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Retail 2020

Competing in a Changing Industry



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Competing in a Changing Industry

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AT A GLANCE

The retail industry is undergoing a major transformation. What is your company doing to adapt and stay relevant today and into the next decade?

THE INFORMED, EMPOWERED CONSUMER

Retailers must determine what their customers value and are willing to pay for. Consumers generally look for the best value, the best service, or the best experience.

COMPLEX, MULTICHANNEL SHOPPING AND MARKETING

With more data on consumers, retailers can create highly targeted, relevant marketing campaigns or in-store interactions. But few retailers have the needed skills and capabilities.

SHIFTING REAL-ESTATE DEMANDS

As even grocery shopping goes online, what role will brick-and-mortar stores play in the future, what will they look like, and what will drive traffic their way?

AN EVOLVING SUPPLY CHAIN

Companies must determine what technologies and configurations will give them the flexibility and efficiency they'll need for tomorrow's demands.

THE RETAIL INDUSTRY IS undergoing a major transformation right before our eyes—and it's just a preview of what's to come. More than a billion Internet users have gone mobile, profoundly changing how people buy and companies sell. As per-store sales decline, all legacy retailers will need to rethink the role of these brick-and-mortar assets, reassess their locations, and rightsize them to meet changing consumer needs. This reevaluation may transform how many companies operate—and lead to massive changes in market shares, the retailer landscape, and commercial real estate.

The explosion of mobile devices and social media is transforming how we connect and how we make buying decisions. As sales channels multiply and the boundaries between them blur, consumers still want a unifying brand experience, no matter where or how they find it. In this new world of retail, consumers are more empowered and influential than ever before: they can instantly compare prices and product quality, voice their opinions online, and help shape new products and services.

But retailers also hold strong cards in their hands. The major players have always used scale to maximize their buying power, but today that scale also delivers a treasure-trove of data on shoppers' behaviors and preferences. With access to more detailed, real-time information about potential customers—and more ways to reach them—companies can improve on everything from innovation to marketing to the overall customer experience. At the same time, a range of maturing retail technologies can help streamline backroom functions and logistics, lowering costs and sharply increasing efficiency. These and other key trends are transforming the industry behind the scenes.

With pricing, quality, and opinions so transparent online—and the value bar continually rising—how does your retail offering compare? Why should consumers spend their hard-earned money with you instead of with another big-box competitor, an established online player like Amazon.com, or an innovative startup selling through an online marketplace? (See the sidebar “The Rise of Online Marketplaces.”) Record stores have all but disappeared in our lifetime, and many bookstores are following suit. Given the accelerating rate of change, what is your company doing to adapt and stay relevant today and into the next decade? Do you understand what your customers really want from you—and what it takes to win them over?

By 2015, with Internet access at the office, at home, and on the move, consumers will be full-time shoppers and most purchases will have some online aspect. In

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THE RISE OF ONLINE MARKETPLACES

As e-commerce grows and consumers become increasingly comfortable with Internet shopping, huge online marketplaces like eBay, Amazon, Taobao, and Rakuten are changing the face of retailing. By providing businesses and small vendors with a low-cost way of reaching a large volume of potential customers, these marketplaces are growing rapidly and becoming dominant players in their respective countries.

Taobao.com, for instance, has virtually defined the e-commerce landscape in China. In 2010, it sold more merchandise than China's top five brick-and-mortar retailers combined. The site boasts more than 800 million prod-

ucts and offers shoppers an instant-messaging tool that allows them to communicate with sellers in real time, a seller-rating system, and an escrow service for payments. Taobao accounted for 79 percent of China's online transaction value in 2010. By contrast, most other e-commerce markets are far more fragmented. In Japan, for instance, leading marketplace Rakuten has just a 30 percent share of online transactions; and in the U.S., Amazon has only a 17 percent share. Still, the top online marketplaces are growing by 50 percent or more per year and have become a retail force to be reckoned with.

order to prepare for this not-so-distant future, legacy retailers must address four critical challenges:

- *The Informed, Empowered Consumer.* How will you continue to attract business and build loyalty?
- *Complex, Multichannel Shopping and Marketing.* With the explosion of touch points and data, in what new ways will you reach shoppers most effectively and deliver the best experience?
- *Shifting Real-Estate Demands.* With even grocery shopping going online, what role will your stores play in the future, what will they look like, and what will drive traffic their way?
- *An Evolving Supply Chain.* What technologies and configurations will give you the flexibility and efficiency you'll need for tomorrow's demands?

