KEARNEY 100

The retail strategy leaders use to conquer six challenges today

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Successful retailers are students of history and masters of their art. They originate strategy instead of following others, especially as they face wave after wave of macroeconomic events and industry challenges.

Several years ago, "retail apocalypse" was the prevailing hyperbole used to describe a record number of retailers facing bankruptcy. A variety of factors brought them to the brink, such as fierce competition from big and small retailers (from Amazon to start-ups and local businesses), disintermediation from brands and consumer packaged goods (CPG) companies selling directly to shoppers, and a failure to be relevant as consumers' expectations and needs shifted faster than retailers could evolve.

Then another wave hit as surviving retailers contended with COVID-19, which created a boon for some and pushed others even closer to bust. Most had inventory issues, rising supply chain costs, volatility in channel preferences, and store and distribution center (DC) labor shortages. The pandemic pushed headquarter employees to hybrid or remote work, sparked demand for extended touchless and automation technologies, and increased theft.

Post-COVID, a fresh wave of challenges is here. There is inflation, probable recession, and the shaken consumer confidence and spending limitations that come with both. In 2023, most retailers are focused on cost reductions to survive while trying to preserve business as usual and match competitive advances. But this may not be enough.

French historian and political writer Alexis de Tocqueville wisely said, “History is a gallery of pictures in which there are few originals and many copies.” Successful retailers heed history but don't repeat it. They note trends and the opportunities they pose. They create and execute original strategies and investments to strengthen the business for the future and use the current macroeconomic environment’s distractions to leapfrog the competition.

What retail leaders don’t do is make knee-jerk reactions to sudden macroeconomic shifts, which can be dangerous. We can learn from global retail movements, but consumers vary widely by market, the health of businesses vary, and no two sets of infrastructure and capabilities are the same.

That said, we believe a set of qualities defines retail leaders, while a set of mistakes could characterize the rest. We also see six major macroeconomic and industry trends that all retailers should constantly track as they evolve and continue to affect the retail business.

What sets winning retailers apart

There is a balance to strike in today’s retail landscape between knowing how to maneuver in it and preventing it from influencing short- and long-term strategy too much.

Several qualities characterize retail leaders that achieve this tricky mix. Among many things, they:

- Are truly consumer-centric. They put the consumer at the center of the enterprise’s culture, incentives, training, policies, investments, experience, and service.
- Insist on speed in analysis, decision-making, and activation across the business.
- Capture alternate revenue through the power of the retail ecosystem, from its data, advertising, and finance, to supply chain and physical square footage.

In contrast, retailers that react mainly to their surroundings move too slowly and scale solutions after the early-mover advantage has disappeared, leaving them as followers. We see them make common mistakes, such as:

- Allowing a chasm to appear between executives and line management. They fail to set a central strategy that supports transparency, accountability, and execution.
- Settling for incrementality. They make subtle changes to traditional models and rely on “rinse and repeat” retail marketing, merchandising, and operations, while applying technology on an as-needed basis.
- Being trapped in a cycle of reaction. Resources languish or are used inefficiently as they try to keep up with ever-changing priorities.

