for consumer experience. The most successful grocers will continue to invest in personalization and omnichannel capabilities to attract, engage, retain, and deliver value to customers. To remain competitive, grocers should use purchase history to inform product offerings.

Kroger, for example, has partnered with Uber Eats and DoorDash to expand market penetration of its ready-made meals in response to shifting consumer preferences. The move comes as Kroger looks to grow its presence in consumers' cross-category food routines, becoming a destination not only for groceries but also for ready-made meals.[14]

3. Broader business diversification

Last year, our analysis highlighted how grocery retailers were building ecosystems by partnering with tech companies, joining forces with delivery companies, and creating new value propositions. Grocery executives continue to explore ways

[10] "The power of private brands 2023: Innovation that drives winning private brands," FMI, 2023.
[11] Louis Biscotti, "From buy buy brands to bye bye brands? How private label is beginning to win F&B brand wars," *Forbes*, May 10, 2023.
[12] "Study reveals Top 10 private label retailers, share of spend," Blue Book Services, August 1, 2022.
[13] "H-E-B returns to the top spot as the #1 U.S. grocery retailer," H-E-B, February 6, 2023.
[14] "Kroger teams with Uber Eats in bid for greater share of food spend," PYMNTS, May 3, 2023.

to create new revenue streams and expand ecosystems, all in an effort to meet consumers where they are.

We now see grocery retailers moving beyond the core by entering new categories, developing new sourcing strategies, expanding into consumer services, and selling B2B services that harness their strengths. For example, Kroger, Albertson's, and many others have launched e-marketplaces that enable third-party vendors to sell directly to consumers. The resulting "endless aisles" vastly increase the available assortment. Both national and regional grocery retailers continue to launch retail media networks to take advantage of the rising demand for a targeted ad experience using consumer data.[15] Moreover, grocery stores have become a destination for health and wellness—not just for food but also for nutrition and healthcare services. To support these new forays and enhance capabilities, the grocery industry has seen a rising number of partnerships between grocery stores and tech companies (for example, Kroger and Cooler Screens).

Grocery's ever-expanding role can enable broader business diversification. Grocers are redefining their business models to capitalize on fulfillment opportunities and adapting their value propositions. They could extend their reach by embracing third-party marketplaces, dark stores, and microfulfillment centers.

Grocery retailers have an attractive set of options for strategic expansion. As margin pressures persist, they should identify growth areas beyond the core to build a broader ecosystem of services and offerings that expand the consumer value proposition, build capabilities, and improve the financial profile of the business.

4. Acceleration of generative AI

Last year, we noted the potential of automation and AI for the retail industry. This year, retailers are exploring that potential. About 85 percent of retailers reported experimenting with new technologies to improve the customer experience, and 35 percent of suppliers are using AI to better harness customer data.[16]

The introduction of generative AI has expanded that potential considerably. Based on our latest research, generative AI could add $2.6 trillion to $4.4 trillion annually to the global economy across more than 60 use cases, including many in retail.[17] For now, the majority of use cases remain within analytics and the consumer front end.

Recognizing generative AI's vast potential, grocery players are already making moves. Kroger has partnered with 360i to develop Chefbot, which uses visual AI to recognize ingredients for more than 20,000 recipes in order to simplify meal planning and minimize food waste. Walmart has invested heavily in using generative AI to enhance store operations and employee experience. It has already implemented AI-powered simulations to predict customer patterns and ensure supply chain readiness. And Instacart launched a ChatGPT plug-in to recommend products by answering shopper questions, such as "What are good sauces for grilling chicken?" or "What are dairy-free snacks for kids?"

Generative AI is not just about labor efficiency. It is reshaping commercial activities (for example, through personalization algorithms), corporate functions (such as call-center support and business operation processing), and heavily labor-intensive store activities. Grocers should consider developing plans to harness generative AI to transform their

[15] Marc Brodherson, Jon Flugstad, Quentin George, and Jack Trotter, "Six secrets of unleashing the power of retail media," McKinsey, May 18, 2023.
[16] *The food retailing industry speaks 2023*, FMI, 2023.
[17] "The economic potential of generative AI: The next productivity frontier," McKinsey, June 14, 2023.

business, capture more value, and accelerate growth opportunities. As a first step, grocers could prioritize relevant use cases—in part by tracking their relative level of adoption among competitors.

5. Sustainability as a driver of the top and bottom lines

A brand or retailer's sustainability commitments continue to influence purchasing decisions, particularly among younger consumers (Exhibit 7). Shoppers increasingly expect companies to "walk the walk." In fact, we see a clear link between consumer spending and a company's ESG efforts.[18] Products with ESG-related claims achieve 1.7 percentage points more sales growth than products that don't.

