



RETAIL'S REVOLUTION

HOW RETAIL AND CONSUMER
GOODS COMPANIES CAN ADAPT

PREFACE

There has never been a better time to go shopping. There has never been a tougher time to run a shop.

Consumers can now find, buy, and receive products in a multiplying number of ways. Where shopping was a chore, it now gets done in a few clicks. Where it was a pleasure, it has expanded into a journey of discovery.

All this depends on a stream of innovations – in fields as diverse as online interfaces, store operations, and delivery. But innovation often means disruption, with new business models being created. Many of the new models will come from new participants in the sector, acting either independently or in strategic link-ups with incumbents. As new models gain popularity, business will drain away from others – something particularly visible in the shift to online sales. This has led to store closures, accompanied by headlines like “the death of retail.”

To dig deeper into these upheavals, we interviewed more than 50 executives in retail, consumer-goods manufacturing, finance, and government, as well as other sectors that interact with retail. The resulting insights enabled us to put together this report, and I would like to thank these participants for their generous contributions.

For me, four conclusions stand out.

First, there are huge opportunities for new businesses and inventive incumbents to thrive in retail. The shopping experience of the future is still being designed, and every new solution will be followed by something even better.

Second, making the most of these opportunities will require visionary leaders who embrace change. Some are already altering the landscape of the industry.

Third, new retail business models will be very different from those of today. Reports of the death of traditional retailers are certainly exaggerated, but many will need to invent new roles in the shopping system to survive and thrive over the long term.

Fourth, brand owners and manufacturers are not immune from disruption either.

We do not claim to have detailed prescriptions for every aspect of the retail and consumer sector. But we have identified some crucial areas where seismic shifts are opening up both opportunities and dangers. And we have some ideas about how best to approach the new era.

I hope you find our report a valuable contribution to the debate.

Best wishes,



A handwritten signature in black ink, appearing to read 'Nick Harrison'.

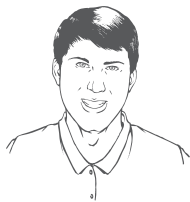
Nick Harrison
Global Retail Practice Co-Leader

REPORT CONTRIBUTORS

Bernard Demeure is a Paris-based partner whose love of travel, wine and good food products drive him to visit and experience stores, markets, and take-aways the world over. He's passionate about innovation.



Bobby Gibbs is a Dallas-based principal who despite his love of technology and reliance on online reviews almost always goes to a store when he needs anything except for the dress shirts he has saved on his favorite website.



Dr. Nick Harrison is the London-based co-lead of the global Retail and Consumer Goods practice who does most of his shopping online but still takes his children to the store as a treat.



Emmanuel Ladoux is a Paris-based principal who looks forward to seeing how retailers will leverage advanced technologies and analytics to operate more efficiently and make customer journeys more natural.



Crystal Liew is a London-based principal who makes most of her routine purchases on her mobile phone, but spends her weekends visiting independent local shops for fresh food, clothing, and books.



Kate Wildman is a London-based marketer for Oliver Wyman who loves fashion but doesn't really love shopping. Direct-to-Consumer boutique brands are what she searches for but the convenience store is where she stocks up on daily groceries.



Marc Poulin is the former CEO of Sobeys and is now a corporate director whose true passion remains merchandising. After being the food butler to millions of Canadians, he now enjoys being the private food butler to his wife, Ginette. He also travels the world always looking for new food delicacies. His latest catch: lion fish.



Richard Pennycook is the former CEO of Co-op UK and now serves as the chairman of four retailers and the British Retail Consortium. When shopping he spends much more time looking than buying – both in store and online – because he loves to see what retailers are doing. He hates the idea of a “retail butler” doing it all for him.



Dominique Schelcher is Vice president of Système U, the French cooperative multiformat retailer. He owns and runs a Super U supermarket, and is in charge of communication for the Système U Group. He is a leading observer of current changes, sharing extensively on social networks.



Sven Seidel is the executive board member responsible for multichannel retail at Otto Group and the former CEO of Lidl. He is an expert in lean retail and operational excellence, but his true professional passion is leading retailers toward seamless integration of offline and online customer experiences.



Frederic Thomas-Dupuis is a Montreal-based partner who enjoys going to the farmers market with his wife but nevertheless wishes the weekly food shop was delivered to his home seamlessly.

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ADDITIONAL CONTRIBUTIONS

James Yang, Edouard de Mézerac,
Sebastian Moffett, Arnaud Schlumberger,
Arthur du Passage, Frederic Reynaud,
Cyril Straughn-Turner, Loubna Lahlou

DESIGN

Campbell Reid, Creative Head
Adrien Slimani, Art Director
Lorena Mondragon, Illustrator
Josselin Coissard, Illustrator
Katharina Vaubel, Image Researcher

A photograph of a man and a woman looking at a smartphone together. The woman is on the left, pointing at the screen, and the man is on the right, looking down at the phone. The image has a blue and purple color overlay.

PART ONE: DIGITAL UPHEAVAL

ONLINE RETAIL'S CONTINUED RISE

The biggest and most visible disruption to retail of the past 15 years has been the continuing rise of online shopping. Predictions of how fast e-commerce penetration will grow over the next 15 years, and when it will cap out, have varied widely. Like many others, we think online growth will continue. While there are too many unknowns to make meaningful predictions on penetration, we think it is helpful to build an understanding of the underlying drivers of e-commerce's continued growth: What is keeping penetration low today? What key

innovations will unlock further increases? How widely will these innovations be adopted in each market?

BARRIERS TO ONLINE SALES WILL COME DOWN

Our 2017 Digital Shopping survey, which was conducted in the United States, United Kingdom, France, and Germany, shows that latent demand for online shopping is very high. Seventy percent of consumers in these countries are open to shopping online: they either shop online regularly or would switch if the convenience, browsing



“How quickly and how well home delivery evolves will be the number one driver of change”

Grocery executive

experience, or value for money improved. Even in food, which has been going digital slower than most other sectors, half of consumers are open to online shopping. Yet online sales still only account for 15 percent of the general merchandise retail market in North America and much of Europe, and just three percent in food.

Two barriers to greater online penetration have stood out. First, there are many shortfalls in the current digital shopping experience. For many users there is still a gap between the intuitive nature of walking around a physical store and the

online browsing experience – especially when this is condensed onto a mobile screen. Second, there remain significant costs and hassles in order fulfillment and delivery. For all but the smallest items, customers either have to wait at home for a delivery, or pick their purchase up from a collection point, which may or may not be convenient. Moreover, delivery costs still pose a barrier, particularly in food where they can add up to 10 percent to the cost of an average weekly shop.

However, solutions are being developed rapidly. (See Exhibit 1.) Advances in

technology are significantly improving the user experience. Voice recognition is starting to provide a viable alternative for people less comfortable with web or mobile browsing. In parallel, predictive algorithms are reducing the amount of information shoppers have to input – whether by voice or other means – by curating personalized ranges, profiling user preferences, and offering time-saving tools such as meal planning. Augmented and virtual reality could make the online shopping experience just as compelling as in a traditional store. In combination, these techniques could even allow retailers to serve customers better online than they can in physical stores.

These ideas have existed for decades, first in science fiction and then as often-clunky proofs of concept. But in the last couple of years, the underlying technology has reached sufficient maturity for them to be taken seriously as practical, commercial solutions. L’Oréal’s Makeup Genius app, which has had over 10 million downloads, accurately applies makeup to real-time images of customers, providing a realistic way for users to simulate new looks. Thread’s designers first create coherent template styles, then rely on machine learning to match customers to the right blend of templates and create sophisticated recommendations. In food, collaborations between retailers and recipe banks, such as Walmart and Tasty in the US, and Sainsburys and *BBC Good Food* magazine in the UK, give consumers the option to view prices and buy ingredients for entire recipes with a single click.

The innovations are not purely technological. Amazon Wardrobe’s try-first-pay-later online apparel proposition lets customers try on a diverse range of styles

in the comfort of their own homes without worrying about their cash flow. That is taken care of by Amazon.

Innovation is not limited to customer experience. New approaches are also reducing the cost and inconveniences of picking and delivery. The average food basket contains more than 30 items of different shapes and sizes. Manual picking is the best way to avoid delivering damaged goods to picky consumers, but it is costly. Ocado has achieved a good middle ground: a system of conveyor belts minimizes the distances pickers have to walk, so they can instead spend more of their time on carefully assembling and packing customers' orders.

Another challenge in food has been the need for a specialized supply chain that can maintain different temperatures for fresh, frozen, and ambient products, while also handling bulky categories such as multipack beverages and toilet paper. Innovations in packaging and passive cooling could help retailers to lower the cost of multi-temperature deliveries by using the same vehicles as for regular parcels. Amazon's Pantry box limits customers to standard-sized boxes, which do not include fragile items such as eggs, sliced bread, and soft fruit.

Taken together, these innovations could significantly reduce the cost of grocery

picking and delivery, allowing retailers to provide these services for lower fees and increasing penetration. If food deliveries become more frequent and they share capacity in standard parcel vans, then delivery costs for other retail sectors could also start to come down. The effect could be particularly marked in rural areas, where lower order frequency and drop density still pose a barrier to online penetration. Greater frequency will give customers more choice over delivery timings, minimizing the disruption to their daily activities.

TRADITIONAL RETAILERS WILL NOT BE NATURAL ONLINE LEADERS

Most traditional retailers are not set up to deliver these innovations. To achieve minimum scale online requires investment into infrastructure which increases the fixed cost base. While some growth in online sales will come from customers who usually shop elsewhere, a significant proportion will cannibalize a retailer's own brick-and-mortar stores, adding running costs but not revenues. Many retailers that have tried and failed to set up in-house digital incubators have also realized that this type of development is not in their DNA. The concepts and working methods required – flexible cross-functional project teams, rapid test-and-learn, a nimble decision hierarchy – remain foreign to organizations with a command-and-control culture. Left to their own devices, few incumbent retailers will manage these innovations.

However, retailers that do not make progress in these areas risk being left behind by companies who have accelerated investment. Investment in innovation is core to the operating models of new-economy giants such as Amazon, while the largest traditional retailers like Walmart are using their scale to place bets. (See Exhibit 2.) In 2017, Code Eight, part of Walmart's startup accelerator

“Competition and collaboration will shift over the next five years. Walmart originally refused to sell the Kindle because it was for a competitor, now of course you sell it”

Grocery executive

“[Retailers need to be] less concerned about competition, more open to collaboration, otherwise the consumer will just go around you.”

Grocery executive

EXHIBIT 1. REMOVING BARRIERS TO ONLINE PENETRATION

COMPANIES ARE EXPERIMENTING WITH SOLUTIONS TO THE BIG CHALLENGES OF ONLINE SHOPPING

FOOD

BARRIERS	SOLUTIONS	EXAMPLES
Infrequent drops and high delivery costs	Retailer-logistics partnerships	Amazon partners with DHL in Germany, where DHL's high drop density makes Amazon Fresh delivery more economical
High delivery costs for fresh and refrigerated products (requirement for refrigerated trucks)	Dynamic routing	Carrefour partners with Cogepart , who optimizes and makes real-time updates to delivery routes
Need to be at home for fresh product delivery	Passive cooling	TEMAX's passive cooling systems limit temperature fluctuations during transport at lower cost than active cooling
Difficulty of choosing from a wide product range online	Food freshness tracking	Timestrip's smart labels flag food that has warmed to give confidence that the product has been handled at the appropriate temperature, even in passive cooling
	Refrigerated lockers	Glory's refrigerated locker enables customers to collect food from a nearby pick-up point
	In-fridge delivery service	In Walmart's trial with August Home , the delivery driver can access a customer's home to place fresh food in their refrigerator
	Plug-ins for featured products	Tasty's recipe videos contain links to buy featured products, such as kitchen tools on Walmart.com and Jet.com
	Recipe boxes on subscription	HelloFresh customers can subscribe to meal kits for recommended recipes

CLOTHING

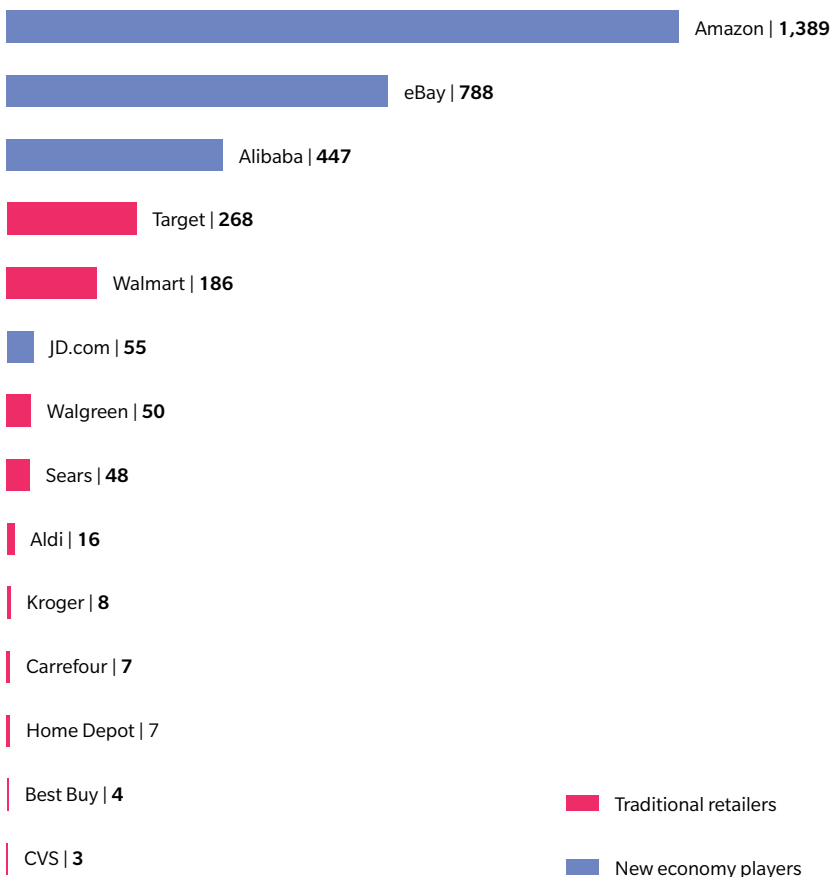
BARRIERS	SOLUTIONS	EXAMPLES
Desire to try clothes before buying them	At-home trial, free return, and pay-later system	Amazon Wardrobe's customers in the United States can try clothes on at home for seven days without any payment; they can send items back using a prepaid return label
Insufficient support for item selection	Augmented reality technology	ASOS has a "Pay Later" option, which gives customers 30 days to decide whether they want to keep and pay for items
	AI-assisted personal stylist	Converse's Sampler mobile app shows users on their smartphones what shoes will look like on their feet
	Live AI advice	Stitch Fix uses a mix of stylists and data scientists to personally curate unique recommendations to each customer
		Pixibo's chatbot provides potential buyers personal style and fit advice in real time

Source: Oliver Wyman analysis

EXHIBIT 2. PATENT COUNTS FOR RETAIL TECHNOLOGIES

NEW ECONOMY PLAYERS TEND TO FILE MANY MORE PATENTS THAN THEIR TRADITIONAL RETAIL COUNTERPARTS

GLOBAL PATENTS GRANTED FOR SELECT RETAIL AND NEW ECONOMY COMPANIES
2012-2016, SCOPE LIMITED TO PATENTS ON RETAIL ACTIVITIES



Source: Quid®, Oliver Wyman analysis

program, announced the development of automated personal shopping services, powered by a strong understanding of customer preferences and product attributes, and targeted at busy mid-to-high income family shoppers. Walmart is also developing a cashier-free store through Project Kepler, an incubator project led by Jet.com co-founder and CTO Mike Hanrahan.

There is also a flood of cheap money into the startup space. For example, in logistics, we see dozens of startups with between US\$5 million and US\$20 million in venture capital funding in North America and Europe. In China, these funding rounds add up to close to US\$1 billion. Since February 2017, more than 250 e-beauty startups have appeared, focusing on improving the digital shopping experience, providing supporting content like coaching videos, or acting as a services intermediary.

Overall, more than US\$30 billion was invested between 2015 and 2017 into retail technology startups worldwide.

PHYSICAL RETAILERS CAN USE PARTNERSHIPS TO GET ONLINE

Retailers are increasingly turning to partners to obtain the necessary capabilities. General merchandise retailers have used third-party logistics for their online deliveries for years, but for a long time this was not feasible in food because of the requirements of bulky or refrigerated products. The first wave of grocery incumbents to move online therefore developed their own closed networks of distribution centers, dark stores, and delivery vehicles – at high cost.

Partnerships are now presenting a viable alternative to this high risk, high investment, and slow break-even route. (See Exhibit 3.) Ocado has leased its Smart Platform to Morrisons in the UK, and in November 2017 closed a deal with Casino

in France to store, pick, and transport groceries. In January 2018, they closed their second international deal with Sobeys to build a warehouse in Canada.

To enhance the online shopping experience, Walmart has opted to use Google Home's voice-recognition software to enable voice ordering, rather than investing to develop their own technology. Best Buy has partnered with Amazon's Alexa to give customers voice access to its catalog. Midsize brands from multiple sectors, such as Kurt Geiger and Tilly's, have chosen to engage specialists such as Aptos to set up their e-commerce platforms.

New-economy giants will also use third-party services, and the specialists will not all be startups. In Germany, DHL

has partnered with Amazon to exclusively deliver Amazon Fresh baskets. As passive-cooling packaging widens the range of potential partners to non-refrigerated fleets, retailers could even take advantage of networks of Uber-style freelancers, particularly in dense urban centers.

Partnering carries risks, which must be carefully weighed against the potential rewards in an uncertain environment. Retailers that indiscriminately partner to cover their capability gaps may find – even if they manage the partnerships well – that they have relinquished control over critical elements of their business model. In the US, many food retailers have partnered with Instacart to move online. In doing so, however, they have ceded a portion of the customer relationship to a third

“Retailers are not thinking about partnerships. In other industry sectors partnerships are the norm; retailers need to learn from outside”

Grocery executive

“Even if food e-commerce penetration is 10 percent, that will decimate the food retailers as we know them”

CPG executive

EXHIBIT 3. PARTNERSHIPS IN RETAIL

A VARIETY OF PARTNERSHIPS ARE ALLOWING TRADITIONAL RETAILERS TO TACKLE THE CHALLENGES OF ONLINE SELLING

PARTNERSHIP AIMS	EXAMPLES	RATIONALE FOR PARTNERSHIP
Make it easier to shop online <ul style="list-style-type: none"> Enhance selection process 	Walmart and Google Home	Walmart customers use Google Home to order online using voice ordering
	Monoprix and Google Home	Monoprix customers use Google Home to order online using voice ordering
	Best Buy and Amazon	Best Buy's Deal of the Day is available on Amazon Echo devices
	John Lewis and Dressipi	John Lewis leverages Dressipi's technology and expertise in fashion to create a personalized shopping experience
Make it cheaper to shop online <ul style="list-style-type: none"> Improve last-mile delivery Improve warehouse fulfilment 	Carrefour and Stuart	Stuart's cyclists and drivers deliver Carrefour products within one hour of order placement
	Morrisons and Amazon	Amazon delivers Morrisons products within one hour of order placement
	Morrisons and Ocado	Ocado handles logistics for delivery of orders from Morrisons' online platform
	Sobeys and Ocado	Sobeys is using Ocado's technology to build a warehouse geared for e-commerce order fulfilment

Source: Oliver Wyman analysis

party – one that might have other plans for growth than simply continuing to scale current operations.

Still, despite these risks, we think most incumbents will need to selectively partner in order to meet ever-growing customer expectations. The move to a more open ecosystem with a wide range of partnerships and alliances will be a significant change for the retail sector, which has historically been more closed to such deals than other sectors of the economy.

PARTNERSHIPS WILL BOOST INNOVATION AND ONLINE PENETRATION

Partnerships like these will enable innovations and new technologies to be rapidly adopted in many companies. This adoption will in turn drive industry-wide improvements in user experience

and reductions in the cost and hassle of delivery.

As a consequence, online penetration will continue to grow at pace. (See Exhibit 4.) In food, if there are no major innovations to lower the cost of delivery, we think online penetration is unlikely to surpass five percent across North America and Europe by 2030. However, reducing the delivery fees to consumers through improved efficiency could see that number double. In the hypothetical scenario that all fees and hassles were to be removed and customers were able to freely choose the channels that best suited their needs, online sales could reach more than 25 percent across North America and Europe. This means penetration of near 40 percent in leading mature markets such as the UK.

In general merchandise retail, online penetration should increase due to continued innovation in customer

experience, the rise of subscription services for routine purchases, and faster, more-convenient delivery. We estimate the 2030 online share to be between 17 and 22 percent in North America and Europe.

Penetration in China already surpasses these levels in many categories. If online retailers in the West can match the disruptive innovations of Chinese retail share could go as high as 40 percent.

Online retail will not grow by itself. But as companies tackling the barriers continue to attract investment and deliver innovation, shopping online will become easier and more popular.