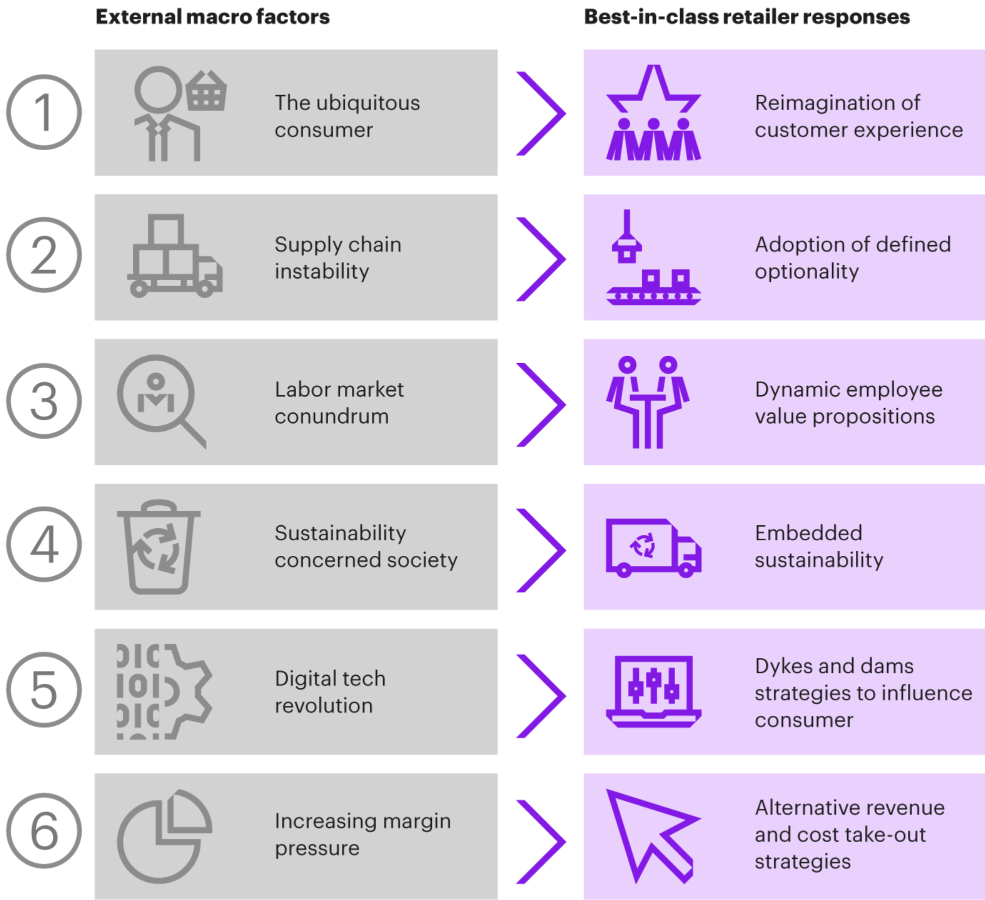
The six most urgent retail trends today

With these leadership characteristics in mind, Kearney tracks six macro-consumer trends that retailers should watch closely (see figure 1). While we do not believe it is wise to base strategy solely on them, these challenges should be at the heart of unique and tailored North Star strategies.

Figure 1
There are 6 leading retail trends in 2023

Key external factors and best-in-class responses

Retail industry focus



Source: Kearney analysis

Let's look at each one, along with ways that best-in-class retailers respond to suit their specific goals.

1. Ubiquitous consumers and the power they wield

Ubiquitous consumers seem omnipresent because they look for a seamless and consistent experience whenever, wherever, and however they shop. They expect flexible shopping options for each unique scenario. Sometimes they want high service and other times crave autonomy. They go to the store in the morning but prefer to order online that evening.

We see the wants and needs of consumer segments changing as well. Some care about the environment or how a product is sourced. Some fixate on price, others make purchases based on a brand's purpose or political position, and still more focus on convenience or style. Post-COVID, we've also seen consumers grow more frustrated with decreased levels of service. They have little patience now for short-staffed stores.

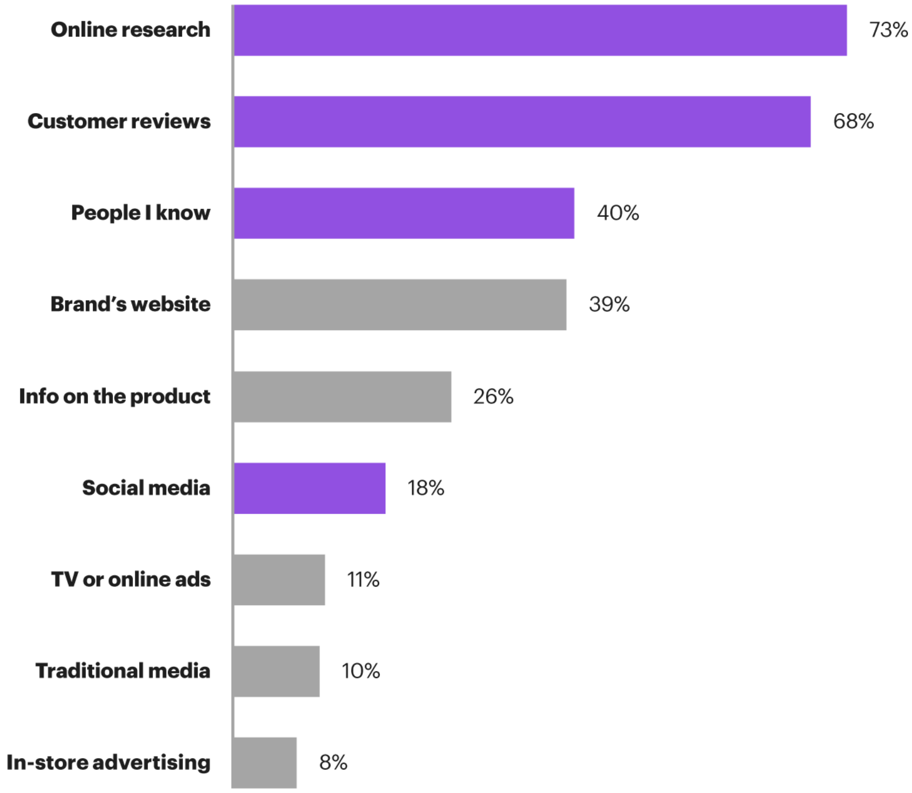
In response, most retailers have turned to perks such as ship-to-home, buy online and pick up in-store, curbside pick-up, and improved service speeds. They're also freshening up stores with remodels.