Any legacy retailer that isn't thinking about how to answer these tough questions is at risk of falling behind as the industry moves forward. Let's look at each of these challenges more closely.

The Informed, Empowered Consumer

Today's consumers are more knowledgeable and discriminating than those of the past—and constantly connected to the Internet. With online access to detailed

product information, price comparisons, user reviews, and the recommendations of “friends” on social media sites, they can cut through marketing hyperbole and make informed buying decisions. And if they’re not happy with their purchases or experiences, they can spread their negative opinions quickly and broadly online, creating PR nightmares that some businesses never fully recover from. But if your customers are passionate about your company’s products and services, they can spread the love just as easily.

To compete effectively, retailers must enhance their traditional function- or category-specific focus with a customer-centric lens. (See the sidebar “Focusing on the Customer.”) They must determine what their customers value and are willing to pay for—and go out of their way to provide it. Consumers generally look for one of three things: the best value, the best service, or the best experience. They may not expect all three from one company, but if you’re not the best in at least one of these areas, why should they shop with you? It’s too easy to find other options. And make no mistake about it: in a world of sharply improved transparency, being the best in one or more of these areas will quickly become table stakes.

THE BEST VALUE

Consumers seeking the best value want the overall lowest price or the best quality for their money. Many traditional retailers face huge pressure from pure-play e-tailers and e-marketplaces like Amazon.com. One shopper we surveyed raved about Amazon’s low prices, extensive selection, and customer reviews. She won’t consider buying a big-ticket item unless it has a critical mass of positive reviews on the e-tailer’s website. Then she knows she’s getting a top-quality product at a rock-bottom price. Other consumers swear by Costco or Wal-Mart. In the digital age, greater price transparency is available for online and in-store purchases alike. Companies selling the same products for more are quickly unmasked. And if your product offers greater quality or value to justify a higher price, finding ways to inform and convince shoppers of that is the challenge.

Agile retailers can pull in bargain shoppers, build loyalty, and become the go-to place for deals by offering discount coupons, sales notices, or other incentives through e-mail, buying clubs, mobile apps, social media, or location-based services such as Foursquare, which encourages users to visit nearby retail establishments and tell their friends about it. For example, McDonald’s Japan sends mobile discount offers to targeted customers at specific times—for instance, to students after school or to families at lunchtime on Saturdays, or as a way to increase traffic on rainy days. Some of these new technologies and techniques designed to draw foot traffic are still immature, and success will be hit or miss as retailers experiment and figure out how best to exploit them. Regardless, established brick-and-mortar retailers must find ways to compete on more than just price, since they tend to be at a cost disadvantage against pure e-tailers in many product categories.

THE BEST SERVICE

Retailers with the best service are easy to buy from, with their fast and efficient processes and excellent support, selection, and convenience. They may offer customized products, the widest or most targeted selection, knowledgeable salespeople, curbside valet parking, complimentary espresso, fast checkout, or hassle-free returns.

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FOCUSING ON THE CUSTOMER

Until recently, retailers typically organized themselves by function and category. Functions such as marketing, category management, retail, online, CRM, real estate, and logistics were solely responsible for the decisions made within their silos. Few companies thought about the customer experience as an integrated whole.

Today's forward-looking retailers are augmenting this model by segmenting consumers on the basis of their shopping habits and spending levels, and ensuring that their organizations are hard-wired to meet the needs of their highest-value customers. This customer-centric model is critical now that consumers have become more powerful and discriminating.