THE BIG DEBATE WILL E-COMMERCE TAKE OFF IN FOOD LIKE IT HAS IN THE REST OF THE RETAIL?

SKEPTICS

“Disruption is massive, albeit happening more slowly than announced. Five years ago, people said we would be at 25 percent of retail online today, we are not there yet”

Investor

“I expect to see food online top out at seven to eight percent”

Financial analyst

“We originally thought that by 2020, 10 to 15 percent of sales would be online, but we’re still hovering around three percent”

Grocery executive

BELIEVERS

“I’ve seen predictions as high as 30 percent”

CPG executive

“It could be 30 percent in food, particularly when we think about millennials”

Grocery executive

“Ten years out we are maybe looking at 25 percent on click & collect and online in the food space [in the US]”

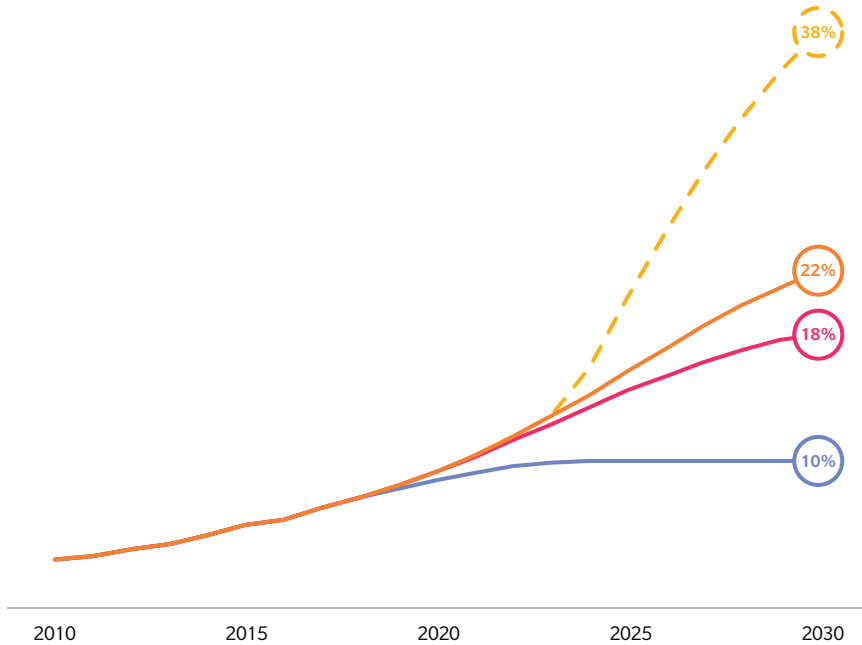
Grocery executive

EXHIBIT 4. ONLINE SALES SHARE

THE TRAJECTORY OF ONLINE SALES DEPENDS ON HOW FAST BARRIERS CAN BE REMOVED BY TECHNOLOGICAL INNOVATION

UK FOOD RETAIL MARKET

SHARE OF E-COMMERCE UNDER FOUR SCENARIOS



SCENARIO 4. ALL BARRIERS ARE REMOVED

Customers all over the country experience no barriers to shopping for food online. Online shopping interfaces are highly intuitive and predictive, and delivery is fast, punctual and free.

SCENARIO 3. DELIVERY FEES ARE REDUCED, AND MORE AREAS BECOME FEASIBLE TO SUPPLY

Free delivery becomes more widely available in suburban areas, enabled by delivery network consolidation.

SCENARIO 2. DELIVERY FEES ARE REDUCED

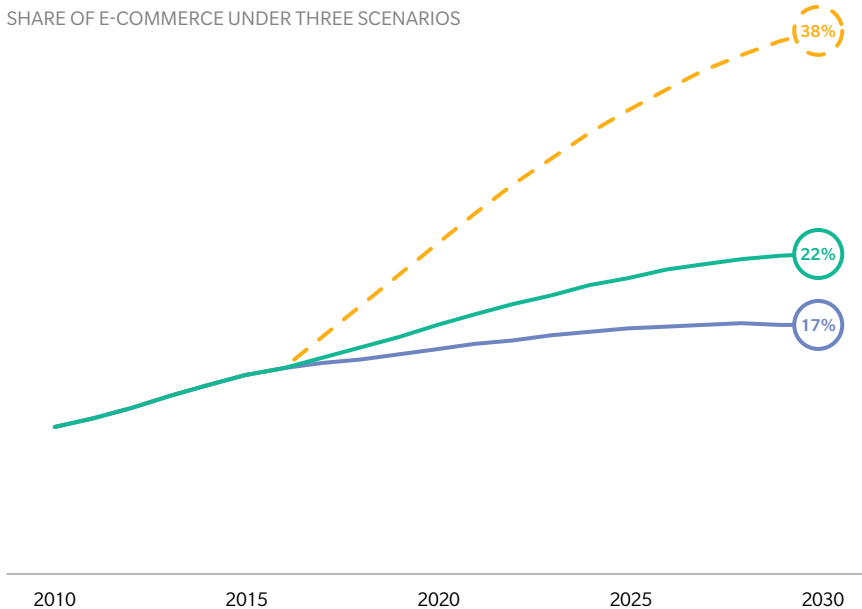
Retailers are able to offer free delivery at frequent, daily slots in the highest-density areas - enabled by innovations in warehouse automation, dynamic delivery routing, and capacity sharing. In lower-density areas, delivery fees and minimum basket sizes persist, or customers have to go to collection points.

SCENARIO 1. CURRENT CONDITIONS REMAIN

Current constraints remain in place, with no major innovations.

US GENERAL MERCHANDISE RETAIL MARKET

SHARE OF E-COMMERCE UNDER THREE SCENARIOS



SCENARIO 3. ALL BARRIERS ARE REMOVED

All major barriers are removed, and consumer demand for online general merchandise shopping is fully met.

The supply chain is drastically improved to equalize the costs of delivery and in-store purchases for the entire range of products; the customer journey is enhanced through personalization and AR-based support, for example.

SCENARIO 2. ONLINE CUSTOMER JOURNEY MADE EASIER, AND ONLINE RETAILERS GAIN SCALE

The customer journey online is made easier thanks to personalization and augmented reality (AR). Store closures drive a rise in online shopping, increasing the scale of online retailers. The supply chain sees incremental efficiency improvements which lowers fees and increases delivery punctuality.

SCENARIO 1. CURRENT CONDITIONS REMAIN

The customer purchasing experience online remains the same. Some incremental advances are made in supply-chain technology, but little else changes.

Source: Planet Retail, Oliver Wyman proprietary eFood model, Oliver Wyman proprietary breakeven model for e-commerce operations, Deutsche Bank, Oliver Wyman analysis

PART ONE: DIGITAL UPHEAVAL

EMPIRES EMERGE AS CHINA DEVELOPS NEW RETAIL MODELS

A BATTLE FOR DOMINATION SPARKS ACQUISITIONS AND PARTNERSHIPS

China was initially slow to go online. In 2006, just 11 percent of the population had Internet access, and online shopping was negligible. However, Internet and mobile access then exploded, and e-commerce took off thanks to the development of trustworthy online payment systems and efficient delivery networks. Roughly half the population had Internet access by 2016, according to the China Internet Network Information Center (CNNIC), and 95 percent of Internet access was via mobile phones. Already, some 10 percent of Chinese consumers buy groceries online.

The digital landscape today in China is dominated by two rapidly expanding

empires. Alibaba owns two of China's largest e-commerce platforms, Taobao and TMall, as well as an electronic payments system, Alipay. Its rival is an alliance between JD.com, a leading online retailer, and Tencent, an Internet and digital-technology conglomerate. Tencent owns WeChat, which is China's largest social app and bought a 15 percent stake in JD.com in 2014.

Flush with capital, Alibaba and Tencent-JD.com have been expanding their empires through acquisitions and partnerships. (See Exhibit 5.) Combined, they now have stakes in six of China's top 10 hypermarkets; the country's biggest electronics retailer, Suning; and one of the largest department store operators, Intime. They also own parts of Wanda, China's largest shopping

mall operator, as well as Wanda Cinemas, the biggest film distributor. In 2016 and 2017, Alibaba made strategic investments totaling US\$21 billion.

One key to the dominance of Alibaba and Tencent is their near-duopoly in mobile payments, 97 percent of which are carried out on their platforms. (See Exhibit 6.) Since 2013, the total value of payments and other money transfers carried out on mobile devices has grown more than 100-fold in China, reaching RMB108 trillion (US\$17 trillion) in 2017.

Mobile payments are ubiquitous today in Chinese fresh-food markets, family-run stores, and restaurants. They are used for as much as 75 percent by value of all food-and-beverage purchases in China, according to our studies. By controlling

EXHIBIT 5. KEY ACQUISITIONS AND PARTNERSHIPS RELATED TO ALIBABA, TENCENT AND JD.COM

CHINA'S TECH GIANTS ARE PLACING BIG BETS TO BUILD THEIR RETAIL PRESENCE

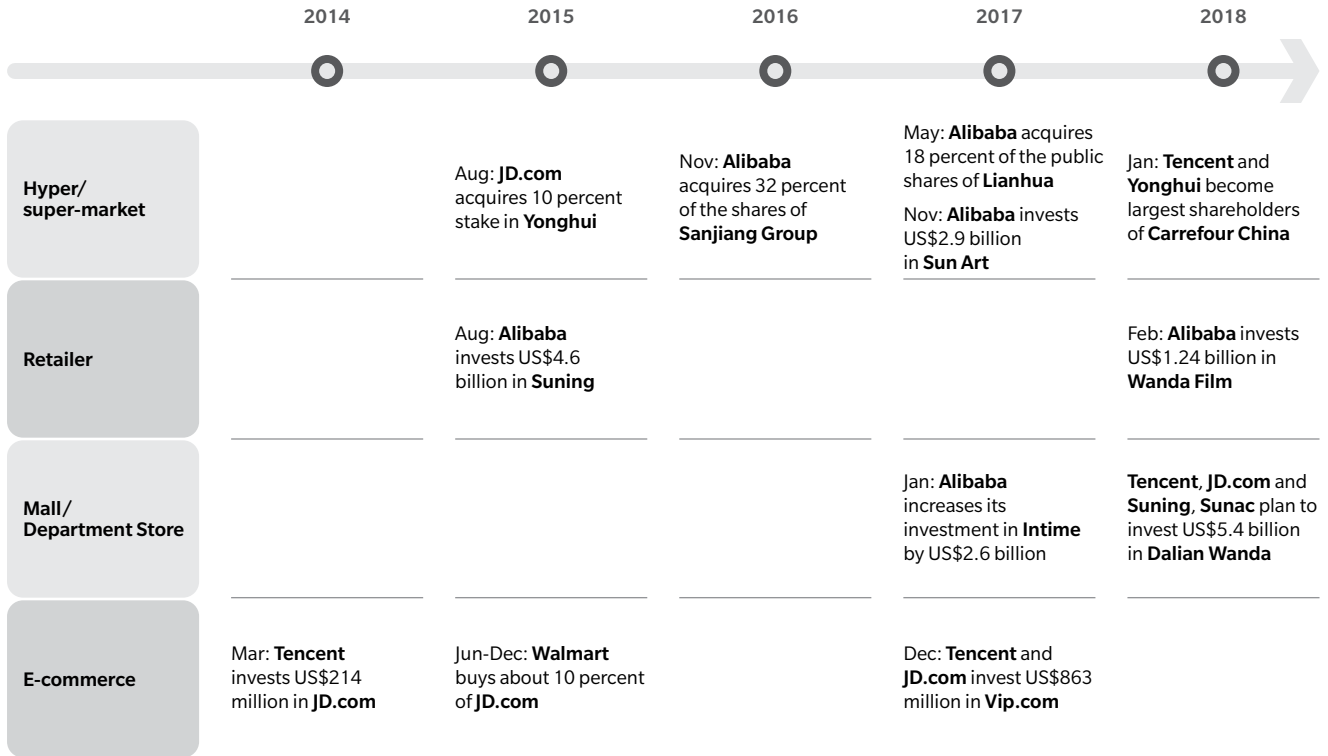
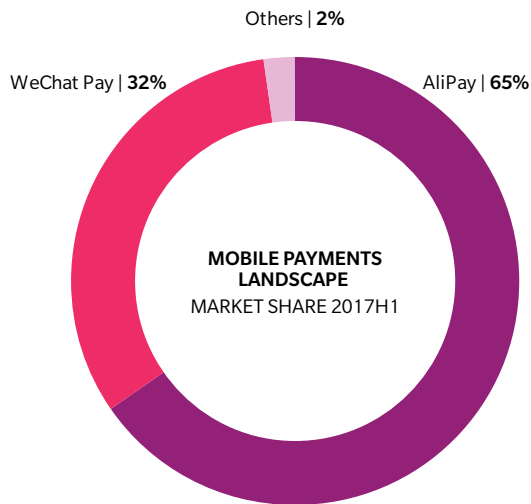
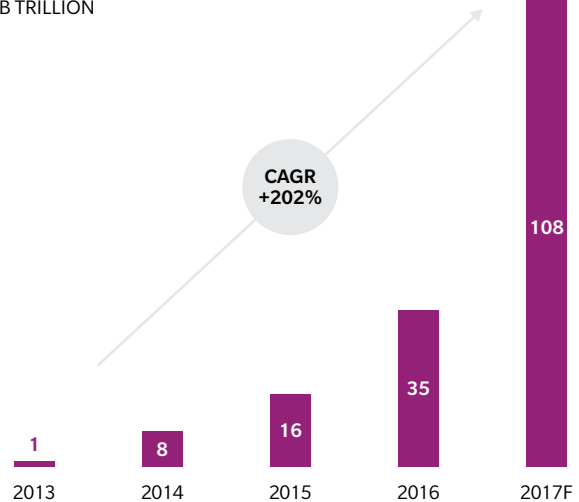


EXHIBIT 6. CHINA MOBILE PAYMENT MARKET LANDSCAPE

EXPONENTIAL GROWTH OF MOBILE PAYMENTS IN CHINA IS LED BY TWO PLAYERS, WECHAT PAY AND ALIPAY



TOTAL MOBILE PAYMENTS IN CHINA
RMB TRILLION



Source: Mobile payment association, Yiguan, Union Pay, Oliver Wyman analysis

mobile payments, the empires can draw consumers into their matrix of services, and then harvest the resulting data. They are now pursuing more-disruptive innovations to help them further transform the retail industry.

“NEW RETAIL”, AN O2O SOLUTION

Shopping for some categories has remained predominantly offline. Consumers buying food and furniture, for example, want to see, touch, and try the products before ordering. So the tech empires are experimenting with new forms of retail that tear down these barriers. At Alibaba's Hema stores in large Chinese cities, customers don't go to checkout counters; they pay by smartphone. Many don't take their purchases with them; the store sends a delivery van. And some don't even want all their food at home; supermarket staff cook it for eating in the store.

Other Chinese retailers, too, are blending digital and physical features to create imaginative O2O solutions – “online-to-offline”, China's equivalent of omnichannel. (See Exhibit 7.)

Early signs are that O2O stores will be more than just interesting experiments, and will significantly change retail. Hema is already attracting younger, wealthier, tech-savvy shoppers, a coveted group. They increasingly trust the Hema brand and are willing to buy fresh food online. While China's lack of strong brick-and-mortar supermarket chains has been a factor in this initial success, the new formats could provide templates for other countries too.

SOCIAL CUSTOMER RELATIONSHIP MANAGEMENT

The ubiquity of Tencent's WeChat has generated a new wave of customer engagement. It is now easier than ever for brands to establish direct relationships with customers, for example by connecting on social media. Retailers can also trace

customers' purchase journeys – how they discovered and eventually chose products – to determine the best marketing channels. To foster viral promotion, they can offer incentives to customers who re-post product offers in their social circles. They can turn some of these customers into brand ambassadors.

The long-term aim of such activities is to develop a “single customer” view. Alibaba and Tencent-JD.com extend far beyond retail and payments into areas such as video streaming, financial services, and travel. The vast amounts of data generated by these businesses can be leveraged to develop customer relationship management with a far higher degree of personalization than at present. Machine learning algorithms can predict what other products customers might buy based on their shopping and browsing activities, so they can be targeted with suitable promotions or vouchers.

SOCIAL SHOPPING

Many customers enjoy shopping trips as social experiences, where friends and families share advice on clothes and discuss what to cook. Social media can help replicate some of this experience online, and they have become an important source of information for shoppers. This is especially the case for fashion where, according to our research, younger consumers get more of their information on fashion from social media than any other channel. (See Exhibit 8.)

WeChat has led efforts to make online shopping more sociable, by encouraging brands, bloggers, and influencers to create in-app stores. In these, users can read reviews, participate in product discussions, and pose questions on customer service – all within a website where customers can also order and pay for products. Brick-and-mortar retailers see the value too. Suning, China's leading chain of electrical appliance stores, pays employees

bonuses if they set up storefronts and these generate sales from their social circles.

Another site that mixes shopping and socializing, Little Red Book, started off as a review site for overseas products. It then evolved into a popular discussion site for shopping, where customers can “like” posts by bloggers and celebrities, and it also features direct links to enable readers to buy products. In 2016, Tencent invested US\$100 million in Little Red Book, and it is now one of the largest social shopping sites in the world, with over 50 million users. Cumulative sales already exceed US\$10 billion.

FUTURE OF THE EMPIRES AND CHINA RETAIL

The race for scale aims to capture as many consumers as possible for a retail empire's online interfaces, physical stores, and payment systems. A customer that pays with Alibaba's AliPay e-wallet or Tencent's WeChat Pay, for example, will find it easier to shop in a physical or online store where a compatible payment system works. Maximizing such touchpoints will generate valuable data on customers' product preferences and spending habits. The firms will learn which websites customers like to visit, the apps they use, and whom they follow on social media. Even when customers shop outside the empires' e-commerce platforms, they will still be a valuable source of data for where, when, and what they are buying, if they use one of the dominant payment systems. And the more the new retail empires know about their customers, the better they will be able to please them.

EXHIBIT 7. THE ROLE OF ONLINE TO OFFLINE (O2O) IN CHINESE GROCERY RETAIL

WITH THE RIGHT INVESTMENT, O2O CAN DRIVE SIGNIFICANT SALES

O2O BUSINESS CONTRIBUTION IN MAJOR GROCERY RETAILERS
PERCENTAGE OF ORDERS

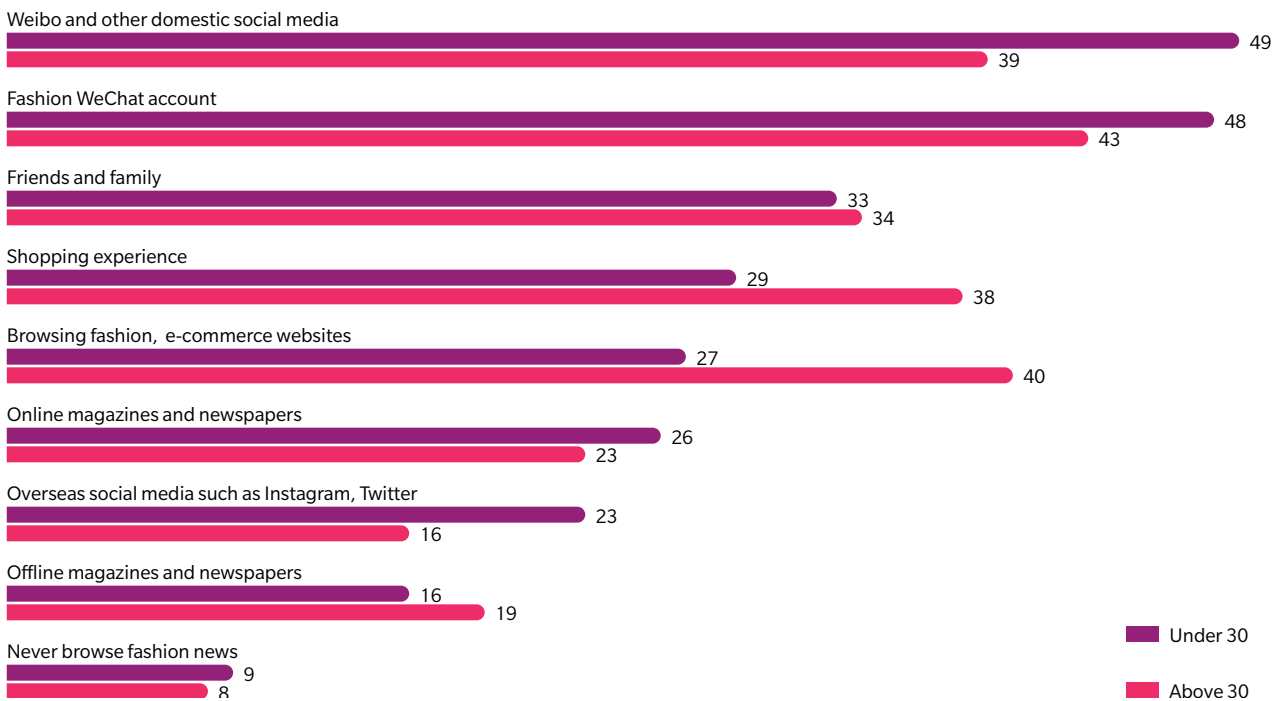


Source: Store staff interviews [Ningbo], store traffic/bag counting [Ningbo & Shanghai], desktop research, Oliver Wyman analysis

EXHIBIT 8. IMPORTANCE OF SOCIAL MEDIA FOR CHINESE FASHION CONSUMERS

CHINESE CONSUMERS LEARN ABOUT FASHION FROM SOCIAL MEDIA, RATHER THAN TRADITIONAL CHANNELS

SOURCE OF FASHION INFORMATION¹ BY AGE GROUP
PERCENTAGE OF RESPONDENTS, N = 260, ONLINE SURVEY



1. "Which channels do you usually get fashion information from?" (Select up to five channels)

Source: Oliver Wyman online survey 201802, Oliver Wyman analysis



PART ONE: DIGITAL UPHEAVAL

THE ROLE OF STORES

THE OMNICHANNEL FUTURE

As online share grows, we think that the future landscape of retail will become increasingly complex. The best retailers will experiment with vibrant new models that blend the best of online and physical retail.