Beyond that, Kearney believes that to appeal to the ubiquitous consumer, retailers will need a unified omnichannel strategy that dynamically analyzes consumer data to improve the customer experience across all channels. Effective use of data is the only way to reliably hit the bullseye for what customers want versus what the retailer's business needs. Over-delivery is too costly, of course, while under-delivery will ultimately lead to losing customers.

Another aspect of the ubiquitous consumer is that their influence is rising while retailers' is dwindling. Their choices are increasing as well, making it more essential to hit the bullseye and harness customers' support. The Kearney Consumer Institute's Consumer Education Study reveals that purchasing decisions are more tied to consumer-led sources, with online research and reviews the most relevant drivers now (see figure 2).[1] This means consumers believe their fellow shoppers more than they do retailers themselves. Consequently, being thoroughly consumer-centric can help win customers' hearts and set your business apart.

Figure 2
Online research and reviews are the most relevant drivers in consumer purchase decisions today

Purchase decision drivers



Source: Kearney analysis

Consumers' lifestyles and external factors impact what they purchase, so the art and science of retail merchandising must stay ahead of trends. For example, post-COVID consumers continue to work from home and spend more on household needs, home improvement, skincare, and loungewear or leisure apparel. Inflationary pressures, lay-offs, and growing economic uncertainty are driving them to delay discretionary purchases and trade down instead, leading to increased purchases of private brands and discount store sales.

Retail leaders anticipate these shifts and use real-time or near real-time consumer data to adjust their plans. They focus on holistic consumer-centric strategies based on policies such as easy returns, zero shipping fees, and longer hours of operation. They're also adopting more consumer-focused cultural norms and policies behind the scenes, including customer-centric performance metrics and updated hiring practices.

Leaders find smart ways to tier consumers, gamify social platforms, and create stickier loyalty programs that form lasting emotional connections. Examples include Alibaba's 88VIP, a premier membership program that rewards their most loyal customers. The company adjusts the cost of membership based on spend levels and offers exclusive discounts, limited edition products, and access to other VIP customers, all with a focus on achieving elite status. Virgin Red, another example, is a free, tiered loyalty program where members earn and redeem points across Virgin-owned companies. They use gamification to keep members engaged and focus on inspiring them to save up points for high-value rewards.

2. Ongoing perils of supply chain instability

Geopolitical tensions, post-COVID effects, and weakening economies make a resilient end-to-end supply chain more important than ever. To combat these pressures, retailers must balance supply chain costs, risks, sustainability, and tech advancements. This means evaluating and tightening processes for internal and external stakeholders across the value chain.

To better prepare for and respond to supply chain needs, retailers should consider:

- Increasing transparency
- Creating a collaborative internal and external ecosystem
- Adopting a strong logistics strategy
- Establishing advanced planning and risk management systems

Transparency

We encourage retailers to have understanding across all suppliers, from tiers 1, 2, and 3, on to manufacturing sites, raw materials, and their sources. This requires mature vendor management capabilities for collecting and handling supplier data. Strengthening these areas helps them build trusting supplier relationships that will also give them insights into suppliers' own challenges and strategies and the effect they could have on the retail business.