Here's how this new focus is changing the way retailers think of their business:

- **Assortment.** Instead of making assumptions about what products customers want on the basis of space and inventory turns, retailers are doing a detailed analysis of what products each segment is buying. This enhanced knowledge helps companies refine how they plan and allocate their merchandise to stores and channels, so they can optimize their assortments and layouts accordingly.
- **Advertising and Marketing.** Instead of making decisions driven by the general effectiveness of marketing and advertising, retailers are analyzing the impact of campaigns on key consumer segments and then communicating with different segments in tailored ways.
- **Promotions.** Instead of aiming promotions at general consumer segments, which can encourage cherry-picking, companies are using them to increase the spending and loyalty of higher-value customers.
- **Loyalty Programs and Communications.** Instead of designing these programs to maximize penetration and adoption of the loyalty card, retailers are using the data they generate to better serve their core, high-value customers—and recruit more of them.
- **Shopping Experience (Store Design, Signage, and Interaction).** Retailers are explicitly tailoring their stores and websites to improve the shopping experience of their target consumers. And as new fulfillment models emerge, retailers are rethinking the role of stores more broadly.
- **Multichannel Touch Points.** Retailers are eliminating the organizational, operational, and technical barriers that impede customer service and moving to more shopper-centric ways of working, although much room for improvement remains.

They make it their business to understand and meet their customers' specific needs and ensure that every transaction goes smoothly and ends with a smile.

For example, customers of Zappos, the online shoe seller that has also branched out into other areas, rave about the company's selection, service, and free returns. Lego lets shoppers use its website to design their own models and then ships the customized pieces. Japan's Seibu Department Stores offer a free makeup "touchup" service from 5 to 8 p.m. for loyalty card members who are leaving the office to go out for the evening. The cosmetics department also provides free consultations, a self-service skin analysis, and an online "click and collect" service that lets customers pick up their orders from a nearby 7-Eleven at no cost.

As service innovations proliferate throughout the industry, consumers' expectations are rising in response. Fortunately, new technologies are also improving in-store service, making it easier for shoppers to get detailed product information, locate specific items, and check out quickly. As low-value tasks are increasingly eliminated or automated through electronic shelf labeling, self-checkout, and other advances, store personnel will be more available to focus on higher-value tasks that enhance service or the shopping experience—important differentiators when the lowest price and the greatest selection are increasingly the realm of pure e-tailers.

THE BEST EXPERIENCE

Outside the narrow province of convenience-related categories or store formats, retailers that offer the best experience understand that shopping can be a form of entertainment shared with family and friends. Instead of just making a grab-and-go purchase, their customers want to learn, have fun, be visually engaged, or socialize with like-minded people. Store appearance and environment are critical, and the shopping experience must build loyalty and support the brand's identity.

Retailers that want to hold on to their traditional brick-and-mortar stores may find that providing a memorable experience is the way to stay relevant and differentiated as more consumers go online. Besides selling outdoor clothing and gear, REI, for example, offers in-store experts, classes and events, indoor rock-climbing walls, clinics on everything from GPS usage to backpacking basics, school and adventure trips, volunteer opportunities, and a family adventure program. The American Girl franchise sells dolls, clothes, books, games, and gifts for young girls. Its family-friendly stores create a special, small-scale dream world with a doll hospital, café, museum, photo booth, and endless displays of dolls and accessories—the perfect place for birthday parties or to spend one-on-one time with a daughter, granddaughter, or niece. American Girl also has a strong online community and website that maintain a connection with girls until their next in-store experience.

These experiential extras come at a cost, however, and retailers must be sure that they can recoup their higher operating expenses through greater sales volume, higher margins, cross-sales, or all of the above—either directly from the store or indirectly through related websites.

The most successful retailers go beyond low prices and find ways to balance value, service, and experience. The best retailers inspire passion and loyalty in their

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customers—and the desire to spread the word. Do your customers feel that way about you? With information and recommendations at their fingertips, it's easy for unhappy shoppers to turn to your competition. And when customers disappear, brick-and-mortar retailers quickly start losing money if they don't have healthy online sales.