BRICK-AND-MORTAR STORES WILL HAVE A NEW ROLE

As retail moves increasingly online, the future of the physical store seems uncertain. Continuing falls in store revenues will pose big challenges to physical retailers with high fixed costs tied up in their networks. But we think a “managed decline” approach to physical stores is wrong. Instead, successful retailers are recognizing that physical stores are a key part of the emerging new picture.

The rapid growth of pure-play online retailers appears to suggest that physical stores are unnecessary. However, these online retailers frequently rely on competitors’ physical stores for their role as showrooms, where customers try out a

product before purchasing. Many online giants are no longer content to passively freeload in such a manner, and are instead actively shaping their physical touchpoints. Indeed, 2017 saw a progression from dabbling in click-and-collect points and the odd pop-up showroom, to a number of much bigger bets.

Amazon’s purchase of the Whole Foods network of 431 stores, hot on the heels of its pilot of the no-cashier store Amazon Go, provided a clear signal of its intention to win in omnichannel retail, not just online. In China, JD.com announced that it would build one million stores over the next five years to better serve rural areas. Alibaba, in a joint venture with Auchan Group, has invested US\$2.9 billion in a stake in Sun Art Retail Group, China’s top hypermarket operator with 446 hypermarket complexes in 224 cities. They have also opened a set of “new retail” stores called Hema that use augmented



reality to enhance the shopping experience and advanced physical infrastructure to facilitate picking items for delivery.

Our shopping survey shows that omnichannel shoppers – people who shop both online and offline – are happier than those who stick exclusively to one or the other. (See Exhibit 9.) This supports the spreading view that, in order to serve customers effectively, retailers need to offer both physical points of presence as well as digital shopping.

PHYSICAL STORES WILL NEED TO DELIVER VALUE IN NEW WAYS

Physical stores that rely on captive trade from customers who live close by, essentially serving the role of stock rooms, will decline as more of their customers find it more convenient to shop online. To survive and thrive, physical stores will need to give customers other reasons to visit. (See Exhibit 10.)

VALUE

For discount chains, no-frills stores remain the most economical way to distribute

products. These savings are reflected in low prices, which are a strong attraction for consumers.

CONVENIENCE

For urgent or “on demand” shopping – most common in food and homeware – a network of stores in high-traffic, high-frequency locations can offer rapid access to products. These locations could, for example, be airports, subways, train stations, or residential areas. Argos, a store-based catalog retailer of electronics and homeware in the UK, has transformed its network of 845 nationwide stores into a hub-and-spoke system that delivers certain items in as little as two hours. For consumers in many locations, popping out to the local convenience store is still by far the easiest way to pick up a pint of milk or missing ingredient.

EXPERIENCE AND SOCIAL ENGAGEMENT

Stores remain hard to beat for human interaction, from routine, everyday exchanges to elaborate customer service for special occasions. For example,

“People are social and for some reason shopping is one way they express their social nature”

Mass retail executive

“Amazon’s acquisition of Whole Foods should have signaled to the market that brick-and-mortar is necessary”

Grocery executive

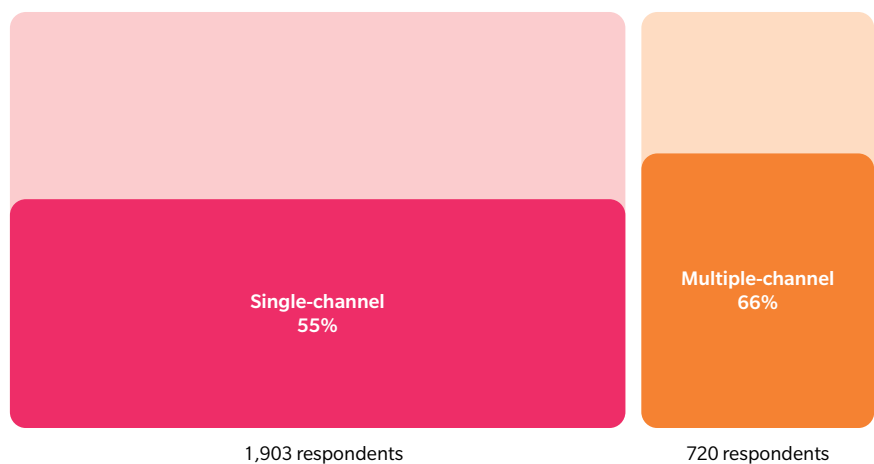
“Customers want to experience product instore, even if they then buy it online”

Apparel executive

EXHIBIT 9. CUSTOMER ATTITUDES TO MULTI-CHANNEL SHOPPING

OMNICHANNEL SHOPPERS ARE MORE SATISFIED THAN SINGLE-CHANNEL SHOPPERS

POSITIVE RESPONSE RATE REGARDING GROCERY SHOPPING¹



1. Include “I love it” and “Generally enjoy it” responses (five possible responses: “I love it”, “I Generally enjoy it”, “Neither love it nor hate it”, “Generally dislike it”, “Hate it and avoid it as much as possible”)

Note: Percentage of respondents, Survey respondents, US/UK/France/Germany

Source: Oliver Wyman internal analysis, consumer survey 2017; international respondents (US/UK/France/Germany)

EXHIBIT 10. STORES HAVE A CLEAR ROLE TO PLAY IN RETAIL'S FUTURE...

...BUT SUCCESSFUL STORES WILL NEED TO PLAY MORE SPECIALIZED ROLES THAN THEY DO TODAY



Source: Oliver Wyman analysis

Nordstrom's Local concept store holds no stock, instead focusing on services such as personal styling, tailoring, and amenities like a cafe or nail bar. This smaller format could allow Nordstrom to reach more customers with its services, and thus build loyalty and brand presence.

AFTERCARE AND TRUST

For high-value, complex purchases, such as technology devices and white goods, the physical store is a key hub for aftercare services that deliver a branded experience and sustain the customer relationship. Apple's Genius Bar and Best Buy's Geek Squad are two good examples.

OMNICHANNEL RETAIL WILL BE CHALLENGING FOR ALL TYPES OF RETAILERS

It was clear to most of the retail leaders we spoke to that the future of the retail experience is omnichannel. Customers will expect to shop both online and offline, depending on the relative strengths of each channel. Retailers will need to offer both online and store-based shopping experiences in order to take charge of the entire customer journey. However, few retailers are well equipped to deliver omnichannel.

Offline incumbents already have stores and understand how to run them. However, most of these networks are not configured for the new role of the store. In destination sites, stores will need to be improved and reshaped to deliver a better experience. Staff will need to be retrained to deliver the services that make the store a destination. A significant proportion of other stores will need to be downsized or closed, as customers find more efficient ways to get products. At the same time, maintaining access to a network of convenient pickup points will be crucial.

Incumbents will also need to change the way they assess their stores' contributions. The old measures of total store sales and store contribution margin

"We sell a lot of lottery, beer, cigarettes, and perhaps one day marijuana. You will always need a human to check the identity cards. This protects us, gives us a reason to exist (as a brick-and-mortar solution)"

Mass retail executive

"You can probably get away without omnichannel in the next couple of years, but in the long term omnichannel is the only way to survive and thrive"

Grocery executive

"We are starting to think of our stores in the same way as banks think of their branches"

Apparel executive

no longer give the full picture. One store may be effective as a site where sales associates help customers understand the product range, before a transaction is concluded on the retailer's website for home delivery the next day. Another may serve as a pickup and trial point for online apparel orders, where customers can try products on and arrange for alterations to get a perfect fit. Some stores may simply function as places where new customers come to browse, an experience that puts the retailer at the front of their minds when they next shop online.

Manhattan-based concept store Story, which charges brand owners for the innovative experiences it creates to showcase products, has trialed AI-enabled cameras to create a heatmap of where customers spend time in the store. This lets Story quantify the number of "views" given to different products. Whether by investing in such innovations or more



JD.com
aims to launch **one million stores**
across China over the next five years

Alibaba.com
aims to turn **six million**
convenience stores into smart
service centers

"We are beginning to think about stores more as a marketing expense and evaluate ROI – how effective are they?"

Apparel executive

"You got people working in stores, you cannot pay them that much more than basically minimum wage. It is all about how to motivate and engage hearts and minds. Amazon has no idea how to do that"

Grocery executive

thoroughly mapping customers' shopping journeys, retailers will need to paint a much richer picture of the value their stores add. Otherwise, they risk closing or underinvesting in key sites, and noticing the overall loss of sales only when it is too late. This could also lead to a way to charge brand owners for product views, similar to how internet advertisers charge per click.

Online retailers are beginning to realize that they too need a physical presence in order to really win on customer experience. Assembling a network of sites can be difficult and expensive, certainly in most major cities. Once online retailers do have stores, running them effectively presents another problem. Just as physical incumbents struggle with rapid innovation, online incumbents lack the

operational DNA to mobilize and motivate large cohorts of staff – who are often low-paid and have a high turnover – to provide a consistent in-store experience.

In the early days of online retail, "brick-and-mortar" became a synonym for "out of date." In the omnichannel era, physical stores are finding new roles – and are seen as an essential part of the shopping experience.



INNOVATION IS CHANGING CUSTOMER EXPECTATIONS

Consumers are becoming smarter, and their expectations are increasing rapidly. To keep up, retailers need to get smarter too. Fundamentally, consumers' demands have not changed. They want to know about the product and to buy it at a good price with minimum hassle. What has changed is the pace at which the internet has enabled these needs to be fulfilled, raising customer expectations ever higher. Retailers that do not meet expectations will lose customers to those that do. And some of those needs may be better met by companies that look very different from today's retailers. Here are three important lessons.

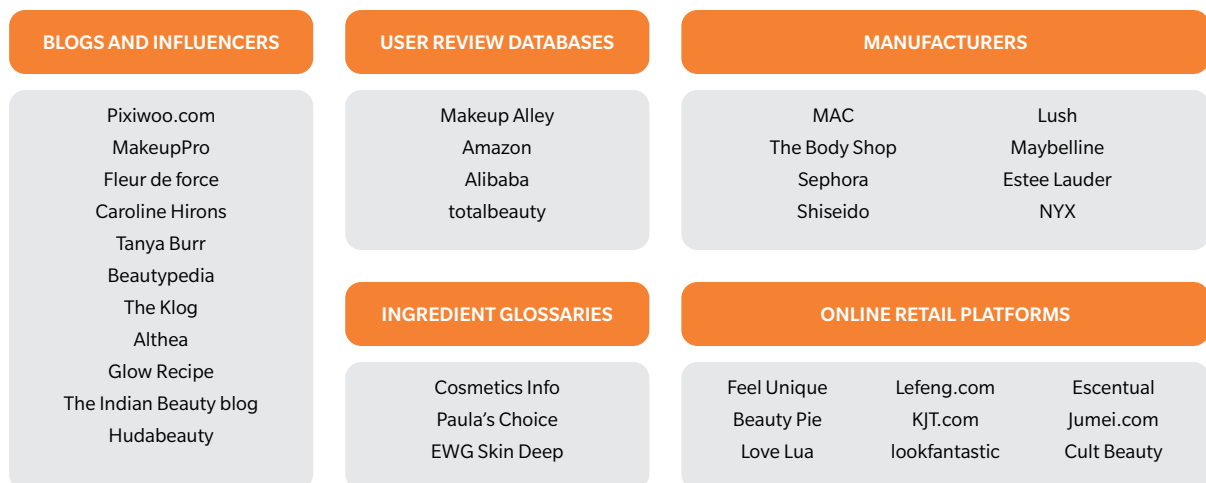
First, consumers are often experts on products. Today's consumer can access a seemingly limitless product range online. There is a wealth of information for every type of shopper: specialist review sites (TechRadar, Wirecutter), mass user-review databases (Amazon, Makeup Alley), and technical ingredient glossaries. Blogs and influencers curate the vast range of available products, helping customers navigate otherwise overwhelming choices. (See Exhibit 11.) Several intermediaries in China are allowing customers to collectively shop for products. Friends can let the savviest among them choose a product,

and the entire group saves by buying multiple units at a discount.

Where could this go? Consumers will become much less reliant on particular retailers to curate product ranges, instead seeing them simply as product distributors. They will be confident enough to buy from relatively unknown retailers and manufacturers, meaning that competition will center more directly on product functionality. Exclusive products will be increasingly important to draw customers to a particular retailer, and the role of brands as a guarantor of quality may come under threat.

EXHIBIT 11. WEBSITES THAT OFFER ONLINE MAKEUP ADVICE

CUSTOMERS ARE BETTER INFORMED BEFORE THEY MAKE A PURCHASE THAN EVER BEFORE



Source: Oliver Wyman analysis

“Loyalty has changed so fast: one bad experience and it is not hard to find other options”

Apparel executive

Second, consumers no longer have to accept the prices they see on shelf. They can access instant price comparisons across multiple retailers via online review and aggregator sites. Some websites, such as CamelCamelCamel, even track price moves over time. This transparency lets consumers see through retailer pricing games, such as inflating margins in some products to cross-subsidize low prices on traffic drivers, and inflating “regular” prices to fund deep promotional price cuts.

Where could this go? Increasingly, retailers with simple, transparent pricing strategies will win consumer trust. As retailers find it harder to create smoke and mirrors with their pricing, those with structural cost disadvantages will be exposed. Overall, there will be pressure on the industry to simplify and focus on the things consumers truly value.

Third, consumers will continue to minimize hassle, as they get used to having more of the work done for them at each stage of the shopping process. Home delivery has eliminated the need to travel to a store, while price

comparison websites remove the need to spend time shopping around multiple retailers.

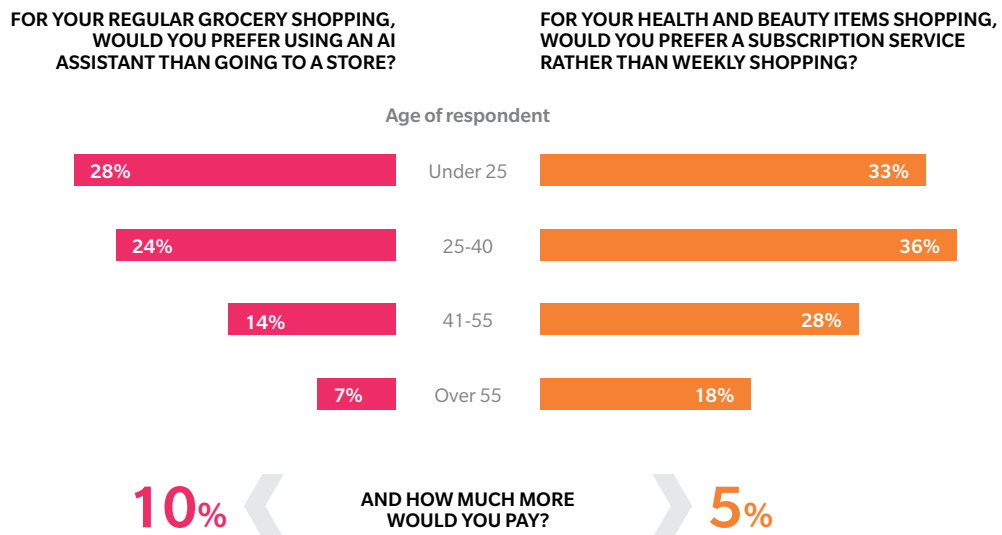
We think the next big hassle to be eradicated will be browsing and choosing products. This has already happened in the music industry. Spotify subscribers still exercise choice, but instead of having to spend hours sifting through thousands of songs, they can instead spend a few seconds choosing bottomless playlists to suit their mood.

Where could this go? Instead of going to retailers to choose from thousands of products, customers will first go to choice intermediaries that provide them with clear recommendations. These could include: capsule wardrobes of clothes for a whole season, mixing basics and more expensive items across dozens of brands; meal solutions based on complex dietary preferences; and tailored gift recommendations based on unstructured information about the recipient. In our Digital Shopping Survey, respondents were on average willing to pay five to 10 percent more for shopping experiences where the selection process was partially automated. (See Exhibit 12.)

Changes in technology are driving changes in customer habits and expectations; in turn, these changes will influence the next wave of innovation.

EXHIBIT 12. CONSUMER DESIRE FOR “CHOOSE IT FOR ME”

THE CONSUMERS WE SURVEYED WOULD PAY MORE FOR SERVICES THAT TAKE THE WORK OUT OF CHOOSING PRODUCTS



Source: Oliver Wyman analysis, consumer survey 2017; international respondents (US/UK/France/Germany)

PART ONE: DIGITAL UPHEAVAL

DISINTERMEDIATION
AND REINTERMEDIATION:

NEW WAYS TO REACH CUSTOMERS

In the old world, retailers acted as the gatekeepers to consumers – and were richly rewarded. In the future, brands will find new ways to get their products to customers, whether directly or through new intermediaries that insert themselves into the value chain. While all eyes have been on the shift from physical to online retail, we believe this disintermediation and reintermediation is the real change to come in the sector, one that will have profound implications.



MANUFACTURERS CAN SELL DIRECTLY TO CONSUMERS

While brand owners have typically run big-budget, above-the-line marketing campaigns, retailers have owned the below-the-line touchpoints, controlling the prominence and appeal of products through in-store presentation, pricing and promotions, and staff recommendations. In return, they have claimed a significant share of revenues. Manufacturer direct channels have existed for decades in sectors such as apparel and premium technology. But they have been rare or nonexistent in areas such as food and homewares, where big-store retailers offer the convenience of buying large, varied baskets in a single shopping trip.

Given the easy scalability of web platforms and the rise of partnerships, more brand owners now have an opportunity to go direct to customer. They also have good reasons to do so: to guard against excessive domination by larger, stronger retailers as the industry concentrates and consolidates; and to take back control of below-the-line brand messaging and engage with customers directly.

Brand owners have four options for going direct in the new world. These offer various degrees of control at varying levels of cost and risk. But all provide significantly more control than the traditional model mediated by retailers.

Direct-to-consumer marketing and loyalty programs use social media and direct marketing to engage with and learn

“Direct-to-consumer for less complex items makes a lot of sense and will be big in the future. For more complex items, the issue is service”

Apparel executive

“Smaller brands emerge online. The filter is now Google and Amazon, not retailers anymore”

Grocery executive

“If I was a new manufacturer today, [going direct-to-consumer] is exactly what I would do”

Investor

“If we need to, we will innovate; the retailers need to understand that; I always say to them, if you do not help us with the consumer, we will go ourselves”

CPG executive

from consumers. In makeup, brands like Zoella and Nyx put social media at the heart of their marketing strategies, fostering direct connections with customers, while distributing their products through major department stores or specialty chains. Consumer goods giant Nestlé is in touch with over 50 million customers worldwide, and uses these contacts to run targeted marketing campaigns.

Manufacturer-owned online channels can achieve break-even scale in sectors such as apparel and technology more easily than a costly network of stores. (See Exhibit 13.) Such a website can be supported by a small number of showroom stores on the model of furniture brand Made.com or Casper, the mattress manufacturer. Warby Parker, which manufactures eyeglasses, started with an online-only proposition, but now makes nearly half its revenues through

its network of more than 60 stores. This model also works well for easy-to-ship, routine subscription products, such as razor blades (Dollar Shave Club) and underwear (MeUndies).

Small cooperative platforms could provide a viable alternative for brand owners with shares of the basket that are too small to draw customers into shopping direct. These platforms aggregate complementary products and could be a good solution for manufacturers of consumer-packaged goods. Early examples include Shobr, a Danish online marketplace backed by a number of household brand names, including Coca-Cola, Kraft Heinz, and Heineken. (See Exhibit 14.) It sold over 70 brands on its beta site before folding in late 2017. INS, a potential blockchain-based successor, located in the UK, has rumoured backing of Unilever and Reckitt Benckiser, and raised US\$41.5 million in an “Initial Coin Offering”. While bumps in the road lie ahead, we think these models hold significant promise for brand owners as new routes to the consumer. We expect to see significant experimentation in this space in the coming years beyond the companies operating today.