Sustainability and cost are often seen as diametrically opposed trade-offs, but sustainability itself is increasingly critical to the viability of business operations and profit and loss (P&L). The transition from fossil fuels to renewable energy is becoming more complex as power outages and increased points of failure threaten disruption of day-to-day operations. The grocery industry's greater reliance on energy—grocers could consume 40 percent more electricity, on average, by 2030—makes it more vulnerable as energy becomes more expensive and intermittent. As an indication of how sustainability has permeated strategy, 87 percent of food retailers and 91 percent of food suppliers have identified environmental, social, and governance (ESG) as an organizational priority.[19]

Some grocers have already taken action to diversify their energy sources. For example, Walmart's Project Gigaton has taken major action to reduce its total Scope 3 emissions. The initial goal was to reduce or avoid one billion metric tons of greenhouse gases from the global value chain by 2030, but the retailer had already achieved 75 percent of its target by 2022.[20]

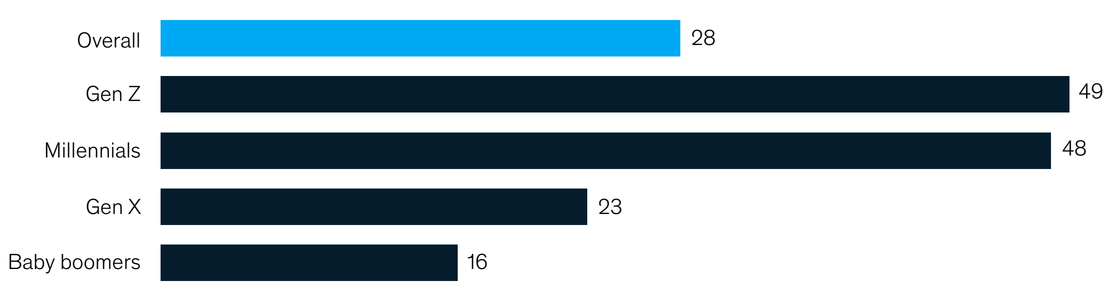
Grocery shoppers have cited the recyclability of goods as the most important sustainability factor.[21] Yet while use of plastic continues to increase, demand for recycled plastic far exceeds supply, and investment in recycling infrastructure is falling short. According to McKinsey analysis, the amount

[18] "Consumers care about sustainability—and back it up with their wallets," McKinsey, February 6, 2023.
[19] *The food retailing industry speaks 2023,* FMI, 2023.

Exhibit 7

Consumers, especially younger ones, continue to place a premium on sustainability.

Attitude toward premiumization and sustainability,[1] % of respondents who are willing to pay more for environmentally friendly products (eg, zero pollution, recyclable materials, or minimized packaging)



[1]Question: Think about the following types of food/services. Which statement best describes your attitude?
Source: McKinsey State of Grocery Consumer Survey July 7–15, 2023 (n = 2,011, sampled and weighted to match the US general population aged 18 years and older)

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of recycled plastic in the market, on average, hasn't changed in 20 years. An added challenge: high-quality recycled material commands a premium in the market.

To have any hope of meeting recycling goals, grocery players would need to work together to embrace recycling solutions. For example, the Beyond the Bag Initiative is a multiyear collaboration across retail sectors to address plastic bag waste.

By the end of the decade, factors that are now adding to complexity—including energy, recycling, and infrastructure—will become critical. Grocers will need to keep pace with changing trends to remain competitive in the long run. Amid growing disruption, grocers could prioritize sustainability now to ensure longer-term success. For example, switching to renewable energy and forming coalitions to meet recycling goals could improve energy stability and waste management, respectively, while generating returns for grocers over the coming years.

Top priorities for 2024

As grocery executives consider their priorities for 2023 and beyond, they should address several questions:

— What steps can we take to enhance the focus on value perception, including the role of private brands in increasing value to the consumer?

— How can we create a seamless omnichannel experience to deliver a personalized offer and messaging at the right time and in the right place?

— What growth areas beyond the core can broaden our ecosystem of services and offerings to provide more value to customers and build capabilities for the business, and how can we reimagine the operating model for long-term profitability?

— Which generative AI use cases should we prioritize, and how do we create a test-and-learn culture to get the most out of this technology?

— What actions do we need to take to accelerate our transition to renewable power, establish recycling solution coalitions with other grocers, and amplify messaging around ESG-related claims?

Grocery executives who can develop effective strategies across these five trends will position their organizations to not only restart growth but also weather an unpredictable landscape.

[20] "Project Gigaton," Walmart Sustainability, accessed September 5, 2023.
[21] State of Grocery Consumer Survey, McKinsey, July 7–15, 2023.

Bill Aull is a partner in McKinsey's Charlotte office, **Prabh Gill** is an associate partner in the Vancouver office, **Dymfke Kuijpers** is a senior partner in the Singapore office, **Nancy Lu** and **Griffin McLaughlin** are consultants in the New Jersey office, and **Eric Marohn** is a consultant in the Chicago office.

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