Ecosystem

A collaborative supply chain ecosystem requires internal partnership as much as it needs external cooperation. COVID-19 exposed internal issues, such as a lack of organizational integration with the supply chain across functions, geographies, and business units. An effective supply chain is well-connected with these entities, which can collectively respond to disruptions. We urge retailers to reevaluate their operating models and processes with this in mind.

Collaboration among suppliers, manufacturers, logistics partners, merchants, and customers across channels is essential as inputs and outputs change. For instance, a retailer and its manufacturers could share digital twins before materials are shipped to reduce waste and cost, and save valuable resources.

Logistics

Logistics costs are plummeting after skyrocketing not long ago. A nimble strategy that lays logistics operations bare while allowing control over warehousing, inventory, and transportation will be the holy grail for retailers as they seek to improve cost management and keep shelves stocked. Freight rates famously rose during the pandemic but have seen broad corrections since in spot rates across modes, making this an opportune time to revisit transportation contracts. Tides appear to be shifting in favor of shippers with capacity increases and spot rate decreases (see figure 3). Now is also the time for retailers to revisit logistics and distribution strategies to mitigate costs, increase visibility, and transform setups.

Figure 3
Capacity increases and spot rate decreases have turned the tide toward shippers

Compass snapshot:
March 2023

Freight segment US domestic	US market size $B	Carrier concentration	Shipper market	Service quality
Truckload	409.8	L		
LTL	79.3	M		
Intermodal	27.8	M		
Water	15.4	M		
Air	97	M		
Rail	61.6	H		
Parcel	119	H		
Last-mile (bulky)	13	L		
Last-mile (specialty)	varies by subsegment	L		

Sources: ATA, company financial reports; State of Logistics Report, Kearney analysis

Advanced planning and risk management

Systems for advanced planning and risk management allow retailers to sense and pivot rapidly based on shifts in demand and supply. New planning tools and technologies powered by artificial intelligence (AI) and enabled by scenario planning let them identify changes and fluctuating demand and act accordingly. Resilience planning is currently one of the areas of key strategic investment to make for a nimbler supply chain.

3. Persistent labor market headaches

Although the Great Resignation of 2022 has ended, retail continues to confront labor market challenges. Post-COVID recovery has been slower than expected and labor is still difficult to find and costlier to hire. Some retail leaders are hoarding labor, using any means to keep employees. Many intend to invest hundreds of millions of dollars in additional payroll in 2023 to attract and retain talent, especially for stores and distribution centers.

Retailers currently struggle with two related challenges the most:

- Reconciling a way of working between remote and in-person locations
- A continued shortage of in-store and DC labor

Retailers find they must establish parameters that address employee preferences for working from home or the office, productivity targets, system and technology infrastructure, and location strategy. While working from home could be productive during the pandemic, retailers now worry that scant in-person relationship-building could lead to reduced loyalty, commitment, and morale. On the other hand, having remote positions can give retailers access to the best talent, regardless of geography. Thus, retailers face a difficult balancing act to ensure the best employee experience, maximum labor productivity, and timely talent acquisition, while finding a way of working that succeeds long term.