Giant marketplace platforms – such as Taobao, Tmall, Amazon Marketplace, and eBay – have long been the go-to platforms for generic product manufacturers and upstart brands. Larger brands, too, are turning to these platforms as a way to access more consumers, especially in new markets, and they continue to grow rapidly. In 2017, Estée Lauder reported a 19 percent increase in sales in China, largely attributed to a doubling of online sales after the launch of MAC on the Tmall platform. Technology brands Canon and Nikon also have flagship storefronts on the site, allowing them to directly engage with the Chinese consumer.

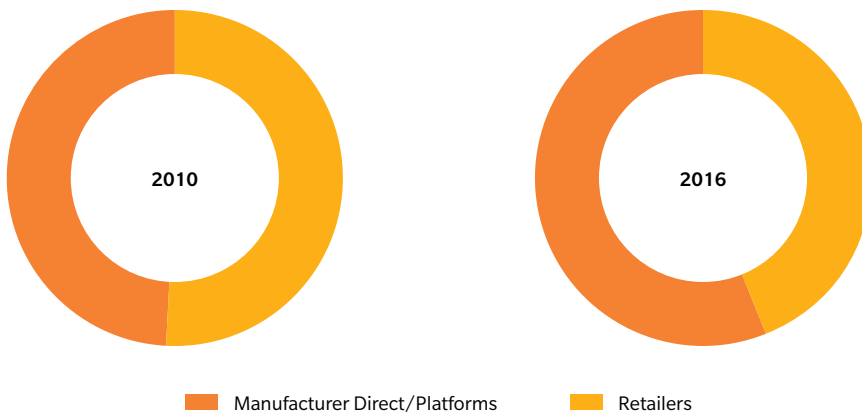
While platforms are well-established in sectors such as apparel and tech,

EXHIBIT 13. INCREASING MANUFACTURER SHARE OF ONLINE SALES

MANUFACTURERS ARE BYPASSING RETAILERS FOR MORE THAN HALF OF TOTAL ONLINE SALES OF GENERAL MERCHANDISE

SHARE OF TOTAL ONLINE SALES BY CHANNEL

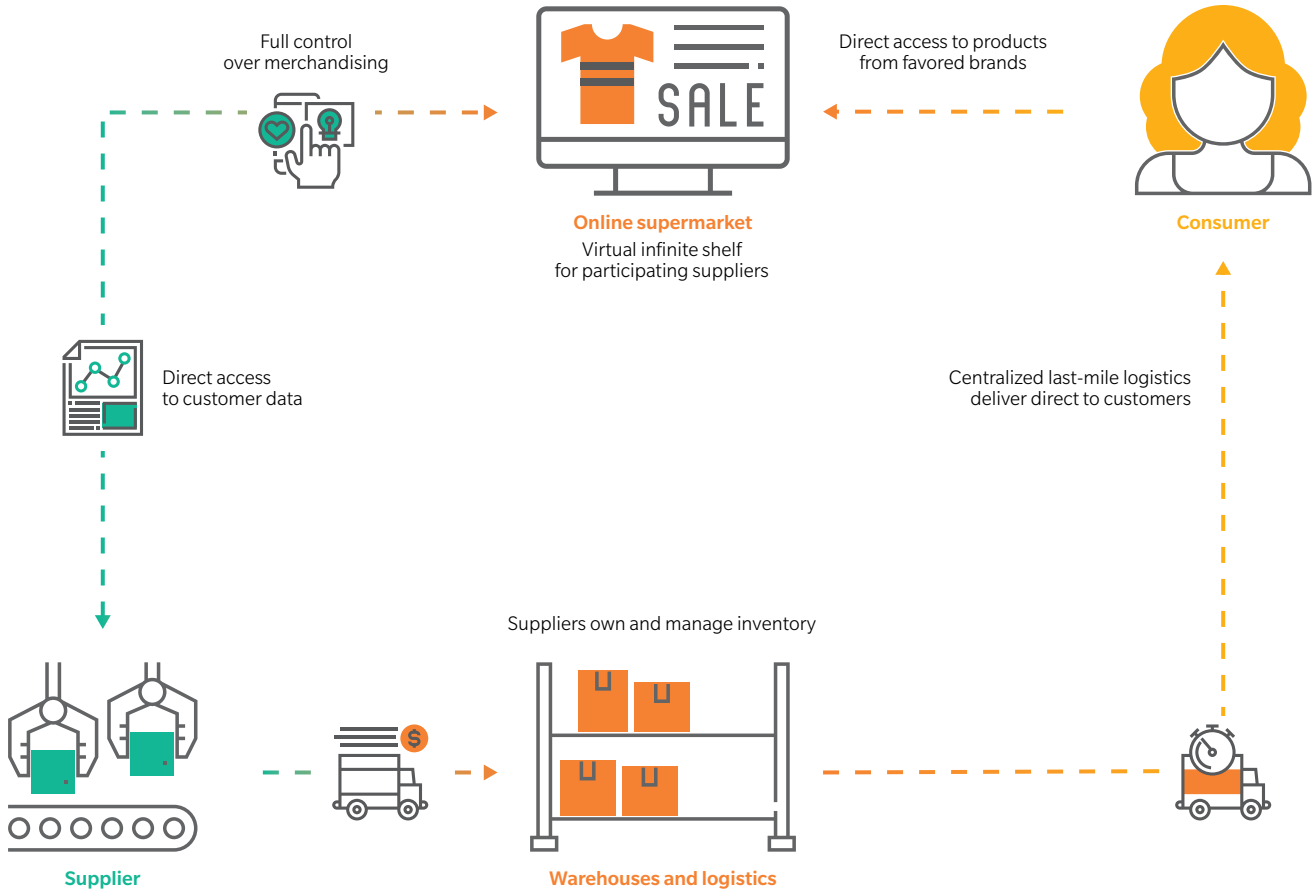
GENERAL MERCHANDISE RETAIL SEGMENTS (APPAREL, HEALTH AND BEAUTY, DURABLES, AND HOME AND OFFICE), US



Source: Planet Retail, Bank of America, Oliver Wyman analysis

EXHIBIT 14. HOW MANUFACTURER'S CAPTIVE PLATFORMS WORK IN FOOD

SHOBR AND INS ARE MARKETPLACES THAT SHOW HOW CPG MANUFACTURERS COULD DISINTERMEDIATE TRADITIONAL FOOD RETAILERS IN THE FUTURE



CPG MANUFACTURERS

CONSUMERS

WHAT IS THE UPSIDE?

Full control over merchandising
 Unlimited shelf space for participating suppliers
 Direct access to customer data

Direct access to products from favored brands
 Lower prices from bypassing retailer margins

SHOBR BUSINESS MODEL

Customer service provided by Shobr (call center)
 Direct control of promotional strategies

One central delivery platform for a range of brands

INS BUSINESS MODEL

Transparent supply chain using blockchain
 INS charges transaction fees (1%) and logistics fees (~10%-15%)

Logistics charges more transparent

Source: Shobr, INS, Oliver Wyman analysis

"I do think it would be helpful... If the platforms could get enough scale that they really do threaten the brick-and-mortar retailers."

CPG executive

"Personalization is crucial. It's more than brand experience – we need to know everything about them so can we can provide a tailored experience."

Apparel executive

in areas such as food and homeware manufacturers are only just beginning to develop these channels. Overall, we think there is significant future growth to come. (See Exhibit 15.)

NEW PLAYERS ARE COMING BETWEEN RETAILERS AND THEIR CUSTOMERS

Manufacturers selling directly to customers will put more pressure on retailers. However, we do not see this as a fundamental disruption. Ultimately, they are simply setting up alternative retail channels with the same business model: sell products to customers to make a return. Retailers will be able to compete along familiar lines: stay competitive on

price and continue to offer a better range and the convenience of a one-stop shop.

Less familiar, and more threatening, are the new intermediaries coming between the retailer and the customer: the choice intermediary and the last-mile intermediary. They have dramatically different business models, and retailers will not be able to compete by simply doing the same things they have always done, only better.

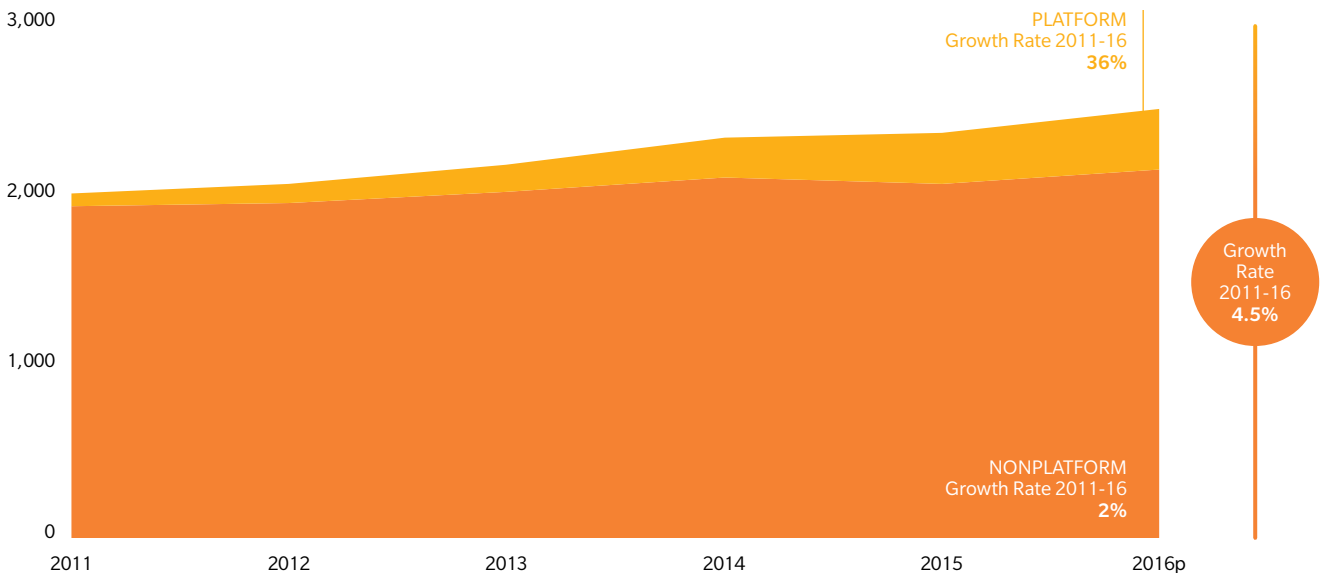
HELPING CUSTOMERS CHOOSE

The choice intermediary is already familiar in the travel industry. (See Exhibit 16.) Giant aggregators – such as TripAdvisor, Expedia, and Google Flights – have all but replaced

EXHIBIT 15. THE RISE IN MARKETPLACE PLATFORMS IN GENERAL MERCHANDISE RETAIL

PLATFORMS HAVE TAKEN THE VAST MAJORITY OF GROWTH IN GENERAL MERCHANDISE SALES IN THIS DECADE

GROWTH OF GENERAL MERCHANDISE ONLINE SALES¹ – PLATFORM VS. NON PLATFORM
US\$ BILLIONS



1. General merchandise is defined as apparel, health and beauty, durables, and home and office products
Source: Oliver Wyman analysis; Planet Retail; Bank of America

EXHIBIT 16. COULD RETAIL GO THE WAY OF TRAVEL?

IN TRAVEL, THE RISE OF “SMART CURATION” HAS TRANSFORMED HOW PEOPLE PLAN AND PURCHASE TRIPS



HOW IT HAPPENED IN TRAVEL

AGE OF MANUAL CURATION

Product range

Travel agent creates a range of packaged holidays

Customer purchase journey

Customer visits a few agents and chooses a holiday from their catalogs

Monetization

Customers pay a commission to a travel agent for the service of assembling the holiday

AGE OF VAST CHOICE AND CUSTOMER DO-IT-YOURSELF

Product range

Hotels and airlines make their inventory available online directly to customers – no longer filtered through agents

Customer purchase journey

Customer visits multiple airline, hotel, train, and car rental booking sites to compare prices and availabilities

Significant time spent researching, with little confidence in the quality of bookings

Monetization

Commissions are mostly eliminated in favor of aggregator ad fees but the customer now does the agent's work

AGE OF SMART CURATION

Product range

Intermediaries such as Skyscanner and TripAdvisor curate the vast choice based on what the customer values

Customer purchase journey

Customer goes to a flight intermediary to find the cheapest flights based on their preferences; TripAdvisor recommends the best hotels and itineraries for their budgets and interests

Purchase is made through the aggregator platform that offers the best bundle discount

Monetization

Aggregators and platforms collect revenue in a variety of ways: small commissions, booking fees, advertising fees, and listing fees



HOW IT IS HAPPENING IN RETAIL

AGE OF PHYSICAL RETAILER

Product range

Physical retailer selects a limited range for a store

Customer purchase journey

Customer visits a few retailers to pick products from their ranges – traveling between physical stores

Monetization

Retailer charges a hidden gross margin on top of the unit cost paid to manufacturer

AGE OF VAST CHOICE

Product range

Online retailers and marketplace platforms list a vast range online: no longer limited by shelf space

Customer purchase journey

Customer visits multiple retailer, manufacturer and platform sites and browses the range directly

Significant time spent comparing prices, reading reviews, and comparing product specifications

Monetization

Gross margins generally decrease as price transparency increases but the customer does more work

AGE OF SMART CURATION

Product range

Unlimited range still exists...

... but using a combination of machine learning and the judgment of a merchant, choice intermediaries provide the customer with a manageable list of personalized recommendations

Customer purchase journey

Customer identifies which problems they are trying to solve, instead of which products they want

Shopping is about accepting or rejecting recommendations rather than seeking out products

Monetization

Retailers, aggregators, and platforms will collect revenue in a variety of ways: gross margins, small commissions, booking fees, advertising fees, listing fees, and data insight sales

Source: Oliver Wyman analysis

“Players who have customer knowledge and client relationship will probably be the new middleman.”

Grocery executive

“The technology for AI personal shopping already exists. It's probably five years away.”

CPG executive

“Retailers are outsourcing to Instacart and ceding control of the experience”

Investor

“Innovation is just not in retailers' DNA”

Investor

travel agents as customers' first step when planning and purchasing a trip.

In food retail, a similar unifying choice intermediary could take the form of a voice-activated intelligent ordering platform such as Alexa, Siri, or Google Home. These can, for example, rapidly automate routine purchases of household goods and groceries. Chicory, a New-York-based startup with 65 million unique visitors a month, transmits recipes directly to partner retailer platforms so that customers can buy ingredients for a specific recipe. It is not hard to see how the choice intermediaries of the future could save time for consumers by helping them plan meals based on their family size, tastes, schedules, and budgets. With further advances in connected devices, they could even help manage

inventory levels in customers' pantries to minimize waste.

Apparel companies such as StitchFix, which was valued at US\$1.4 billion when its shares were floated in November 2017, are finding ways to add even more value as choice intermediaries. By combining machine learning with expert design and curation, they can predict customers' tastes and sizes. They then scan a wide variety of retailers' stock to assemble recommendations for their clothing-as-a-subscription service.

Choice intermediaries benefit from being independent of retailers, as they can help customers choose from the widest possible range of options, which might cross traditional category boundaries. Solutions for “dinner tonight” could involve a recipe cooked from scratch, a frozen premium



THE RISE OF THE ACCESS ECONOMY

Access economy players allow customers to rent rather than buy items, so they share the cost of the asset and pay less per use. Services like Spotify and Netflix have already revolutionized the music and film industries, while Rent The Runway and Girl Meets Dress are allowing more consumers to access luxury and designer apparel. However, the rise of the access economy could diminish the total demand for the products concerned.

We think this model has the potential to expand to other categories where products are purchased and not used regularly, for instance power tools and

other infrequently used household appliances, some sports and leisure equipment, and many children's toys. Today, retailers address the issue indirectly by sourcing cheap, low-quality products that may not last very long, but do bring down the cost per use. But this has consequences both for the environment and the quality of the consumption experience.

Retailers and manufacturers in such sectors face a choice between continuing to drive wasteful consumption and helping their customers access products in more efficient ways. These could include setting up swap clubs as well as standard rental models. Rapid and convenient fulfillment options – “we can have the power tool you need for that DIY project at your door in an hour” – may help to “unlock” such models.

ready meal, or a takeaway from a nearby restaurant. Outfits could be designed to mix and match inexpensive accessories from fast-fashion outlets with articles built to last from higher-end boutiques that will optimize cost per wear over a few seasons. Even retailers that curate within their own ranges will find it hard to cross these boundaries to match independent curation engines.

Choice intermediaries could channel consumer demand to the retailer who offers the best deals on each part of the basket, or even suggest that a customer delay a purchase when there is a high likelihood of an upcoming promotion. This is already commonplace in travel, with flight intermediaries like Hopper and Skyscanner helping consumers to find the lowest possible prices. And just as Expedia makes bookings directly with hotel chains, choice

intermediaries could also start to negotiate terms directly with major manufacturers, and pay retailers only a nominal fee for their undifferentiated role in fulfilment and delivery.

If consumers shift to beginning their shopping journeys with choice intermediaries, retailers could find themselves reduced to undifferentiated providers of catalog for these intermediaries. They might then struggle to defend their cut of the margin stack. (See Exhibit 17.)

THE LAST MILE AS A KEY CUSTOMER TOUCHPOINT

Last-mile intermediaries build a direct relationship with customers. At first glance, this may not seem like a threat because they are just providers of a service – delivery – that many retailers

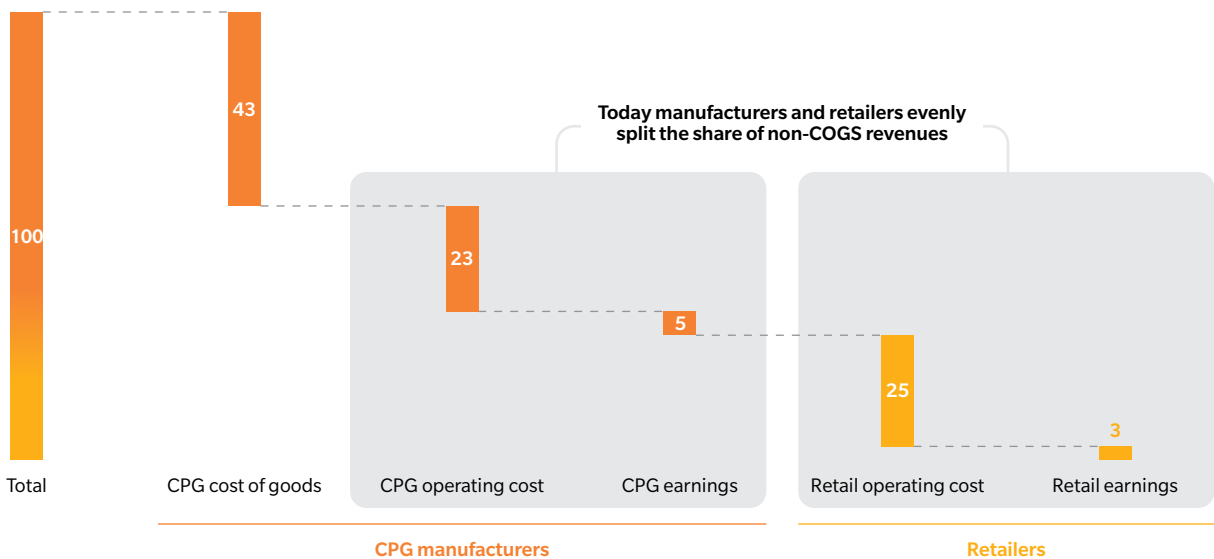
have chosen to outsource. However, the threat lies in their direct interaction with the consumer. Once customers are loyal to a last-mile provider, retailers may find themselves tied into offering delivery through that provider, even if the terms are unfavorable. If loyalty is particularly high, customers may even go to their last-mile portals as a first step in the shopping journey – in order to find compatible retailers. They might then browse a shortlist of products that could be delivered in the next few hours at no added cost due to spare capacity in the network.

One example is DPD. As well as simply delivering packages, it offers additional services such as live tracking of the delivery van, which draws customers into direct interactions. The drivers are rated and reviewed by customers,

EXHIBIT 17. THE SHARE OF TOTAL RETAIL VALUE “UP FOR GRABS” BY NEW INTERMEDIARIES

BY SUPPLANTING RETAILERS, NEW INTERMEDIARIES COULD CLAIM A LARGE PORTION OF THE MARGIN STACK

BREAKDOWN OF RETAIL REVENUE BETWEEN CONSUMER PACKAGED GOODS MANUFACTURERS AND RETAILERS
2016, FOR US\$ 100 OF RETAIL SALES



Note: Scales CPG Earning, Operating, COGS to Retail COGS

Source: S&P Capital IQ – All public companies under “Retailing (Primary)” or “Consumer Staples (Primary)” (5,613 companies worldwide)

creating a personal connection. Instacart's customers already conduct the whole of their shopping journeys within its ecosystem. The system today is a fairly transparent portal onto retailers' own websites. But Instacart is a tech player, and it is well funded and on the lookout for new ways to scale profitably beyond its current business model. Once Instacart controls access to a large part of a retailer's high-value customer base, it could start to act as a gatekeeper. For instance, it could incorporate technology to suggest that customers choose a different retailer with lower prices or better products.