Because of the growing market complexity and heightened consumer expectations, retailers must have a strong, dynamic multichannel strategy.

This dynamic also works in reverse. When retailers get it right, they can win share disproportionately from the weaker players. As word quickly spreads, the positive buzz increases momentum. With growing sales volume, more inventory turns, and greater scale, these retailers have more funds to invest in service, merchandising, store appearance, and expansion. The virtuous cycle for winners and downward cycle for losers have always existed, but they're getting stronger and faster given consumers' growing power, their instant access to information, and the explosion of new sales channels.

Complex, Multichannel Shopping and Marketing

Channels are multiplying—providing more opportunities to interact and engage with consumers. Because of the growing market complexity and heightened consumer expectations, retailers must have a strong, dynamic multichannel strategy. They need to be absolutely clear about whom they're targeting, what value proposition they're offering, and what their competitive advantage is—especially since consumers are bombarded by choice. Yet many of the strategies we see are fuzzy, rely on unrealistic assumptions about shopper loyalty or stickiness, and fail to fully recognize the new reality.

As consumers become more comfortable buying online and on the go, they are becoming channel agnostic. Shoppers don't "pick" a channel with which to conduct their business. Instead, they tend to use a mix of online and offline channels as they move through the purchasing process, and may not even be aware of it. For instance, they may go online to get product information and customer reviews but buy offline at a trusted store or through an in-store terminal. Or they may go to a store where they can see and touch different products, and then go online to find the best price and make the purchase or buy out-of-stock sizes. Or they may repurchase a product online by scanning the product code on the package with their cell phone. The key is to provide shoppers with a seamless experience. Today's consumer has high expectations and limited patience for or understanding of lack of channel integration—such as the inability to return to a store something purchased online.

With more data on consumers—their online and in-store activities, purchasing patterns, and preferences—retailers have the potential to create highly targeted, relevant marketing campaigns or in-store interactions. But few have invested sufficiently in the skills and capabilities needed to make sense of this explosion of data and use it to their advantage. This is unfortunate, because today's savvy consumers are increasingly unforgiving of mass mailings, "personalized" offers that miss the target, and errors related to faulty or poorly integrated CRM systems. Until retailers correct these shortcomings, their customer-outreach efforts are bound to fail—and they'll risk becoming irrelevant and losing out to more adept competitors.

This proliferation of sales channels is also leading to growing complexity. Besides traditional media outlets such as TV, print, billboards, and catalogs, companies have in-store, online, and mobile options to contend with. Mobile advertising alone offers a dizzying range of possibilities: messaging-based ads, Web display ads, search ads, location-specific ads, and ads in games and other applications. All of these alternatives are creating new opportunities to connect with consumers. The challenge is figuring out how to use each channel most effectively and how to reach shoppers at each stage of the marketing “funnel”—attraction, conversion, and retention.

As the amount of new information available grows exponentially and possibilities to interact with consumers increase at a dizzying pace, brick-and-mortar retailers are experimenting. For instance, Ikea bridges the gap between the real and virtual worlds by offering apps that let users visualize furniture in their own rooms. Marui, a popular fashion retailer in Japan, seamlessly integrates online and offline channels; shoppers can try on clothes, browse the company’s website, order for delivery anywhere, and return items bought online. United Arrows, another Japanese retailer, launched a website called UA Style Share. Shoppers can dress their personal “avatars” in outfits and share them with friends through Facebook and Twitter. The website drives traffic to the stores by letting users see what inventory is available at the nearest location. And the stores drive traffic to the website by displaying Quick Response (QR) codes that shoppers can scan with their smartphones to get free or discounted items online. Other retailers are using Facebook and Twitter to reach consumers. Starbucks uses social media to raise awareness of new products and has a highly successful mobile app that builds loyalty and repeat visits. Sephora tracks how many sales come from advocates and from friends’ recommendations on social media sites.