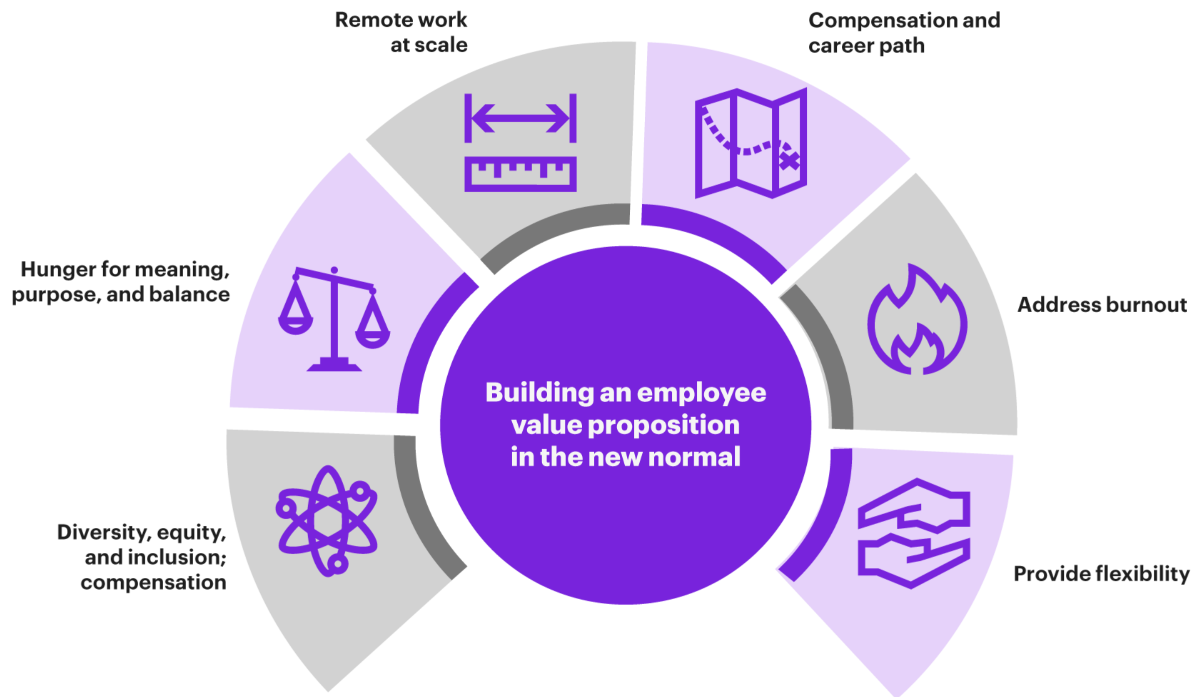
The shortage of in-store and DC labor is a major challenge and, given changes in workforce dynamics, it won't resolve any time soon. Retailers struggle to hire enough workers to maintain store hours, support customer service standards, and meet supply chain service levels. Some are rethinking store and DC operations to reduce costs while they maintain or improve employee and customer experiences.

We urge retailers to make a continuous effort to digitize stores and distribution centers, including automating low value-add tasks, adopting flexible scheduling, and using contactless checkouts. For example, some retailers create smart warehouses with robotic process automation, collaborative robots, and autonomous mobile robots to handle repetitive and predictable tasks. Others use more consumer self-service, digital employee tools, and robotics in stores.

Retailers are also finding new ways of working to attract and retain talent and transform their store and DC operations. Most have increased wages, expanded benefits, and offered temporary bonuses. The fruits of these investments will disappear, however, without a deep understanding of employees' wants and needs, supported by a tailored value proposition. This approach can improve employee well-being with benefits, job duties, career pathing, flexibility, and purpose (see figure 4).

Figure 4
A comprehensive employee value proposition can lead to employee satisfaction

Employee value proposition framework



Source: Kearney analysis

Such a value prop can also save a retailer in time, effort, and cost. One company found that although they'd invested a great deal to increase wages and expand benefits, store employees were dissatisfied with schedule volatility. The retailer had invested in the wrong area. We have found employee satisfaction ultimately has a multiplier effect: it enhances retailers' ability to attract new talent (such as through referrals) while retaining existing talent. As our example illustrates, employee satisfaction cannot be bought with a wage increase alone.