These two new models offer very different propositions from traditional retail. The choice intermediary offers customers transparency, neutrality, and an infinite catalog. The last-mile intermediary offers low-cost, high-quality delivery services through a dense,

well-optimized network, which then gives it privileged access to the customer and the opportunity to become a favored intermediary. Retailers run the risk of becoming back-end utilities serving these new intermediaries – supplying a ready catalog of standard products, and struggling to differentiate their offer.

The travel industry provides a good benchmark for the value such intermediaries can command. The total value of bookings in the global travel market was US\$1.3 trillion in 2016. The three biggest online travel choice intermediaries – Expedia, Priceline, and C-Trip – together had gross bookings accounting for approximately 15 percent of this market. On this gross booking value, they took between three and 20 percent as their fees – amounting to over US\$20 billion in net revenues. All three continue to forecast annual growth rates

of between 20 and 45 percent, so they are building phenomenal global scale.

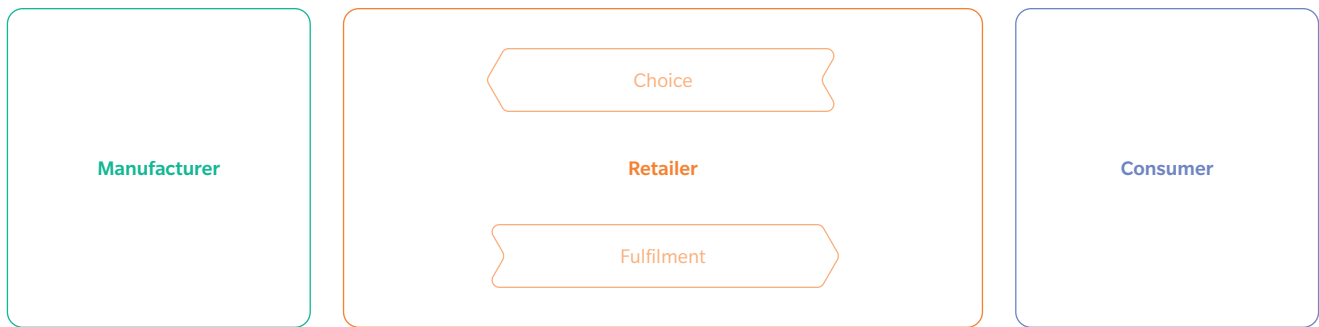
The grocery sector in North America and Europe is one and a half times the size of the global travel market. Therefore choice intermediaries – imagine a digital “food butler” that manages a household's food and places orders when necessary – participating in 15 percent of the market and charging a commission between five and 10 percent would be a US\$15 billion to US\$30 billion business. It would also benefit from significant network scale effects once its algorithm was perfected.

Though the shift to online is the most visible sign of change, the really profound changes in retail could come from disruptive models that create more effective links between manufacturers and consumers. (See Exhibit 18.)

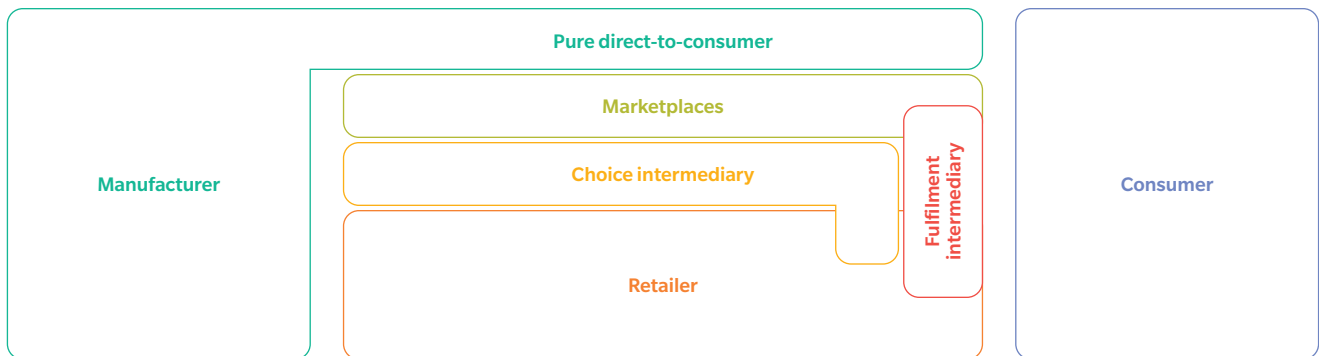
EXHIBIT 18. THE OLD RETAIL VALUE CHAIN IS BEING TRANSFORMED...

...WITH NEW INTERMEDIARIES AND ROUTES TO MARKET SUPPLANTING THE RETAILER'S TRADITIONAL ROLE

OLD VALUE CHAIN



NEW VALUE CHAIN



Source: Oliver Wyman analysis

INDUSTRY VIEW



MARC POULIN

FORMER CEO OF SOBEYS
AND CORPORATE DIRECTOR

One reason food shopping has mostly stayed offline is that the current model is so efficient that it is difficult to disrupt. However, the system relies heavily on customers to do much of the work that makes it cheap and convenient. They plan their own meals, pick items from shelves, and then haul them back home and these tasks turn food shopping into a chore.

That gives technology an opportunity to disrupt today's model. But there will be conditions. Thanks to their own participation in the work, customers have grown accustomed to low prices – and they will not want to pay any more. But retailers' margins are already very slim, so any new system will have to be extremely efficient for them to avoid subsidizing online baskets.

These are high bars to clear. Here are three ways to achieve this level of efficiency.

First, consumers need to be able to select products online at least as quickly as they do in a physical store. Most online food interfaces are poorly designed, and building a basket online now takes roughly as long as shopping the aisles of a supermarket. But, by applying artificial intelligence to data on a customer's past purchases, the process can be shortened – even while adding services such as meal planning.

Second, product picking for online baskets has to cost supermarkets as little as getting customers to pick from store shelves. This is doable. While

it is difficult to create robots capable of picking from stores, robots find warehouses much easier to navigate. Capital expenditures are offset by reductions in labour costs, spoilage and theft, and real estate, thus generating enough economies to pay for delivery, enabling a full loop system with similar costs to traditional supermarkets.

Third, delivery has to be more practical for the consumer without adding extra cost. Drone delivery may be far from mature, but the use of passive cooling technologies and existing delivery networks by logistics providers could drop the cost significantly – even if it does not match the immediacy of the store.

Has all the technology required to make these breakthroughs been invented yet? I do not think so. However, I think it is close enough that traditional food retailers should be preparing. Their volumes – and, therefore, their productivity – will erode, creating enormous pressures on their cost structures. However, they will still benefit from their convenient locations. And, at least for the time being, they have superior information on the customer base through card data and the local expertise of store staff. Plus, there will always be a place for personal service and human interaction.

One thing that seems sure is that grocery shopping will be less of a chore in future. Now, the only chore will be clearing up after cooking!

PART TWO: RETAIL IN THE FUTURE

NEW MODELS FOR SURVIVING IN THE FUTURE

The impact of these changes on the retail sector will be fundamental. New business models will emerge, and retailers as we know them today will cease to exist. Those that survive will do so by reshaping themselves along the lines of one, or more, of these new models. Many others will go out of business, and there will be significant consolidation across the sector.

THE TRADITIONAL RETAIL BUSINESS MODEL IS NO LONGER ENOUGH

The traditional retail business model has been stable for the past century. First, create a winning format – the right mix of products, value, and service for the target customer segments. Second, propagate this format to more and more locations. Finally, once the market is saturated, tune the offer to local

demand and optimize store space, while continuing to offer good value.

A significant amount of the strategic control in the old model came from being customers' closest store – the one they could reach with the minimum hassle. However, for an increasing number of consumers, the internet has become the closest store, particularly for planned purchases where waiting a day or a week for delivery is no barrier. This disruption has already hit the retail industry hard and been reflected in measures such as stock price valuations. (See Exhibit 19.)

However, the shift to online retail is only the start of the disruption to come. Consumers' behavior, habits, and expectations are changing. New intermediaries are arriving to meet these demands, threatening retailers'

once-privileged position as the only route to the customer. Online players are slightly better positioned to respond by virtue of their agility, their innovation DNA, and their growth tailwinds – but the challenges are relevant to the entire sector.

Of course, incumbent retailers can find ways to fight back for a while. Most traditional retailers have already started to cannibalize themselves online – working to keep the customer in their ecosystem

by building a credible online offer. This threatens profitability, as they have to sustain both the high fixed costs of stores as well as the high marginal cost to serve online.

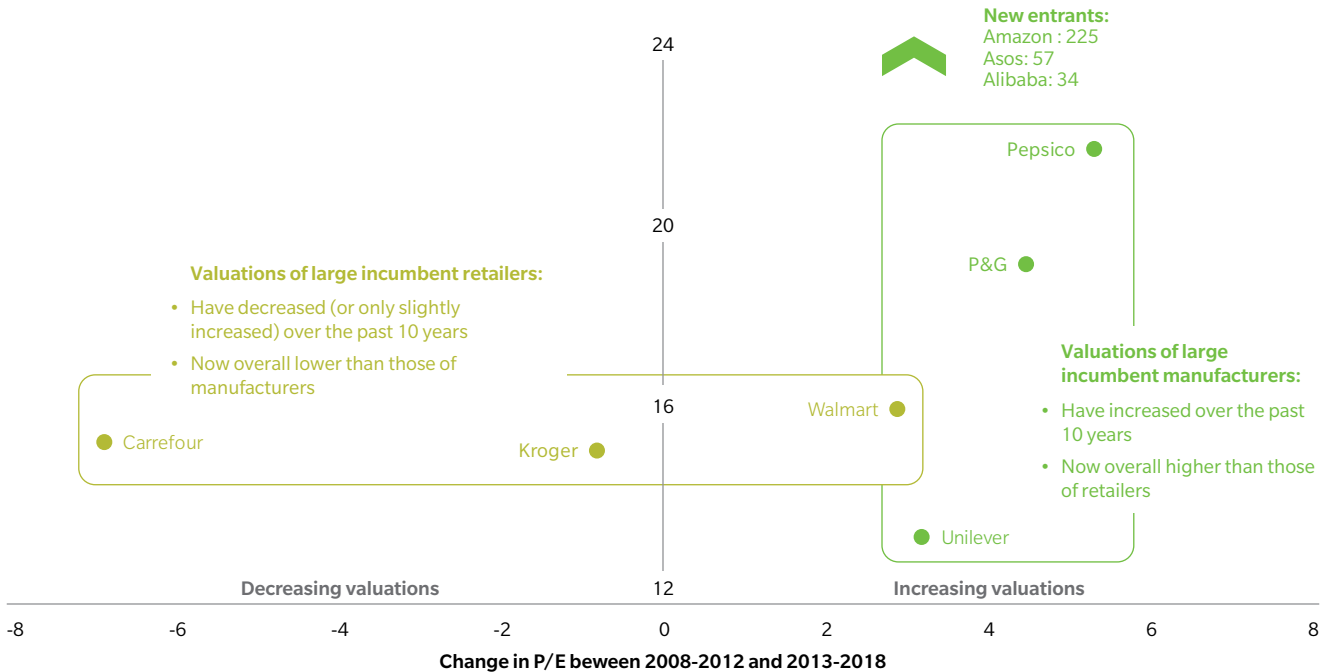
Other companies are growing by serving the need-it-now mission, where physical proximity and strong range curation remain strategic strengths – but this will only sustain a relatively small set of niche retailers.

“Dave Gilboa of Warby Parker said it best, ‘Mediocre retail is dead’”
Apparel executive

EXHIBIT 19. MARKET VALUATION OF TRADITIONAL RETAILERS COMPARED WITH CPG COMPANIES

FINANCIAL MARKETS HAVE VALUED CPG COMPANIES MORE HIGHLY THAN TRADITIONAL RETAILERS

P/E RATIOS AND CHANGES OVER TIME
 SELECTED RETAIL AND CPG COMPANIES



Source: Capital IQ; Oliver Wyman analysis



SIX NEW MODELS CAN HELP BUSINESSES WIN IN THE NEW ERA

For most of the industry, whether physical incumbent or pure-play online, the old formulae for success are no longer good enough. We see six models that will prosper in the new world, each based on a particular dimension of strategic control. Most retailers will likely combine elements of more than one of these models to achieve success and continued growth.

For example, Alibaba is building a magnetic ecosystem with its integrated Alipay payments solutions and is also leading as a fulfilment intermediary with its low-cost next-day delivery service. Its platforms such as Tmall allow foreign brands to showcase their ranges online, building Alibaba's credentials as a choice intermediary – the first place that consumers go to search for and compare multiple brands.

The new models also serve as a framework to analyze the success of Amazon. Its infinite range, recommendation algorithms, and unparalleled bank of genuine customer reviews positioned the company as an early choice intermediary for numerous sectors. More recently, Amazon Prime has helped to build a magnetic service for its subscribers. Now, Amazon is developing its strengths in fulfilment and product leadership.

1. PRODUCT LEADER

WHAT IS IT?

Product leaders offer market-beating products that consumers cannot get elsewhere. These products offer value for money and unbeatable quality on dimensions the customer cares about.

HOW TO WIN?

Product leaders have the ability to design and create products that satisfy consumer needs. They are also able to source effectively to deliver these products at reasonable prices. Their products are not limited by the geographic reach of their own channels – demand for them is strong enough to sustain third party channels.

In this model, as product leaders expand into more markets, their increasing scale enables higher R&D spending and better supplier terms, further improving product quality and reducing costs.

While global scale confers advantage, we also see a role for small, local producers. The growing consumer demand for low-carbon-footprint, ethically produced food and apparel has benefited smaller-scale producers, who find it easier to sell their wares through online platforms.

New technologies such as additive manufacturing – that is, 3D printing – and semi-autonomous sewing robots could also reduce the cost of creating customized products and apparel. Technology could thus herald a comeback for “preindustrial” crafts and artisan products.

WHO IS DOING THIS TODAY?

Most apparel players are vertically integrated and aim to be product leaders. Zara is a leader in fast-fashion thanks to innovative supply chains designed to respond rapidly to customer demand.

In the food sector, the model is at the core of the success of upmarket retailers such as Mercadona

and Marks & Spencer, as well as the discount chains Aldi and Lidl. Aldi has recently started to sell its own products beyond its own stores, via the Chinese e-commerce marketplace Tmall.

In consumer electronics, California-based Monoprice's private brand is growing fast through aggressive value-engineering that replicates the quality of major brands at a significant discount.

At the hyper-local, artisanal end of the scale, independent producers are emerging in affluent urban centers throughout the western world. We think this trend is here to stay, threatening luxury brands among aspirational consumers.



2. MAGNETIC ECOSYSTEM

WHAT IS IT?

Magnetic ecosystems create compelling shopping and consumption experiences that give customers strong reasons to keep coming back. They do this through exclusive features that deliver seamless, hassle-free shopping or add value to an ongoing consumption experience.

HOW TO WIN?

Magnetic ecosystems are usually created through a mix of strategies. A magnetic purchase experience might involve personalized recommendations, one-click payment, and same-day delivery. To create ongoing customer engagement, companies could set up user communities, proprietary apps, and connected devices – all available to customers who stay in the ecosystem.

Some of these strategies work well on a market scale: social networks, rapid delivery services, and discounts at partner brands. Others have the potential to go global, for example, connected devices or integrated payments infrastructure.

WHO IS DOING THIS TODAY?

Amazon Prime makes the shopping process seamless with their one-click payment, free next-day delivery, and no-quibbles returns. They offer ongoing

“We aren't afraid that Instacart will steal our customers because we have unique products”

Grocery executive



“Merchandising has been the core function of retailers, which have essentially provided a curated marketplace experience. But with e-commerce, customers can act as their own merchants. As a result, retailers need to backwards-integrate to become more like CPG companies, and add value by offering unique products”

Grocery executive

“I would give Prime customers credit for knowing the difference. If it is not on the doorstep in two days, they know it is a third-party seller, not Amazon”

CPG executive

value to members with services such as personalized promotions and free streaming of exclusive video content.

The Alipay payments system was set up with an escrow functionality in order to tackle the lack of trust in remote purchasing which was holding back the growth of Alibaba in China. Today, Alipay has expanded far beyond the Alibaba website to allow its customers to pay for purchases virtually anywhere in the world.

Nike has created a system of connected devices and compatible sports apparel, participatory events, and personalized trainer apps. These give customers strong reasons to buy compatible products and stay within Nike's ecosystem.



3. CHOICE INTERMEDIARY

WHAT IS IT?

Choice intermediaries are where customers start their shopping journeys, because they help customers match products to their needs. Customers find they save time and money, and make better decisions, compared to going direct to retailers or manufacturers.

HOW TO WIN?

Successful choice intermediaries deliver high-quality recommendations that match each customer's needs – in a variety of different ways.

Review aggregators assemble and maintain large databases of high-quality reviews. In travel, leaders such as TripAdvisor offer customers the ability to filter reviews to ensure relevance – for instance based on the purpose of the trip.

Learning algorithms analyse customer behavior to create a customised set of recommendations. Netflix was one of the pioneers of this technology,

famously offering a \$1 million prize for the best algorithm to predict a given user's preference for films.

Market mappers focus on products, helping the consumer rapidly make sense of the range of available choices. Travel technology companies such as Skyscanner and Kayak optimize thousands of route and carrier combinations to give users the most cost- and time-effective options for getting between two points.

The choice-intermediary model could scale well globally, particularly in sectors with few market-specific products, such as technology, hardline goods, and some parts of apparel. It is not necessary to physically distribute products in this model, as other retailers can do this once customers have made their selection.

WHO IS DOING THIS TODAY?

Amazon aggregates user reviews and customizes recommendations using its learning algorithms.

Womenswear retailers like Topshop and John Lewis partner with Dressipi, a technology company that creates personalized "style edits": outfits recommended for each shopper on the basis of initial profiling that is then tuned to individual preferences through machine learning.

E-commerce player Jet.com acts as a market mapper by making transparent the true marginal costs of customers' orders, so that they can then modify their behavior to share in cost savings.

In Europe at least, the European Union's General Data Protection Regulation (GDPR), which gives customers control over their own data, will make it easier for disruptors to acquire the data needed to make a success of this model.



4. CUSTOMER EXPERIENCE SPECIALIST

WHAT IS IT?

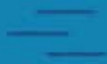
In this model, retailers create the best customer experience in-store, on the phone, and online. These retailers then become the preferred destinations for a great shopping experience, whether for everyday purchases or special occasions.

HOW TO WIN?

Spending heavily on staff headcount and free in-store services is not enough. Only a tiny segment

"You do not go to a department store, because you cannot find any help"

Apparel executive



"Costco, HEB, Wegmans, Publix, Trader Joes, Aldi. What do they all have in common? They put employees first and pay better"

Grocery executive

of consumers are willing to pay the premiums required to make such services profitable.

Instead, retailers who provide a superior experience often have passionate frontline staff, who are strong product and brand advocates in store or on the phone. Smart retailers find ways to empower their staff to deliver a great customer experience in an efficient manner, for instance by building back-end systems that let staff readily access stock data or pull up customer account details.

The best scale for this model is typically the local market: It is strengthened when the retailer is in some way part of the community and understands local consumers. However, e-commerce players that execute this model well – in particular, those that offer interactions with front-line staff through digital technologies – could potentially scale internationally as well.

WHO IS DOING THIS TODAY?

US-based home improvement retailer Lowe's Innovation Lab develops ways to apply disruptive technologies to enhance the customer experience both in-store and online. For instance, its mobile app shows the layout of Lowe's stores to help customers find products quickly, while its "Holoroom How To" is a virtual-reality DIY skills-training clinic available in stores.

Back Country, a North American online specialty outdoor gear retailer, employs a team of 'Gearheads' – outdoor sports aficionados who can give technical advice to customers via digital chat, email, or phone. As a result, Back Country offers far superior customer advice than competitors that rely on in-store staff who typically have less direct experience of the products.

It is not all about technology, however. Zappos has built up legendary customer service ratings based on an analog approach to staff training and management. Call-center staff are highly trained, and enjoy a high degree of autonomy in dealing with customer requests and complaints. This builds employee engagement, which in turn leads to superior service.

"In many markets, we have had the same delivery driver for 10 years"

Grocery executive



5. FULFILMENT SPECIALIST

WHAT IS IT?

Fulfilment specialists own the last mile. They get products from distribution centers and stores to customers rapidly and cheaply – often, but not always, to their front doors.

HOW TO WIN?

Efficient, low-cost delivery requires good system design, which can be done in a number of ways. Successful hard discounters like Aldi and Lidl set their stores up to be as streamlined and efficient as possible. The savings they offer are enough to persuade customers to travel to the store to pick their own baskets.

Online fulfilment specialists will build scale networks that send delivery vehicles to nearly every street in a given market every day. To achieve such densities, they need to win and keep customers by offering great service and reliability. For attended delivery, such services may include allowing customers to track their their delivery in real time, and offering flexible options to reschedule. Great unattended delivery service would require offering frequent drops and a wide network of collection points to maximize convenience.