It remains to be seen how many of these new approaches will succeed over the long haul and how many will become yesterday’s news. But one thing is clear: retailers must continually change, experiment, and learn, revisiting and revising their positioning and capabilities as needed in order to stay relevant. Standing still will be the kiss of death in this rapidly changing industry.

Shifting Real-Estate Demands

As consumers buy more online, it’s not surprising that some traditional brick-and-mortar stores are beginning to see an erosion of foot traffic. Unlike pure-play e-tailers, which have no commercial real estate, established retailers have substantial asset bases, and those with a large number of big stores are the most vulnerable to the changing industry dynamics. This situation is very different from the days when store scale conferred labor and cost advantages and an overall economic edge. With so many stores trading only marginally above their breakeven points, even a small loss of foot traffic and sales can quickly put them in the red.

The changing traffic patterns mean that undifferentiated superstores and shopping malls that are neither convenient nor iconic are at risk of losing business unless they find new ways to attract shoppers, such as offering in-store pickup or the ability to check product availability online. Mall operators must attract and retain “destination” stores that draw an ongoing volume of shoppers. Temporarily, at

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least, this may mean that popular retailers will get more attractive deals at the expense of less popular mall stores.

As these and other trends unfold and the role of traditional retail formats is gradually redefined, there will be a strong impact on the commercial real-estate market and the shape of retail footprints. (See the sidebar “Ten Trends to Watch.”) Forward-looking companies are analyzing their holdings, identifying suboptimal locations, exiting some locations as their leases expire, evaluating new formats, and exploring creative solutions for managing excess space and increasing profits per square foot. For instance, some companies are cutting costs and square footage by moving from self-service to service counters; such stores require less shelving and space but can accommodate more stock in high-density backrooms. In the accelerating rush to capture favorable locations and unload less desirable ones, the early movers stand to win.

TEN TRENDS TO WATCH

These ten trends are reshaping the retail industry. How will your company respond?

of product origins. But it remains to be seen whether they will pay more for green products.

1. Empowered, Discriminating Consumers.

With access to product information, price comparisons, and user reviews, consumers can make informed decisions—and widely share their complaints. For retailers, the bar is rising, and they must add meaningful value to what shoppers can find for themselves, both online and in stores.

2. Ubiquitous Connectivity.

With the Internet available at work, at home, and on the go, consumers will be full-time shoppers and most purchases will have some online aspect. Smartphone numbers will be in the billions by the end of this decade.

3. Buying Local, Going Green.

Shoppers want to consume in a responsible, sustainable way. They want to purchase from organic and local vendors, and want proof

4. Explosion of Consumer Data.

Points of sale, social media, corporate websites, and tracking URLs are generating an enormous amount of consumer data, but few retailers are capable of fully exploiting the potential value of this input. It will take time, because the volume of data is still growing faster than the ability to process it.

5. New Age of Marketing.

With more data on customers, their online activities, and purchasing patterns, retailers will be able to create more targeted marketing campaigns—once they figure out how to mine the insights. This will require experimentation and calibration—and consumers will have limited tolerance for misguided marketing efforts.

6. Scientific Retailing. By applying smart algorithms and deep,

As retailers rethink the role of stores and the economics of their real-estate footprints, shoppers can expect to see a plethora of experimental, next-generation stores spring up both on Main Streets and in malls. These stores will offer specialized products, new order-fulfillment options, new services, and so-called experiential features to help generate new revenue streams. The key is to redefine the role of stores so that they better meet shoppers' needs and expectations in a way that is economically feasible.

Tesco, the U.K. grocery chain, has long been a pioneer in experimenting with different formats and locations to cover a broad spectrum of shoppers' needs and price points. Among its holdings are large hypermarkets, bargain warehouse stores, convenience stores, suburban supermarkets, and city supermarkets. Tesco also actively manages its sales channels and portfolio of stores to best meet shoppers' patterns and behaviors. To this end, it recently announced a deliberate focus on

data-driven analytics to the unprecedented volume of data from multiple sources, companies can optimize all aspects of their business, including inventory levels, pricing, warehouse space, assortments, shelf displays, and staffing.