4. Societal desire for sustainability

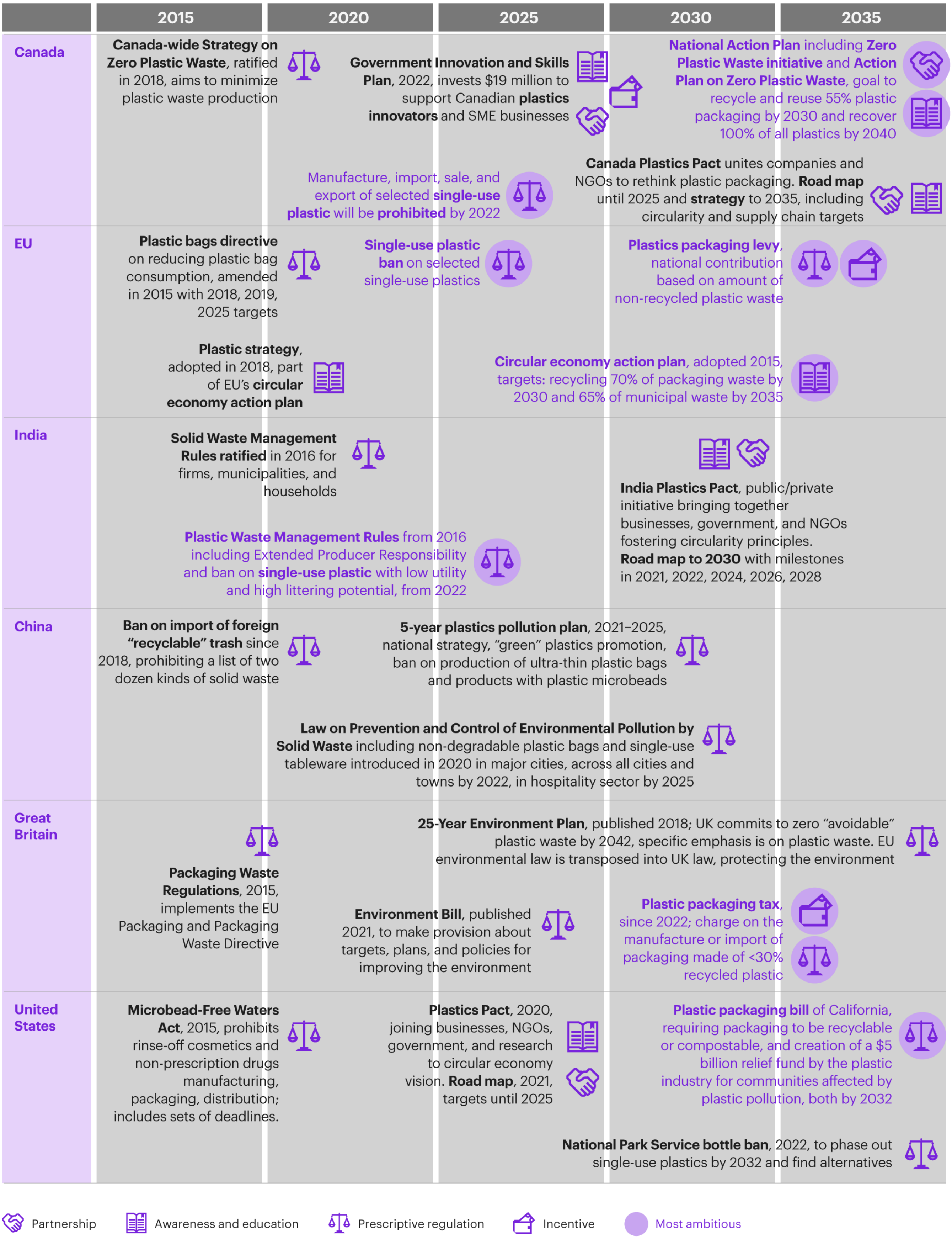
Environmental policies in countries around the world have rapidly developed, along with more aware and environmentally focused consumers. These shoppers have better access to information on a variety of topics, from carbon emission claims and resource depletion to fair trade. Consumers are bolder—they can make greenwashing charges, scrutinize a product's value chain to see if it is ethically sourced, and validate product ingredient lists. They choose more sustainable options and get their voices heard via powerful methods, such as social media platforms and the traceability of ESG claims.

When it comes to ESG, countries and their officials are focusing on areas including the limitation of resources, climate change, and geopolitical pressures. Many states hope to move to a more circular economy and enforce policies that push sustainable innovation across industries. For plastics and packaging alone, countries have enacted or plan to enact numerous policies (see figure 5).