WHO IS DOING THIS TODAY?

Tesco's acquisition of the Booker Group gives it potential access to 125,000 independent convenience stores across the UK. If it uses many of these as collection points, it could dominate unattended delivery.

Amazon, through its DHL deal and Amazon Locker trials, appears to be pursuing a comprehensive strategy for the last mile, which is understandable given the importance of delivery for its entire business model.

Beyond retailers, French parcel delivery firm DPD has introduced real-time driver tracking in its app, as well as innovations such as the DPD virtual address, which allows customers to access cheaper international shipping. These innovations are the key to becoming customers' preferred delivery service – and reaping the scale benefits.



6. KEY LOCATION PLAYER

WHAT IS IT?

Key location players own, manage, and create the best high-traffic locations for capturing consumers' attention. They are physical-world versions of magnetic online ecosystems, which acquire strategic control by owning the physical locations where consumers want to spend time shopping.

HOW TO WIN?

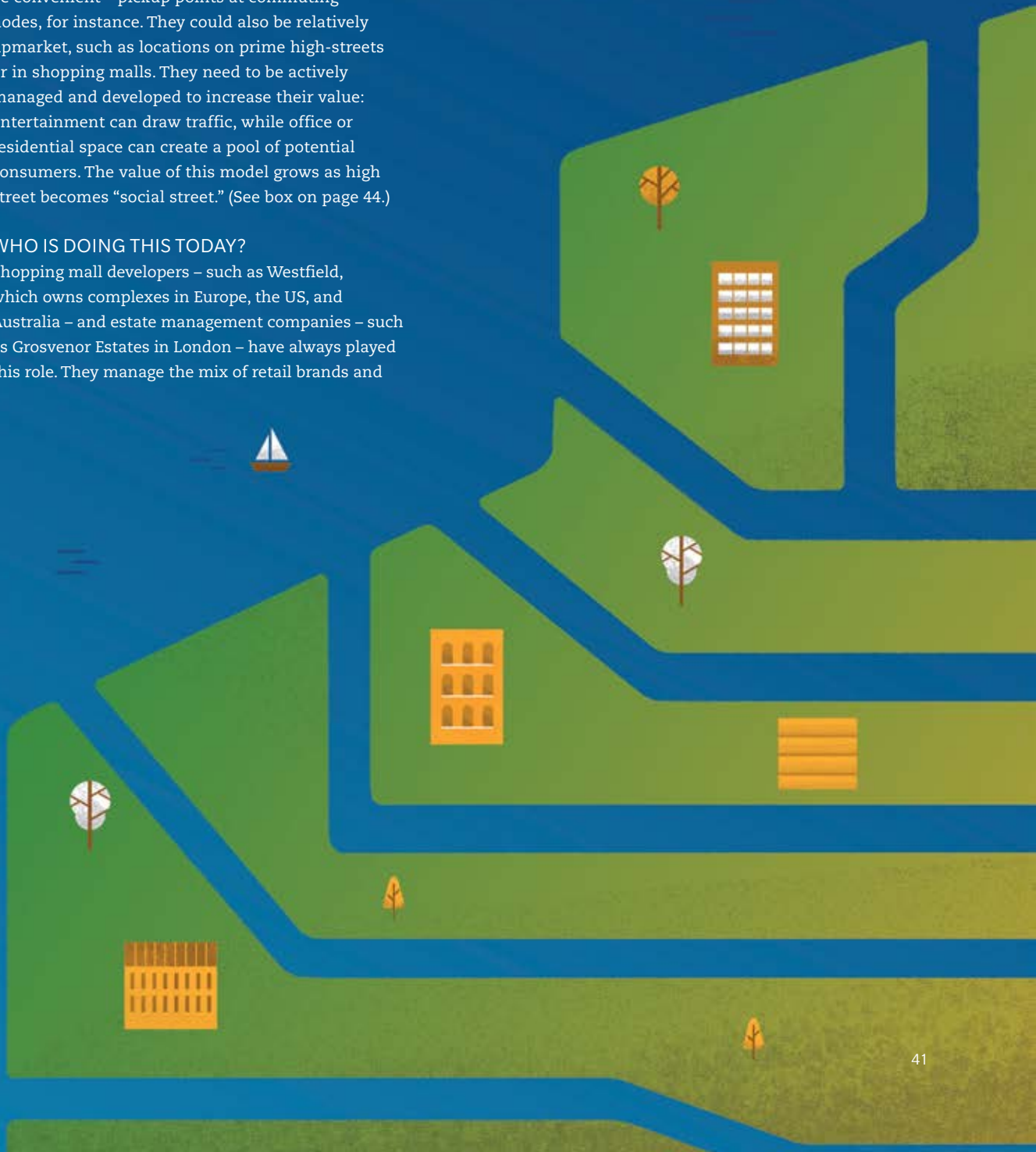
Key location players need both farsighted purchasing to own the best locations and active management to generate traffic. The sites could be convenient – pickup points at commuting nodes, for instance. They could also be relatively upmarket, such as locations on prime high-streets or in shopping malls. They need to be actively managed and developed to increase their value: Entertainment can draw traffic, while office or residential space can create a pool of potential consumers. The value of this model grows as high street becomes “social street.” (See box on page 44.)

WHO IS DOING THIS TODAY?

Shopping mall developers – such as Westfield, which owns complexes in Europe, the US, and Australia – and estate management companies – such as Grosvenor Estates in London – have always played this role. They manage the mix of retail brands and

other attractions in their shopping centers and high streets. In a different kind of example, French retailer E. Leclerc profits from the customer traffic coming to its hypermarkets by charging rent to other retailers that join the cluster and benefit from this traffic.

At the other end of the size spectrum, convenience players have flourished in recent years with many of them adding additional services to their offering and optimizing for smaller, more focused baskets. We expect the importance of this business model to grow as the role of physical stores changes.



TOMORROW'S WINNERS NEED TO BE MATCH FIT TODAY

The choice of which models to pursue will vary by retailer and depend on their current areas of strength, the profile of their target customer base, existing competition in the market, and the resources available to make the transition. Regardless of which models retailers choose, three enablers can help to execute the new strategy effectively. For most companies, putting these in place will be a no-regrets move that should be carried out as soon as possible. Many of the executives we spoke to recognized these priorities, but delivery is not straightforward in many legacy organizations.

COST TRANSPARENCY

As customers grow accustomed to price transparency, retailers will need to ensure their cost bases are at least as streamlined as those of other players in the market, in order to match competitor prices without profits suffering. Moreover, most will also need cash to fund the strategic transformation in their business model.

Cost leaders have a clear view of which of their activities drive value, and they can be ruthless in culling those that do not. Most incumbents we spoke to lack this insight because of their highly complex legacy organizations. So, while cost is on the agenda of most of the retailers we have spoken to, few so far have taken bold moves. Those that have made the most progress have applied a “zero-basing approach” – redesigning their organization from nothing, and adding back in only those cost-generating elements that deliver the most value. For most retailers, such a radical approach is the best way to free up the substantial funds needed to pay for transformative investments in the future while simultaneously providing great value for customers.

CUSTOMER DATA

Almost all of the new models will depend on the effective use of customer data to evaluate and improve services, and develop the most potent, cost-effective propositions.

However, omnichannel customer behavior will make customer journeys and decisions increasingly difficult to track, as they will involve in-store, phone, and web touchpoints. Furthermore, the GDPR legislation in the EU will give consumers legal control over their data, so their explicit consent will be needed to use it or share it with third parties. To retain permission to use customer data, companies will need to offer benefits that are clearly supported by data sharing, such as high-quality recommendations and tailored services or offers.

Many incumbent retailers have found it a challenge to build world-class data and insight capabilities. In one common structure, digital teams which are separate from the commercial parts of the business are responsible for processing customer data and drawing insights from it. Such disconnected digital teams often find it difficult to engage with the legacy organization to discover ways of using customer data to add value. Without a good business case, digital projects are frequently too low on the executive agenda to drive real change and investment. So retailers need to develop a clear picture of how customer data will enhance the effectiveness of their entire business – and a clear roadmap to collect and deploy data in their organization.

AGILITY

Insights from data are only useful insofar as they guide decisions and actions. To keep up with the pace of innovation at digital and new-wave intermediary rivals, most incumbent retailers need to be able to design, test, and rapidly implement

new solutions. However, retail corporate culture is often based on faithfully rolling out a proven format. Even at head office, teams are typically accustomed to working within narrow functional areas with limited autonomy. New projects usually require sign-off from an array of stakeholders, each tasked with defending an element of the winning formula.

By contrast, digital-native companies frequently deploy partially-built solutions, and then make improvements based on learnings from pilot or beta testing. Rather than waiting to approve a project until there is sufficient data to be certain about its prospects, agile companies break a project down into small, low-risk deliverables that minimize the costs of any misstep.

Successful retailers will replicate key aspects of the agile operating models they see in new economy players – even while they stop short of blindly copying all elements and compromising their operational consistency.

MANY RETAILERS WILL FAIL, LEADING TO CONCENTRATION AND CONSOLIDATION

CONCENTRATION AND CONSOLIDATION AHEAD

Retailers who are unable to give shoppers a reason to come to them first will lose customers or find that access to their customers is controlled by new intermediaries – probably on less favorable terms. As they face the choice between losing volumes and margins, they will find it harder to invest in new capabilities and their customer proposition. A fair number of these players will likely go out of business or into managed decline.

When a company is in decline, the best policy for its investors is often to preserve the company's capital and ensure that it

is managed for cash, so that it can fund innovation elsewhere. This is of course a hard management role to play – and it often happens far too late.

By contrast, companies that are well positioned on one or more of the six dimensions of success should grow. In the past, retail was primarily a game played at local scale. But some of the new models bring advantages on a global scale, encouraging the emergence of international giants. This will be the case particularly for business models based on product leadership, which are powered by sourcing scale. It will also apply to models with a significant technology component, such as choice intermediaries that offer algorithm-driven services such as a food butlers and personal wardrobe assistants. These will scale globally given the technology investment required and the benefits from having more customers – and data points – to learn from.

This does not mean the end for local winners though. At a national or market level, there remains a clear role for retailers that can create strong customer experiences and a sense of community, or build the local scale to dominate last-mile delivery.

However, a condition for winning will be to build the crucial enablers of cost transparency, customer data, and agility. These are essential for companies to have the cash and core capabilities to develop their new business models.

Retail is changing fundamentally. In the future there will be fewer bigger retailers, and new models for success will emerge.



“It is difficult to get buy-in from the company to invest when they will not see immediate returns but we have to change the mindset on this or many companies will not be around much longer “

Investor

“Talent can be a barrier to changing. These are operators, not PhDs and so change is difficult. Also, we need to make sure the customers follow”

Grocery executive

“The rate of change has speeded up and it is not going to slow down”

CPG executive

“It is a murky picture. No one knows how it is going to play out; all you can do is make bets and be flexible”

Mass retail executive

“There will be another round of significant fall out in the industry”

Grocery executive

“No matter what companies do with AI, automation, etc, there is not much they can do to stay afloat. They are dead but do not even know it. If I were those guys, I would sell as fast as I could”

Grocery executive

“Our strategy is heavily based on our culture of treating our customers like kings and queens. We spend a fortune on technology to understand customer trends and demand. We embed a thousand different ways of using timely and insightful market information to drive our key business processes”

Grocery executive

“Data will be the currency in the future. We need to make sure we are collecting data to stay relevant”

Grocery executive

“No one has as much data as retailers do. Brands will never have as much data. Retailers will have to play a role on data, but they still do not value this data”

Grocery executive

“The biggest problem of traditional retailers is that they do not know how to use the data as opposed to eRetailers”

Grocery executive

“There needs to be more risk-taking and investment and understanding that ROI will be further out, because the industry and competitiveness of the environment are changing consumer expectations faster and faster”

Grocery executive

WHERE COULD THIS ALL LEAD? PREDICTIONS FOR SOME SECTORS OF RETAIL

GROCERY: INTERNATIONAL BEHEMOTHS AND LOCAL HEROES

We see online penetration picking up, particularly in affluent, densely-populated cities and suburbs, as some barriers to last-mile delivery are removed. One contributor will be fulfilment intermediaries providing last-mile delivery services for all players. There will likely be a small number of these for each market or region, some of which will emerge from joint ventures between incumbent grocers seeking viable scale. Customers will also be more willing to pay for the service of picking and home delivery, especially as online shopping interface quality improves, for instance through better curation and recommendations that save time.

A particular kind of online retailer – the product specialist or category killer – will hurt the margins of full-basket grocers by picking off products or categories where they are making outsized margins, and offering bulk deals and good-value product subscriptions. The trial and adoption of this model will be supported by choice intermediaries that can help consumers find good opportunities to save money.

A few product businesses with international scale will continue to grow in the markets where they currently have a toehold. Examples include discounters such as Aldi and Lidl, which will consolidate their scale advantages, in particular across Europe. Mid-market product-led retailers such as Mercadona will seek opportunities to help their products find new markets and channels, by selling internationally through platforms and partners.

A small number of winning incumbent grocers who have consolidated across borders will grow into international customer champions. Their strengths will be improved sourcing and product development carried out on a greater scale, and they will also leverage their scale to invest in technology that drives other services. These could include choice intermediaries and connected devices that form a magnetic ecosystem. Customer segments with complex needs, such as diabetics, could use customized recipe

services, or gamified health features such as diet or fitness tracking.

The growth of these three models will leave a smaller role for national and regional retailers. We think that within the next 10 to 15 years, there will be half as many as today. Those that remain will consolidate their strengths as local heroes focused on customer experience and locally-sourced products.

“Food butler” choice intermediaries will help manage customers’ food needs from the choices offered by different retailers. They will become an increasingly important part of the landscape as customers come to trust them to construct meals to suit specific nutritional needs, tastes, and budgets. Customer loyalty will accrue to the food butlers, rather than to retailers, and such intermediaries will reduce retailer margins by taking the work out of basket splitting. They will enable cherry picking of promotions, and more volume will automatically flow to the lowest-cost players. Brands will decline in importance, as the choice intermediary highlights lower-cost generic substitutes of similar quality and taste. Choice intermediaries might aggregate across hundreds or thousands of customer baskets and make retailers “bid” for these sales. One overall consequence will be the loss of retailers’ insight into customer-level shopping behavior.

CONSUMER ELECTRONICS AND OTHER HARDLINES

Hardlines and technology products face continued disruption, both from the continued growth in online share and the new trend towards ordering direct from manufacturers. In particular, western consumers will enjoy unprecedented access to manufacturers in China via marketplaces such as AliExpress, which connect consumers directly to the manufacturer and dispatch the product, involving no retailer and providing significant savings.

Choice intermediary services will speed up this trend by helping consumers select complex products with confidence and navigate foreign brands. With such assistance, consumers might find products with quality and features they value but would not otherwise have

recognized. As a result, we expect continued decimation of traditional hardlines and technology products retailers, as some stagnate and others shrink. Consolidation will continue.

One model for survival is to develop strategic advantage through capabilities as a product business, such as the French sporting goods retailer Decathlon. Such a business understands consumer needs in depth and then specifies high-functionality, low-cost products to meet those needs. These may even be manufactured in Asia by the same companies that are also selling direct to consumers via platforms.

Another model is to develop “product lifecycle” services that encourage customers to stay in an ecosystem – for instance by providing aftercare and advice. Indeed, the potential advent of “right to repair” legislation could increase the number of retailers offering repair and servicing propositions – including for products they did not sell.

APPAREL: NEW WAYS OF SHOPPING, BUT CONTINUED BRAND DIVERSITY

Fashion brands have always played a strong role in curating and taste-setting. And except in the case of the lowest-price discount clothing retailers, customers generally expect some assistance with choosing – whether in the form of online look-books or in-store advice.

The next wave of innovation in the industry will see the rise of businesses that go even further in helping consumers to choose. Instead of just assembling looks or recommending pieces, curation services assisted by artificial intelligence will help customers assemble whole wardrobes, personalized to individual budgets, tastes, shapes, and sizes. They will help people evaluate their wardrobes in terms of cost per wear, which could drive a move away from disposable fashion towards apparel that lasts, reducing textile waste. Brands will need to adapt and deliver versatile, high-quality clothing that fits the new patterns of consumption.

Another set of innovations will help customers try on products virtually, minimizing the disappointment of receiving an order that does not fit or flatter. Augmented- and virtual-reality technology can help, but the key barrier is sizing consistency. Unless customers are reordering, it is impossible to know how something will fit. One startup, Bonobos, stocks only a very narrow set of styles in a very wide range of colors and sizes. That enables it to aggregate demand and produce a much more granular set of sizes, combining different waist sizes with five fit styles. Another company, Fit Analytics, groups

customers into fit profiles, and then aggregates feedback from each fit profile to recommend the best size for each article.

Such innovations will accelerate the move to online apparel shopping, as the experience will soon surpass that in stores, where fitting room queues and insufficient stock remain customer bugbears that are costly to fix. Winning brands will focus on creating market-beating products, rather than grabbing physical store space.

The diversity of consumer tastes and the value placed on access to a wide range of styles and price points mean that apparel has always been a fragmented sector with a large number of players. For this reason, we do not see significant consolidation in brands in the future. However, scale will help the development of technologies that improve the online customer experience, such as fit-matching and trialing through augmented and virtual reality. Apparel brands could access such technologies via partnerships, or they could become “product companies” that sit under the umbrella of large choice intermediaries that help customers choose. Such disintermediation is less of a danger in apparel than in sectors such as food, because customers will always want to access the hot brand of the day.

HIGH STREET BECOMES SOCIAL STREET


The shift of volume online has led to many predictions of the death of the high (or main) street. We think that, while there will indeed be fewer physical stores, some high streets in the best locations have a bright future as destinations for social shopping. These new “social streets” will be dominated by a mix of retail stores operating as customer experience specialists and outlets offering aftercare services. There will also be a good smattering of restaurants, cafés, and leisure facilities. Some outlets may also double as collection points for goods ordered online. Customers will frequent social streets with friends and family when they want to engage with shopping as an immersive, fun experience – not as a chore.

PART THREE: FALLOUT

BRAND OWNERS AND MANUFACTURERS:

UPSIDES AND CHALLENGES





The upheavals in retail will also have impacts on brand owners. Unlike retailers, brands do not face a clear, immediate threat to their existence. However, the changes in the ecosystem will challenge brands' continued ability to grow profitably. At the same time, brands will have new opportunities that could enrich them – for example, if they establish more direct connections with their customers.

MANAGING IN A CHANGING RETAIL LANDSCAPE

The first challenge will come from the changing retail landscape. Retailers are likely to concentrate into fewer, larger groups, as weaker players in each market cede share to those with more effective business models and, ultimately, get taken over or go under. These emerging giants will develop internationally, thanks to the global scalability of some of their business models. To some degree, this is a continuation of the ongoing trend of the past decade towards greater international consolidation. (See Exhibit 20.) The difference we think manufacturers will notice is that from this point forward the

consolidated entities will increasingly operate more as a single company than as banners in a holding entity. This will let them benefit from scale in technology development and synergy in purchasing and product development.

The changes in retail pose three challenges for manufacturers. Firstly, the rise of a smaller number of large, multinational players will give manufacturers fewer options, meaning tougher conversations across the negotiating table.

Secondly, the rise of a few online-first e-commerce giants means that manufacturers will have to reassess how best to obtain terms that secure a share of growth in these channels. This will involve redesigning legacy systems of list prices, promotional funding, and joint business plans for every account in every market.

Finally, big retailers will increasingly develop their private brand products and market these throughout their global networks; a couple of players have already developed such business models,

“Acquisitions in the right space are definitely a key strategy”
CPG executive

notably the hard discount chains Aldi and Lidl. This will reduce the market share of manufacturer brands. In the past, many CPG manufacturers also produced retailers' private brands alongside their regular brands – thus mitigating the threat of private brand growth. Now, both traditional and discount retailers are increasingly owning the entire private brand production chain. As retailers become larger, their ability to develop innovative (or innovative enough) products will mean that private brands could become an existential threat to many brands in CPG manufacturers' portfolios.

NEW BRANDS RISE OUT OF THE DISRUPTION

There are many possible partnerships that can enable relatively small manufacturers to reach consumers directly and better compete with big brands. Brands that are

making outside profits or offering products that can be improved on relatively easily are particularly open to disruption.

One example is the success of Dollar Shave Club, which offers razor subscriptions for a fraction of the cost of buying from market leader Gillette. (See Exhibit 21.) DSC keeps costs down by mailing razor blades direct to customers, bypassing the costly, complex distribution offered by physical retail channels. Launched in 2012, DSC now has 54 percent of the online shaving market. It was bought in 2016 by Unilever for US\$1 billion. By contrast, Gillette owner P&G's share of the men's shaving market declined from 70 percent in 2010 to 54 percent in 2016.