- 7. Growing Retailer Power.** The top five grocery stores in the U.S. now have a 33 percent share of the market—up from 25.5 percent in 2000. As their spending increases, they have more clout with suppliers. But in several categories, the increased retailer power may tilt toward large Internet players or marketplaces as their growth outpaces the brick-and-mortar competition.

- 8. Maturing Retail Technologies.** A wide range of maturing technologies is allowing companies to streamline backroom functions and increase efficiency, helping to offset higher labor costs. While these are part of the solution for brick-and-mortar retailers, they

won't fundamentally alter the relative economics between store-based and online transactions.

- 9. Blurring Boundaries Among Channels, Formats, and Brands.** CVS is selling fresh food, grocery stores have in-house bank branches, and bookstores have cafés selling Starbucks coffee. Rather than thinking in terms of channels, consumers are simply opportunistic. If they have a need and can fulfill it easily and conveniently, they will.
- 10. Challenged Store Economics.** The rise of online buying is eroding store traffic, forcing retailers to rethink their costly real-estate assets and merchandising formats. How valuable will bricks and mortar be in the future and for what role? Dynamics will play out very differently by category and location.

As channels proliferate, fulfillment models change, and store roles evolve, most retailers will need to revisit their traditional supply-chain strategies and tactics.

Web-based channels. The company has also announced plans to open its own online marketplace selling general merchandise, and inviting other retailers to join in.

Novelty watch maker Swatch uses pop-up stores to capitalize on “spot traffic” and manage peak demand. It often sets up a one-day pop-up store for a single concert or festival, as well as stores for peak times only, such as Christmas. By moving quickly to respond to the latest trends, it maintains its flexibility—and beats competitors to the best locations. Japanese retailers such as Uniqlo and Tokyu Hands are also moving to smaller-format satellite shops in high-traffic locations such as train stations. Similarly, the Argos department-store chain took its gift catalog to train stations in the U.K. during the holiday season. Last-minute Christmas shoppers could reserve the items they wanted by scanning the QR codes with their smartphones and pick up the gifts later at a store.

A few companies are already fundamentally rethinking the purpose of their stores—moving away from the idea of sales transactions as their primary goal. For instance, Dwell in the U.K. views its stores as “shopper recruitment vehicles,” where store managers are rewarded for the number of e-mail addresses they gather, not for the volume of sales they generate. Other retailers are using their stores as learning centers or product showrooms, where consumers can touch and feel the merchandise before committing to a purchase. As the purpose of stores changes, retailers will need new metrics to measure their effectiveness—such as the cost of acquiring customers or their “lifetime value,” instead of sales or gross margin per square foot.

Legacy retailers must develop clear strategies for store formats and supporting real-estate portfolios. The key is to continually test new approaches, learn from successes and mistakes, and adapt both the store concept and the network footprint to evolving consumer needs and the competitive multichannel landscape.

An Evolving Supply Chain

As channels proliferate, fulfillment models change, and store roles evolve, most retailers will need to revisit their traditional supply-chain strategies and tactics as well. Shifting from the traditional wholesale movement of bulk merchandise to stores toward the faster, more agile piece “pick and pack” models of the online world requires a fundamentally different mindset and supply chain configuration. To compete with e-tailers such as Amazon, which offers about 50 million items, nonfood retailers must sharply improve the choices they offer—while avoiding the crushing carrying costs. To this end, they must think hard about what to stock in stores, what to carry online, what to warehouse, and what to source directly from suppliers when orders come in. Virtual supply chains are part of the answer. Instead of owning and holding every item they offer, retailers must develop responsive supply chains that can deliver many goods from the manufacturer’s warehouse directly to the customer. But this agility often comes at an additional cost. Retailers that want to delight customers with broad product choices and differentiating service must keep in mind that there is a limit to the price premium that shoppers are willing to pay.