Owners of large brands can use the rise of upstart challengers as part of an innovation strategy. Pharmaceutical companies shifted from developing drugs

“Smaller companies are more agile. RXBar brought a new product to market in 30 days. For the big guys, it would be 18 months on a good day”

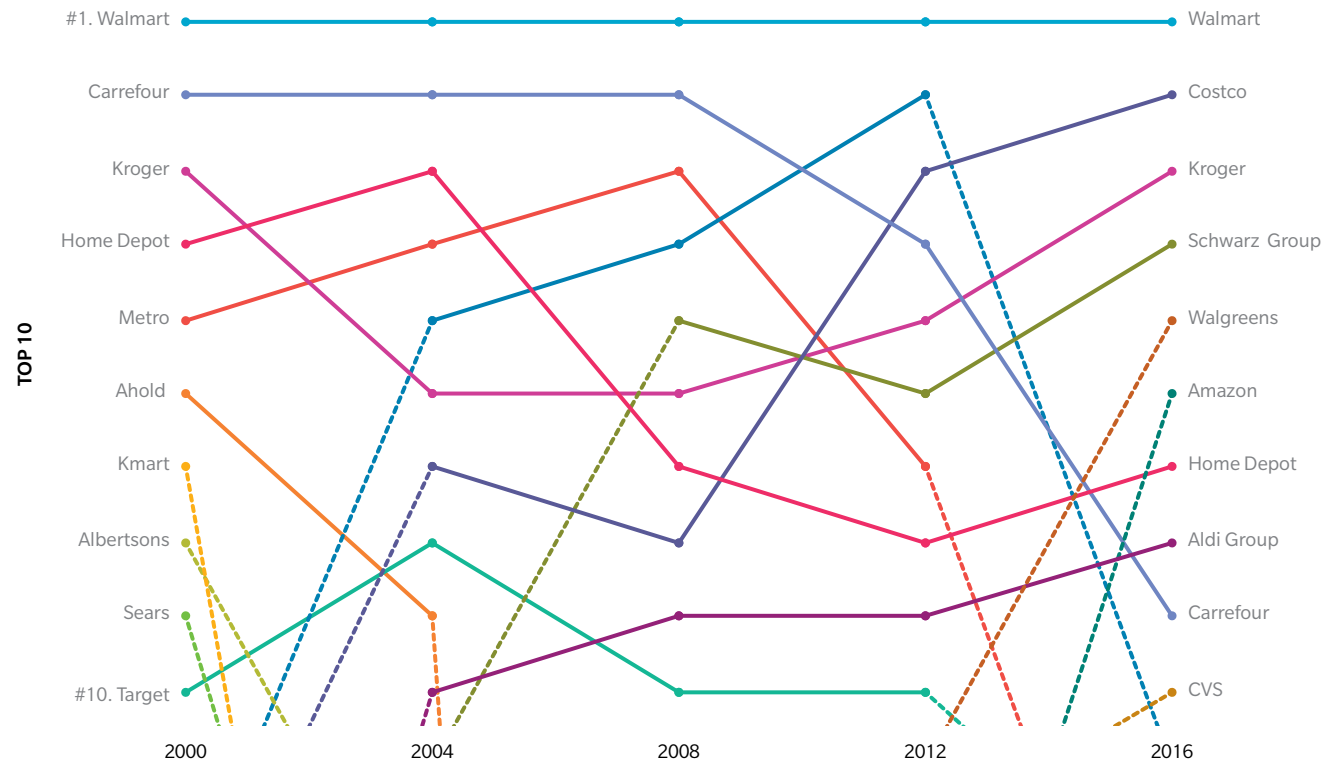
CPG executive

EXHIBIT 20. HOW THE LANDSCAPE OF TOP 10 RETAILERS HAVE EVOLVED

RETAILERS ARE CONSOLIDATING INTO FEWER LARGE, MULTINATIONAL PLAYERS

TOP 10 GLOBAL RETAILERS

FISCAL YEARS 2000-2016, RANKING IN REVENUE



Source: Deloitte, “Global Powers of Retailing”, 2002 to 2018 (Fiscal Years 2000 to 2016), Oliver Wyman analysis

in-house only, to a mixed portfolio strategy of scanning and buying. Consumer goods companies could do something similar, by studying the market for successful cult brands to buy and scale up, and for proven new product concepts to adopt and improve upon. Many are developing such an approach.

The rise of Chinese marketplace platforms may also open the way for new brands from Asia to challenge established brands in the West. For example, Xiaomi, China's largest smartphone manufacturer, also produces a wide range of consumer electronics under the Mi brand name, including Bluetooth headphones, fitness trackers, smart TVs, and even blood pressure monitors. These cost a fraction of the price of established brand equivalents, but in reviews compare favorably on quality and durability. Product manufacturers will

need to increase their level of vigilance to avoid being disrupted by the next wave of upstarts.

SPECIAL PRODUCTS ONLY PLEASE

A major role of brands has been to guarantee the quality and consistency of products, and when customers begin to shop online in a sector they often turn to familiar brands at first. However, the rise of online reviews and choice intermediaries is reducing the importance of this role. Purchasers of skincare and cosmetics products, for example, can consult detailed, functional review sites such as Makeup Alley; watch detailed online makeup tutorials; and look up ingredients in technical glossaries such as EWG's Skin Deep. As a result, consumers are becoming increasingly brand-blind. The trend could

"Walking through the center store, how many of those brands actually bring innovation?"

Grocery executive

EXHIBIT 21. HOW DOLLAR SHAVE CLUB DISRUPTED THE US RAZOR MARKET

NEW UPSTART BRANDS ARE NOW ABLE TO DISRUPT INCUMBENTS WITHOUT SIGNIFICANT CAPITAL INVESTMENT

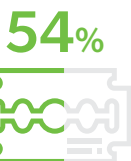
SHARE OF US RAZOR MARKET

GILLETTE



2010

The market leader has lost 16 percentage points of share in six years



2016

AN "ASSET LIGHT" MODEL

DSC manages only product design, brand and customer service. Manufacturing, distribution, and web-hosting are handled by **third parties**

STAGGERING GROWTH

Sales have more than doubled each year since 2012, surpassing **US\$250 million** in 2017

ACQUISITION OF DSC BY UNILEVER

for **US\$1 billion** (July 2016)

DOLLAR SHAVE CLUB

REDUCED MARKETING EXPENSES

by using **unconventional events** to reach new customers (regional food festivals)

HIGHLY COMPETITIVE PRICES

Subscription to shaving blades from **US\$3/month**, including shipping (half the price of Gillette razors bought in stores)

Source: Macquerie Research Power to the People; Business Insider, April 2017, Oliver Wyman analysis

strengthen if algorithmic choice engines continue to grow, and manufacturers may find an increasing share of sales going to consumers who are no longer willing to pay brand premiums.

Rather than going directly to favored cosmetics brands, millennial consumers increasingly turn to the product recommendations of beauty bloggers and other social media influencers. This channel has spawned new challenger brands to the established beauty houses. One of these – Kylie's Cosmetics, a makeup brand belonging to TV and social media personality Kylie Jenner – reaped revenues of US\$386 million in its first full year of operation, and is on track to hit annual sales of US\$1 billion in five years.

In food, owners of "A" brands of fast-moving consumer goods already invest

significantly to maintain a quality edge. Heinz Tomato Ketchup is not just made to a specific recipe – it is made from Heinz's own breed of tomatoes, a strain selected for color, taste, and yield. These give Heinz a quality advantage that allows it to charge a price premium over other brands. Brands that do not offer true functional differentiation will be increasingly exposed, as consumers turn elsewhere. For this reason, the impact of choice intermediaries on brands is a significant concern for the long term.

We expect leading brands to double down and invest on consistently delivering quality in aspects of the product that consumers really care about – constantly studying the market to understand and keep ahead of these preferences. Fewer and fewer brands will be able to coast along on an established brand name, as undeserved

"If you have got no product differentiation, then you're stuffed"

CPG executive



price premiums will be exposed by the range of information available to savvy consumers.

DIRECT-TO-CONSUMER: THE NEW OPPORTUNITIES

One of the biggest opportunities for brands comes from going directly to consumers. For many this is a necessary step to protect their business. There are three objectives which brands should consider in designing a D2C strategy. (See Exhibit 22.)

Firstly, they can learn from it. Deeper insights into consumer tastes, consumption

patterns and purchasing behavior help manufacturers better design products and distribution channels. In 2010, P&G launched P&G Shop, an eStore in the US. Operations were outsourced to a partner firm, and the store was not a commercial success. But its purpose was to learn rather than sell. Through the exercise, P&G for the first time got access to their own proprietary data on online behavior and consumer buying habits.

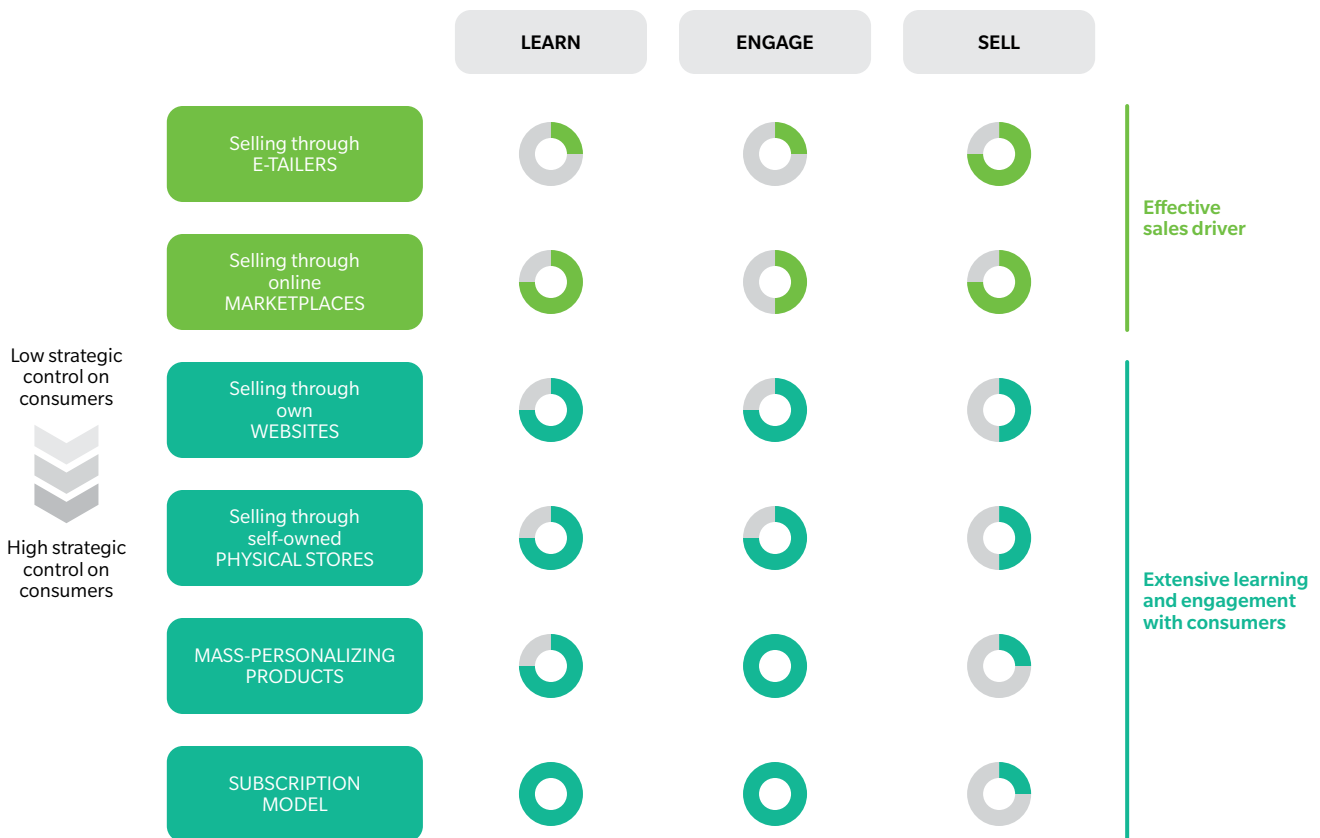
D2C can also help brands engage with consumers. Brand loyalty and engagement can be developed directly by using a mix

“Our minimum score in blind taste tests is 60/40 (i.e. preferred in blind taste tests 60 percent of the time) and our target is 70/30”

CPG executive

EXHIBIT 22. HOW AND WHY MANUFACTURERS GO DIRECT TO CONSUMER

D2C ALLOWS MANUFACTURERS TO LEARN, ENGAGE, AND SELL WITH A COMBINATION OF MODELS



Source: Oliver Wyman analysis



of digital and traditional touchpoints that create connections with customers. Lego's 130 shops worldwide host monthly mini-build events and have iconic destination features such as the pick-a-brick wall. This physical presence establishes customer intimacy – even if customers still mostly buy Lego through third-party retailers.

A third use for D2C is to sell more. Directly selling through marketplace platforms or brand-owned web channels can boost revenues, improve margins, and help expand into new market segments. Though this model was first started in the apparel and luxury sectors, in the past two years consumer packaged goods have cooperated to test online retail platforms like Shobr and INS.

D2C engagement may also offer an opportunity for brand owners and manufacturers to develop new modes of consumption for their products, such as subscription services, or to access new “value pools” from managing a product lifecycle, such as repair and servicing.

As brand owners develop their approaches to the new retail world, they should be alert to some key points. For many, there will be a significant cultural challenge inherent in adding a customer-facing function to a legacy organization that focuses on product engineering and manufacturing excellence. They will need to ensure that their capabilities keep pace with their ambitions, as channels that are unable to keep up with frontline consumer demands risk damaging the brand image and destroying consumer trust in future initiatives. In addition, brands often overestimate their ability to reach minimum commercial scale, and they close down projects that are not delivering the desired additional revenues – even if they are yielding important learning and engagement objectives, which may be worth the investment.

INDUSTRY VIEW

DOMINIQUE
SCHELCHER

VICE PRESIDENT OF SYSTÈME U

The retail industry is shifting from a product-focused model towards one focused on customers. The mass-market era we have known for the past 40 years – which offered mass products to customers coming en masse to buy them – is ending. Now, customers are at the heart of approaches to marketing, and they expect personalized interactions that maintain their trust in brands. That implies an exceptional and ever-more exclusive experience, including customized offers even for food products.

Hyper-connectivity has given consumers more choice, and consumption patterns have become fragmented. This trend has had an impact on the average basket size, and mass retailers are increasingly competing with specialized or dematerialized businesses. E-commerce is growing rapidly, across all sectors other than food. But attempts continue to spread it to food, such as new, unexpected partnerships that aim to overcome the challenges of delivery.

As a result, new players are competing with brick-and-mortar supermarkets in parts of our traditional value chain. Each link of the chain can be challenged by a new platform or intermediary. At the same time, technological advances are accelerating. Big-data analysis, robotization, artificial intelligence, and intelligent personal assistants will shake up our traditional business practices, which have changed little over the past 40 years.

We believe that the right business model for the coming years will be one that creates connections.

Shopping will be carried out in places where people live, and customers will use all their senses when deciding what to buy – looking at products and receiving advice from a human voice. The best algorithms in the world – whether they provide information to someone sitting on a sofa looking at a tablet or a person carrying a mobile phone – will not replace the pleasure of meeting and connecting with others, or of a pleasant surprise waiting around the corner.

The majority of consumers will not be satisfied simply by placing an order online and then waiting for a package to be delivered by another in a succession of anonymous agents. So we will make the places we live and shop even more attractive, by bringing together the physical and digital worlds, ending the era when they excluded each other.

Système U reaffirms its faith in the future of physical stores. Even if e-commerce continues to grow, physical stores will still have meaning, especially in food retail. In France, customers decide what products to cook primarily with their eyes. We will have to be constantly attentive to the quality and innovation of our food offerings.

Tomorrow's business model will not involve a choice between physical and digital commerce. Its aim will be to ensure that customers can move fluidly between different product categories and sales channels. Today, we describe this as omnichannel commerce. But soon it will just be called retail, which will have been reinvented once again.

PART THREE: FALLOUT

IMPACTS OF THE RETAIL REVOLUTION ON ECONOMIES AND SOCIETIES



The retail industry is a big part of most economies and societies, so this revolution will have impacts beyond the business itself. In particular, we anticipate effects on employment, the environment, and the allocation of capital.

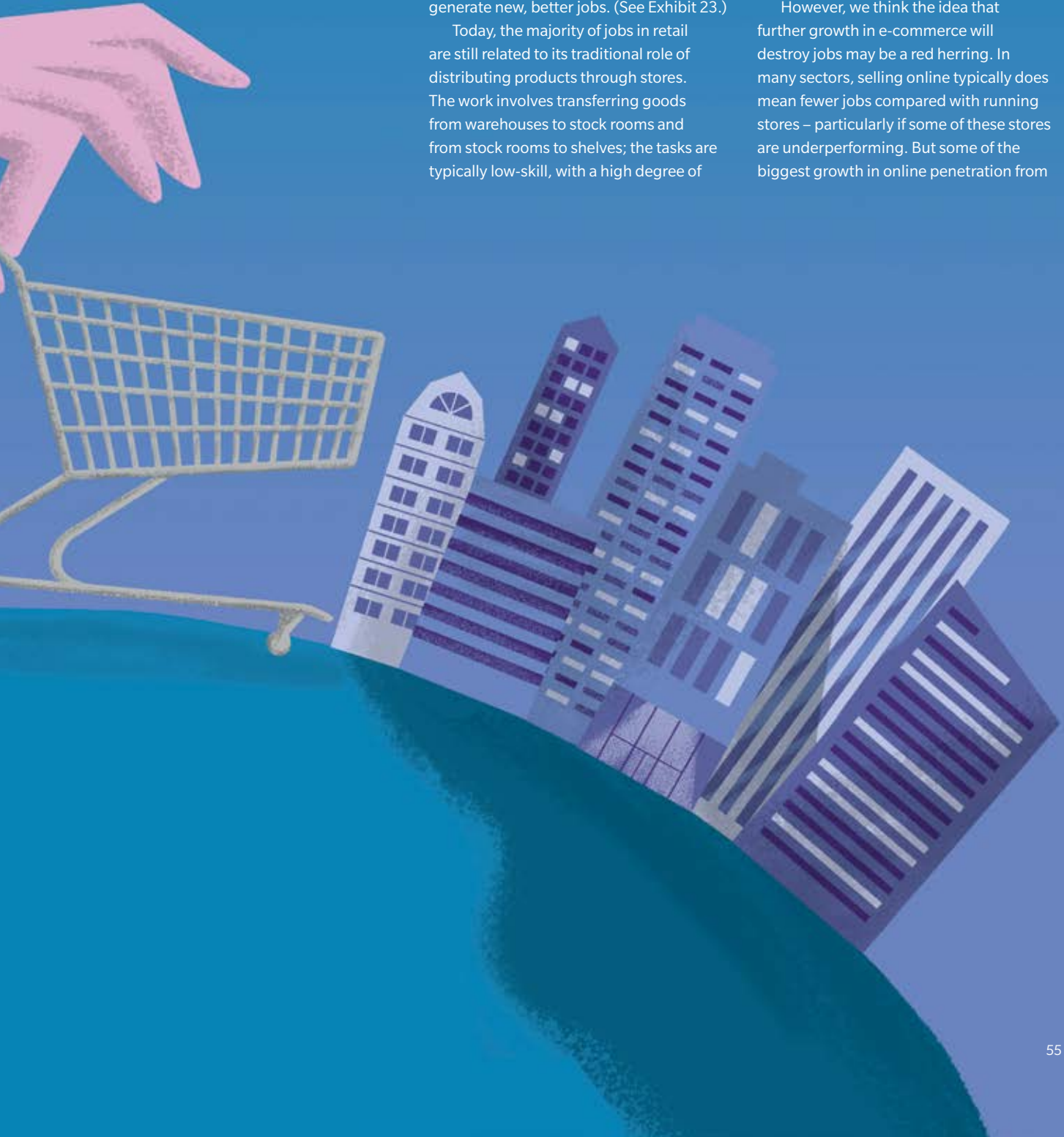
RETAIL WILL PROVIDE BETTER – THOUGH FEWER – JOBS

Retail will provide fewer low-skill jobs in the future, but this wave of disruption will generate new, better jobs. (See Exhibit 23.)

Today, the majority of jobs in retail are still related to its traditional role of distributing products through stores. The work involves transferring goods from warehouses to stock rooms and from stock rooms to shelves; the tasks are typically low-skill, with a high degree of

standardization and control. These jobs make a significant contribution to most economies, and retailers are the source of a significant proportion of entry-level jobs. Furthermore, retail jobs tend to be distributed around a country, often providing employment in places that offer few alternatives. For this reason, job losses from the collapse of traditional stores and chains have been a concern in many countries – and the shift to online sales is often seen as the culprit.