Traditional food and grocery retailers continue to struggle with the financial viability of online ordering and fulfillment models. They are experimenting with a range of fulfillment options—full delivery, shop and deliver, and online ordering with store pickup (“click and collect”). For high-volume, fast-turnover grocers operating in densely populated areas, “dark stores,” or warehouses that prepare customer orders and offer the option of either pickup or home delivery, are becoming more prevalent. Grocery stores in areas with less demand density (like E. Leclerc or Groupe Auchan in some regions of France) continue for now to rely on the click-and-collect model. This model creates significant operating challenges, such as the need to feed real-time and accurate information on in-store product availability into a website or mobile shopping app. Grocers that hope to operate a profitable online business will need to increase their technical capabilities and continue to test different fulfillment and pricing models. Because the relative competitiveness of fulfillment channels varies according to the size, weight, and value of goods, grocery retailers are likely to develop different shopping options for different categories and product types.

The right information systems—and absolutely reliable data—are critical to ensure better assessments of inventory levels and demand, as well as faster response times. A number of technologies are emerging that will help in this area. RFID is finally maturing, demand-sensing technologies are improving replenishment decisions, and POS data analysis and in-store tracking will help make inventory data more robust.

The repercussions will be felt upstream as well. As they seek ways to compete with the advantaged cost structures of online players, legacy retailers will look to their suppliers, which will be expected to ramp up their supply chains to offer shorter cycle times and greater availability. The next generation of collaborative-planning, forecasting, and replenishment tools will allow retailers to work more closely with suppliers—and their suppliers’ suppliers—to further minimize overstocks or shortages. Wal-Mart’s pioneering Retail Link has long offered an electronic bridge to suppliers, providing them with data on sales and inventory levels. Now replicated by most large grocers around the world, this type of close integration also gives suppliers a better sense of true demand, which can reduce inventory levels and improve availability throughout the supply chain. Spanish grocer Mercadona has created an integrated supply chain with 110 suppliers and a goal of eliminating any activities that don’t add value. The company has sharply improved operating efficiency, information flows, and innovation, and is known for its low prices.

Greater information transparency and supplier integration can provide a foundation for true demand-driven ordering and vendor-managed inventory (VMI), in which suppliers take responsibility for stock replenishment. Proven results include increased product freshness, improved on-shelf availability, and reduced inventory.

Distribution centers and warehouses will also evolve to accommodate new supply-chain configurations. Many retailers are moving toward joint warehouses or “consolidation centers,” often partly funded by suppliers. By enabling stockless operations or the ongoing flow of goods, these approaches eliminate the need to carry any inventory at all. Retailers that understand their evolving needs and have the

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flexibility to adapt their supply chains accordingly will gain a sustainable cost and service advantage.

“Eco friendly” practices are also expected to gain wider adoption. Backhauling—the practice of picking up goods from suppliers on the return trip after making a delivery—saves miles, labor, and energy costs. One retailer made its transportation-management system more efficient by integrating its delivery routing and scheduling, and by tracking vehicles more closely. As a result, the company was able to cut turnaround times by 15 percent, increase on-time deliveries by 17 percent, and reduce empty truck runs by 12 percent. Software packages can greatly optimize load building to increase trailer utilization and reduce planning time. But few retailers have the capabilities and work processes that would fully exploit the functionality of these software systems.

As consumers form new buying patterns, new store formats and fulfillment channels emerge, and new technologies mature, retailers must continue to adapt their supply chains to ensure that they remain relevant and offer the best possible service in the most cost-competitive ways.

ALTHOUGH THE COMPETITION and pressure on traditional retailers are heating up, the future is still largely unknown. The only certainty is the magnitude of change that is coming—change that will drive a major industry transformation. To survive, retailers must constantly reinvent themselves and develop strong capabilities in the areas of consumer insight, CRM, fulfillment channels, store concept development, performance management, and supply chain integration. These are uncharted waters, and retailers must test, learn, and correct course as they go. Make no mistake about it: the future will belong to those agile industry players that can rapidly renew themselves—and refuse to cede ground to the competition.

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