However, we think the idea that further growth in e-commerce will destroy jobs may be a red herring. In many sectors, selling online typically does mean fewer jobs compared with running stores – particularly if some of these stores are underperforming. But some of the biggest growth in online penetration from



“We are having trouble attracting the majors that we need. Supply chain is important but it will be more focused on math and engineers than on supply chain experts”

Grocery executive

“Industrial maintenance is a hot topic. We cannot find even half the people that we need to support it. We want to start shifting people from activities that are no longer needed to where we will have the shortages”

Grocery executive

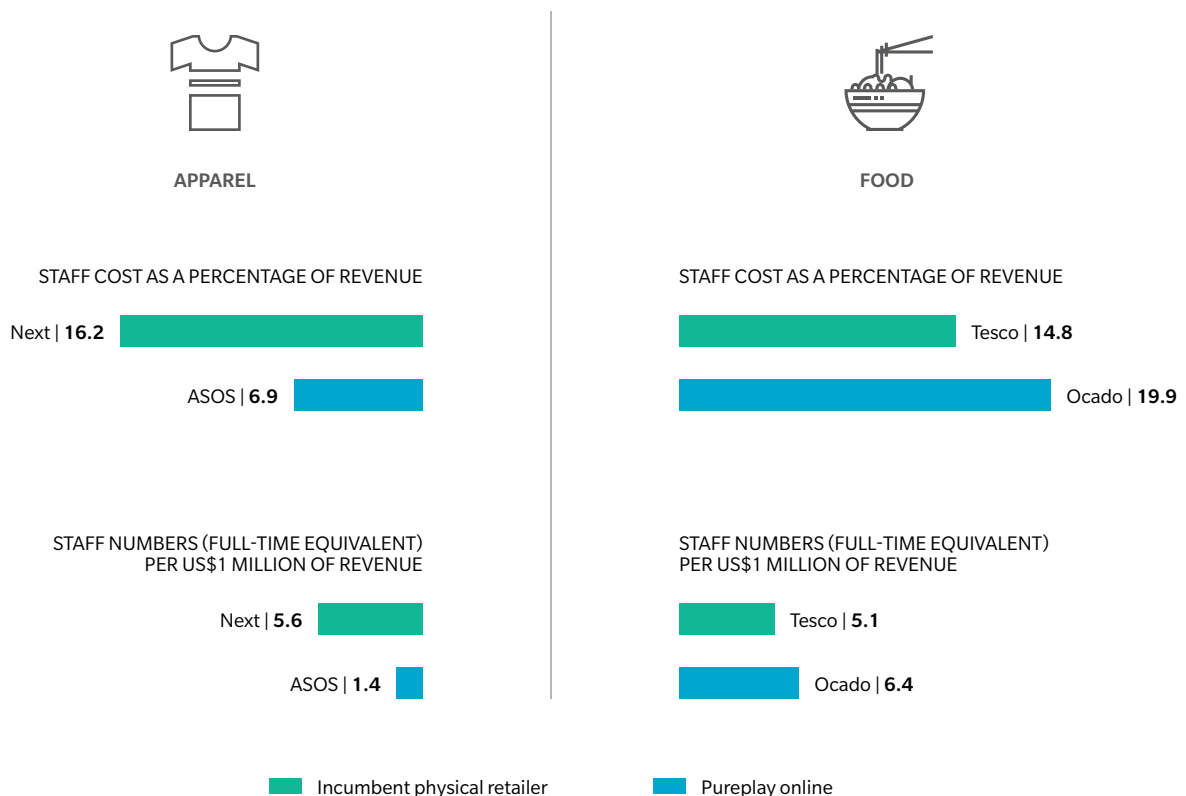
now on will come in food, where many retailers are taking on labor-intensive picking and distribution work that customers previously did themselves. The effect can be seen in the cost structures of pure-play online retailers such as Ocado, which despite significant efficiencies at head office, is less labor-efficient overall than physical incumbent competitors such as Tesco. Moreover, as we have mentioned in this report, online giants in

both the food and non-food sectors are now building a physical presence, adding jobs in the process.

What will remove jobs across the retail sector is task automation, which is a trend in many industries and not the focus of this report. In particular, automation will hit low-skill store and supply-chain jobs, as well as repetitive tasks in head offices. The first casualties have been at supermarket checkouts, where a single

EXHIBIT 23. ONLINE RETAIL'S POTENTIAL IMPACT ON JOBS

THE RISE OF ONLINE RETAIL MAY NOT HAVE THE SAME NEGATIVE IMPACT ON JOBS IN FOOD AS IT DOES IN APPAREL



Source: Company annual reports, Oliver Wyman analysis

employee can staff between four and six automated self-service terminals. Task automation will often be led by some of the disruptors we have mentioned in this report. It is no surprise, for example, that online supermarket Ocado is leading in the automation of warehouses, or that Alibaba was fast on the heels of Amazon Go with its own fully automated convenience store Tao Café. Traditional retailers will have to follow quickly in order to compete.

We see a silver lining, however, in the higher-skill, higher-agency jobs that will be created by many of the new business models we predict will grow. To stay competitive, retailers will have to improve productivity and drive out routine tasks – and, hence, lower-paying jobs – from the system. At the same time, completely new jobs will be created, for example delivering packages to customers' front doors where previously customers would have picked them up from a store themselves.

Product businesses will rely on expert teams of creative designers and skilled sourcing managers. They will also need strong front-line connections with customers to receive and analyze feedback. Choice intermediaries are likely to rely heavily on technology to provide customers with large numbers of high-quality recommendations, but they will also need a small number of highly-skilled staff, for example to direct algorithms and provide human advice on top. As these intermediaries' function is entirely new, so too will be these jobs. If choice intermediaries became a US\$30 billion industry across multiple retail sectors (see previous section), and had the same revenue per employee as Expedia or pure-play online apparel platform ASOS, this would create more than 60,000 high-skilled

jobs in the United States alone. Magnetic ecosystems, too, will likely create new, high-skill technology jobs.

Customer experience champions will need skilled store staff who may also use technology, for instance, to look up relevant product specifications or enrich their expert advice. Digital chat – which has long been used to field routine customer service queries – will also require remote salespeople who enhance the online shopping experience by offering high-quality advice. An example is the Gearheads at Backcountry.com. Fulfillment intermediaries may one day manage to fully automate delivery, but until then they will need a relatively large number of employees to pick products, pack them, and deliver them to customers' homes. And some will differentiate themselves by deploying drivers on stable routes, so they can get to know the customers.

These changing labor demands mean that retail jobs of the future will on average be more interesting and more rewarding. But the trend could pose challenges for society, as retail has long provided highly-localized, entry-level jobs with relatively flexible hours. Other labor-intensive sectors such as catering, and jobs requiring a human touch, such as social care, may well benefit from the increased labor supply, but only if people are able to retrain and are given support to make the transition.

HOME DELIVERY PRESENTS NEW ENVIRONMENTAL CHALLENGES

The growth of online shopping – and hence home delivery – has increased the number of delivery vehicles on the streets, and led to a corresponding

“I do believe some things will change, but there will always be something for people to migrate to. There will still be a demand for labor but it will be different than what we have today”

Grocery executive

“There will be fewer entry-level jobs, as the repetitive, simple tasks are automated away”

Grocery executive

“There will be fewer, but better, jobs in retail”

Grocery executive

“What is the right model? Giant warehouses 200 miles apart or thirty thousand small nodes near the customer. No one knows the answer to this. The market is doing a bunch of tests and pilots to figure out the model. There will be a tremendous amount of capital flushed down the toilet on this”

Grocery executive

rise in emissions of carbon dioxide and pollutants, as well as in noise and hazards caused by the extra traffic. On the other hand, home delivery – particularly of groceries – typically means fewer individual shopping trips by car. That said, online shopping has taken off fastest in cities, where customers are more likely to use public transport anyway. The net results of these effects are not yet clear, and they will vary between countries and between urban and rural areas.

Still, there is significant potential for reducing waste. Now, multiple vans from different retailers often serve the same household on the same day – while a different set of vehicles serves the neighbors. Over time, we think the new fulfilment intermediaries will find ways to deliver more efficiently, maximizing drop densities and consolidating orders from multiple retailers into a single run. If customers are flexible enough to allow retailers to plan efficient routes, the result could be a net reduction in vehicle emissions and traffic. This will be the case especially if the fulfilment industry consolidates to a small number of winners in each area. Indeed, some local governments might even mandate such consolidation to increase efficiency and reduce traffic.

Secondary packaging constitutes another potential environmental impact, as products are often shipped in cardboard boxes, paper, and foam – even though they are often already protected by the primary packaging they left the factory floor in. Changing consumer attitudes towards minor damage to primary packaging would help reduce secondary packaging. But ultimately, the solution lies in a coordinated industry move to create secondary packaging standards that reduce waste. Governments may step in to back this up with legislation, as they already have with mandatory charges for supermarket carrier bags in Europe. For instance, reusable bags

and boxes could be picked up on the next delivery run. Fulfilment intermediaries could prove instrumental in driving these efficiencies, just as they could play a consolidating role in routing.

DEPLOYING CAPITAL WHEN A BUSINESS IS IN DECLINE

In any industry disruption, some incumbents will reinvent themselves, while others go out of business. The story will be no different in retail. Successful reinventions are full of risks and unknowns, making the business case for them hard to write. For many retailers, there simply is not one. In such cases, the most efficient way forward, both for investors and for society as a whole, is to recognize this early and allow resources to be redirected towards business models that can create value for society.

In practical terms, this means no longer investing for the long term, but instead running these businesses as cash machines to fund innovation and new models elsewhere in the sector. One trap that often prolongs the decline of doomed retailers is the relative ease of pursuing short-term measures that boost performance, without addressing the fundamental shifts in consumer expectations and, hence, behavior.

Furthermore, management teams are often reluctant to manage decline; it is not what most went into business to do. It is the role of capital owners to nudge them in the right direction.

INDUSTRY VIEW



RICHARD PENNYCOOK

CHAIRMAN OF FOUR RETAILERS
AND THE BRITISH RETAIL CONSORTIUM

When Zhou Enlai was asked in 1969 whether the French Revolution had been a good thing, he was rumored to have replied, “It is too early to tell.” We can probably be more definitive about the benefits of other revolutions.

The British Agricultural Revolution in the 18th century and the Industrial Revolutions of the 19th and 20th centuries have transformed our human existence. Living standards for the vast majority of people in the West exceed those of even the very wealthiest people in previous epochs. Globally, the number of people living in extreme poverty has been halved over the past 30 years, and life expectancy has increased by eight years. So we should probably think these revolutions were a good thing.

But the Luddites did not, and nor did the Lamplighters. Weavers whose skills were overtaken by machines and men who no longer carried the flame to light the lights saw few of the benefits of the revolution going on around them. Instead, those with the energy and drive were forced to re-skill and relocate, whilst for many the world left them behind.

We are in the early stages of what is being called the Fourth Industrial Revolution, where almost infinite processing power and connectivity are allowing unimaginable developments in artificial intelligence and robotics. If we think the Digital Revolution of the past 20 years was disruptive, we have not seen anything yet.

As retailers, that should give us pause. Our industry is vibrant and dynamic, but is being reinvented in a way every bit as profound as when organized retail first emerged in the late 19th century. The difference, this time, is that whereas it took over a hundred years to develop the structure of brick-and-mortar stores, served by complex supply chains and directed centrally by large home offices populated by smart people, this time it is moving much more quickly. The implications for us as business leaders, and for our politicians, are profound. Future generations will benefit greatly from the changes to come. The question is whether we can be far-sighted enough to avoid large numbers of our colleagues in retail today becoming the modern-day weavers and lamplighters, and getting left behind.

PART THREE: FALLOUT

BETTER RETAIL FOR BETTER LIVING

The average American spends over five hours a week on shopping – or the equivalent of 34 working days each year. A significant proportion of this time is spent on relatively routine tasks, such as the weekly supermarket shop. As retailers compete to offer a smoother shopping experience, with more and more aspects of the customer journey streamlined and automated, time spent on chore shopping will be gradually re-allocated to shopping for pleasure, or to entirely different work or leisure activities.

Advances in artificial intelligence will give an increasing number of people access to products and services that used to be the exclusive preserve of the wealthy. Just as the access economy makes luxury apparel affordable by sharing the cost of a product with dozens of other consumers, services such as Stitchfix are making personal styling and shopping services affordable to thousands. In the past, only wealthy households would have been able to pay for a housekeeper to fetch groceries for them. Online grocery retailers such as Instacart and Ocado have

made picking and delivery so efficient that far more households can now afford a few extra dollars for home delivery. Artificial intelligence will also help to better match products to people's needs, giving them more control over their consumption, reducing waste, and possibly encouraging healthier diets.

Finally, as stores start to focus more on experiences and services rather than holding stock, the shopping experience should become a lot more interactive and enjoyable. The quality and richness of interactions between customers and staff will improve. The conversation need no longer center on the availability of a particular shoe size, but can focus on advice and product information. And the high street will become a social venue, where people arrange to meet up and make new friends.



ACKNOWLEDGEMENTS

“If I have seen further than others it is by standing upon the shoulders of giants”

Isaac Newton

As part of writing this report we spoke to more than 50 senior people in the industry. We thank them all for their contribution; their ideas have helped shape our hypotheses and conclusions.

AHOLD DELHAIZE USA

Kevin Holt, CEO

ASSOCIATED WHOLESALE GROCERS

Dan Funk, EVP Marketing and Merchandising

BARCLAYS

Karen Short, Managing Director

BRITISH RETAIL CONSORTIUM

Helen Dickinson, CEO

BRYAN GARNIER

Olivier Garnier de Falletans, Managing Partner

Charles Tellier, Managing Director

Jean Cailliau, Executive Advisor

THE BODY SHOP

Jeremy Schwartz, ex-CEO

CBRE – CONVERGENCES

Jérôme Le Grelle, Executive Director Retail France

CHICO'S FAS

Shelley Broader, CEO

THE CO-OPERATIVE GROUP, UK

Steve Murrells, CEO

COUCHE-TARD

Alain Bouchard, Chairman

E. LECLERC

Maud Funaro, Strategy, Digital and Innovation Director

EBAY

Kumaran Adithyan, Director of Trading

Strategy & Planning

FÉDÉRATION DU COMMERCE ET
DE LA DISTRIBUTION

Jacques Creyssel, Director General; Vice-President

FIRAE (International federation of retail)

FOOD CITY

Dan Gleib, EVP, Merchandising & Marketing

FOOD MARKETING INSTITUTE

Mark W. Baum, SVP & CCO

GRAIN DE MALICE

Alain Boittiaux, Chairman and CEO

GROUPE BEL

Francis Le Cam, former COO

GROUPE CASINO

Régis Schultz, Chairman and CEO of Monoprix, member of the Casino Group ExCo

Franck Poncet, Commercial and Technical Group Director, Monoprix and President, Naturalia

Gabriel Naouri, former Deputy Head of International Operations

GROUPE CARREFOUR

Gérard Lavinay, Merchandise, Flow and Formats Executive Director and ExCo Member

Matthieu Malige, CFO and ExCo Member; former CFO, Fnac-Darty

GROUPE GALERIES LAFAYETTE

Ugo Supino, CFO and Executive Board Member

GROUPEMENT DES MOUSQUETAIRES

Alexandre Falck, CEO

HANESBRANDS

David Bortolussi, President, Australasia

John Marsh, President, Global Activewear

H-E-B

Craig Boyan, President

HSBC

Dave McCarthy, Head of Consumer Retail Europe

IBOTTA

Kane McCord, COO

ICA SWEDEN

Anders Svensson, CEO

INSTITUT DU COMMERCE

Xavier Hua, General Manager

THE J.M. SMUCKER COMPANY

Mark T. Smucker, CEO

LAGARDÈRE TRAVEL RETAIL

Dag Inge Rasmussen, Chairman and CEO

MANOR

Stéphane Maquaire, CEO

MAXEDA DIY

George Adams, former CEO; former Chairman Screwfix; current Non Exec and Chairman, various

METRO INC. (CANADA)

Eric R. La Flèche, CEO

MICHEL & AUGUSTIN

Michel de Rovira, Cofounder and CEO

MIZZEN+MAIN

Kevin Lavelle, CEO

NESTLÉ USA

Paul Grimwood, Chairman & CEO

ONEX PARTNERS

Matt Ross, Managing Director

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UK DEPARTMENT FOR BUSINESS, ENERGY AND INDUSTRIAL STRATEGY

Laura Robinson, Deputy Director

UNIBAIL-RODAMCO

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Charles Redfield, EVP, Food

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WOOLWORTHS HOLDINGS AUSTRALASIA

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Juan Pirlot de Corbion, Founder, Chairman and CEO

GLOSSARY

Augmented reality

Technology that uses direct or indirect views of the world to superimpose computer-generated sensory stimulation. Most commonly, this refers to visual images imposed on the real world through cameras and screens to provide additional information.

Access economy

Sometimes referred to as the “sharing economy.” A form of commerce in which consumers purchase access to products rather than outright ownership. Popular examples include Uber, Airbnb and Zipcar.

Choice intermediaries

Businesses that help consumers choose which specific products best meet their needs. The role of choice intermediary can be distinct from purchase and fulfillment activities, or it can be embedded within a single entity that does all three.

Direct-to-consumer (D2C or DTC)

DTC: Direct-to-consumer is a variety of channel opportunities by which manufacturers are able to sell to consumer while maintaining control of the merchandising levers. DTC can include manufacturer stores, online shops, and participation in online platforms.

Dynamic routing

Using advanced analytics techniques to update routing in to real-time based on current network information to redesign how products get to a destination.

Fulfillment intermediaries

Businesses that help deliver products to consumers after the purchase event. The role of the fulfillment intermediary can be distinct from purchase and fulfillment activities, or it can be embedded within a single entity that does all three.

General merchandise

General merchandise retail broadly refers to any product that is non-food and non-grocery. More specifically, it is often used to refer to sectors like electronics, health and beauty, and apparel.

Last-mile intermediaries

A subset of fulfillment intermediaries that specialize in getting product to customers’ homes in an affordable manner.

Latent demand

Consumers who want to shop online but do not because of various “blockers” related to cost and convenience.

Omnichannel retailers

Retailers who offer consumers the opportunity to shop and complete purchases in stores and via internet channels.

Omnichannel shoppers

Consumers who shop and complete purchases both in stores and via internet channels.

Online penetration

The percentage of sales in which the purchase occasion is completed either on a computer, a mobile device, or via an intelligent assistant (such as Google Home or Amazon Echo’s Alexa).

Passive cooling

A technique of design that allows for the transport of products at low temperature without requiring active refrigeration.

Platforms

Also referred to as marketplaces. These are online ecosystems where manufacturers maintain control of the merchandising decisions and control of the products until purchase occasion. Most but not all platforms also rely on third-party fulfillment intermediaries as well.

Purchase occasion

The moment of exchange of money for goods, which can be separate from when the goods are received.

Traditional retail

The model in which retailers purchase product from manufacturers and sell to consumers. In traditional retail, the retailer plays the role of both choice intermediary and fulfillment intermediary. The purchase occasion happens in the retailer’s store.

ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialised expertise in strategy, operations, risk management, and organisation transformation.

In the Retail & Consumer Goods Practice, we draw on unrivalled customer and strategic insight and state-of-the-art analytical techniques to deliver better results for our clients. We understand what it takes to win in retail: an obsession with serving the customer, constant dedication to better execution, and a relentless drive to improve capabilities. We believe our hands-on approach to making change happen is truly unique – and over the last 20 years, we've built our business by helping retailers build theirs.

www.oliverwyman.com

CONTACT

JAMES BACOS

Global Retail & Consumer Goods Practice Leader
james.bacos@oliverwyman.com
+49 89 939 49 441

WAI-CHAN CHAN

Global Consumer Goods Practice Leader
wai-chan.chan@oliverwyman.com
+852 2201 17 00

NICK HARRISON

Global Retail Practice Co-Leader
nick.harrison@oliverwyman.com
+44 20 7852 7773

SIRKO SIEMSEN

Global Retail Practice Co-Leader
sirko.siemssen@oliverwyman.com
+49 89 939 49 574

RICHARD MCKENZIE

Retail & Consumer Goods Practice Lead – Asia
richard.mckenzie@oliverwyman.com
+852 2201 1700

FRANCOIS AUBRY

Retail & Consumer Goods Practice Lead – France
francois.aubry@oliverwyman.com
+33 1 4502 3388

RAINER MUENCH

Retail & Consumer Goods Practice Lead – Germany
rainer.muench@oliverwyman.com
+49 160 621 8210

COEN DE VUIJST

Retail & Consumer Goods Practice Lead – The Netherlands
coen.devuijst@oliverwyman.com
+31 20 541 9790

JEREMY SPORN

Retail & Consumer Goods Practice Lead – North America
jeremy.sporn@oliverwyman.com
+1 646 249 0517

MARIA MIRALLES

Retail & Consumer Goods Practice Lead – Iberia
maria.miralles@oliverwyman.com
+34 615 036 406

STEPHAN DERTNIG

Retail & Consumer Goods Practice Lead – Russia
Stephan.Dertnig@oliverwyman.com
+49 89 939 49 239

NORDAL CAVADINI

Retail & Consumer Goods Practice Lead – Switzerland
nordal.cavadini@oliverwyman.com
+41 44 553 37 64

ANDREW GLOVER

Retail & Consumer Goods Practice Lead – UK
andrew.glover@oliverwyman.com
+44 20 7852 7770



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