Figure 5

Increasingly, countries are enacting packaging and plastics circular policies

Mega trends, non-exhaustive



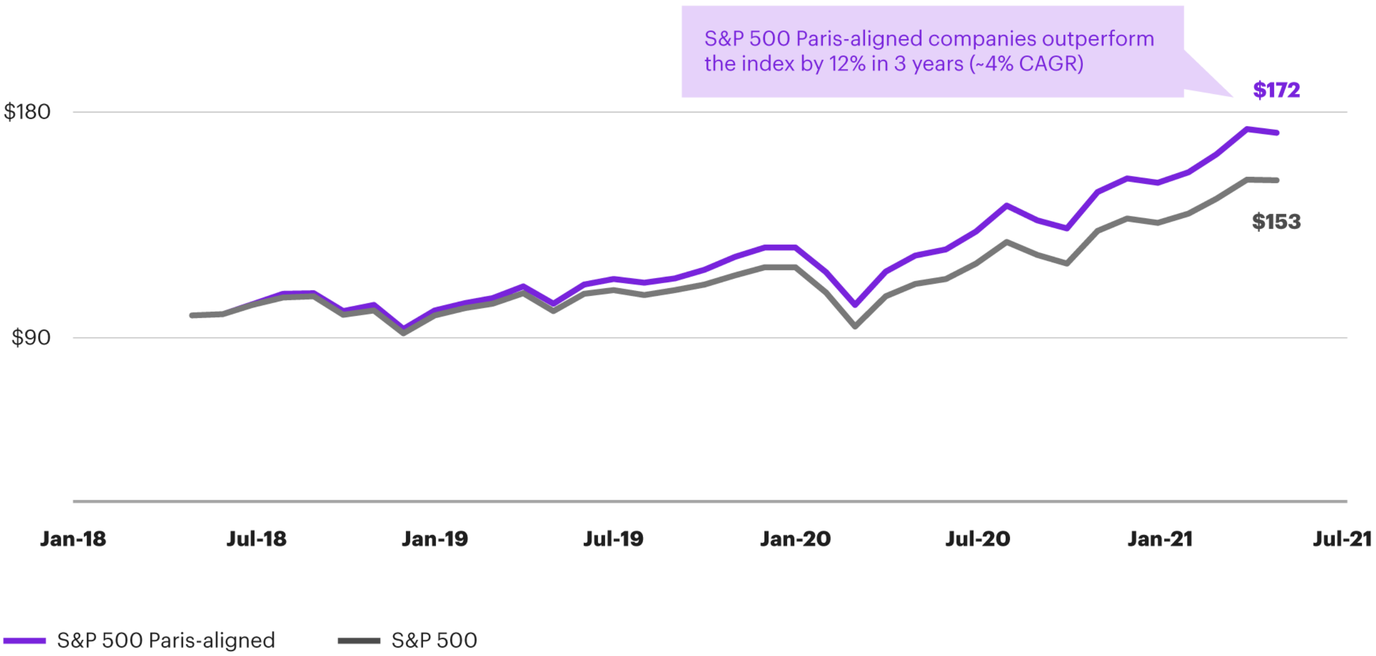
Source: Kearney analysis

These developments have helped support a dramatic increase—109 percent since 2015—in the number of retailers honing their ESG agenda and setting aggressive ESG targets. Yet, a target is just a first step. Retailers must follow through and be accountable by embedding and hitting multiple operations goals using the right strategy and execution. They need to continuously measure progress with key performance indicators and accurately report successes, all without losing sight of changing policies, shifting consumer preferences, and the rise of more advanced sustainability technologies. It's enough to leave a retailer out of breath!

Notably, retailers that were fast to invest in ESG practices have already realized economic benefits, including a rise in brand perception, improved taxation, revenue growth, and a superior return in shareholder value. S&P 500 companies aligned with the Paris Agreement, for example, outperformed the index by 12 percent (4 percent CAGR) from 2018 to 2021 (see figure 6).

Figure 6
S&P 500 companies aligned with the Paris Agreement have performed better

S&P 500 Paris Agreement-aligned climate index performance



Source: Kearney analysis

To take a leadership position in the long-term ESG journey, we believe retailers should take a number of steps, including:

- Stay informed on regulations around the world, including ones in the pipeline for the foreseeable future.
- Constantly innovate to meet and outperform on sustainability targets. Establish innovative rent, recycle, and upcycle models, for example, to be more relevant with consumers.
- Know which sustainability issues appeal to consumers the most.
- Have a robust strategy and execution governance to track progress.

5. Digital revolution promises and demands

Rapidly changing retail technology is reshaping commercial and operational processes along the value chain. Automation, machine learning, AI, big data, the Internet of Things, blockchain, and virtual reality are just some technologies retailers are adopting to differentiate themselves from laggards.

With so many technological choices and areas for progress, retailers need a sharp digital strategy that prioritizes solutions and solves urgent and long-term business problems. It should balance investments to run the business and drive future growth, with a focus on continuous progress. It will keep retailers on track and help them avoid spending time and money on alluring technologies that lack direct business value or staying power.

We see five areas where retailers can benefit the most from digital solutions.

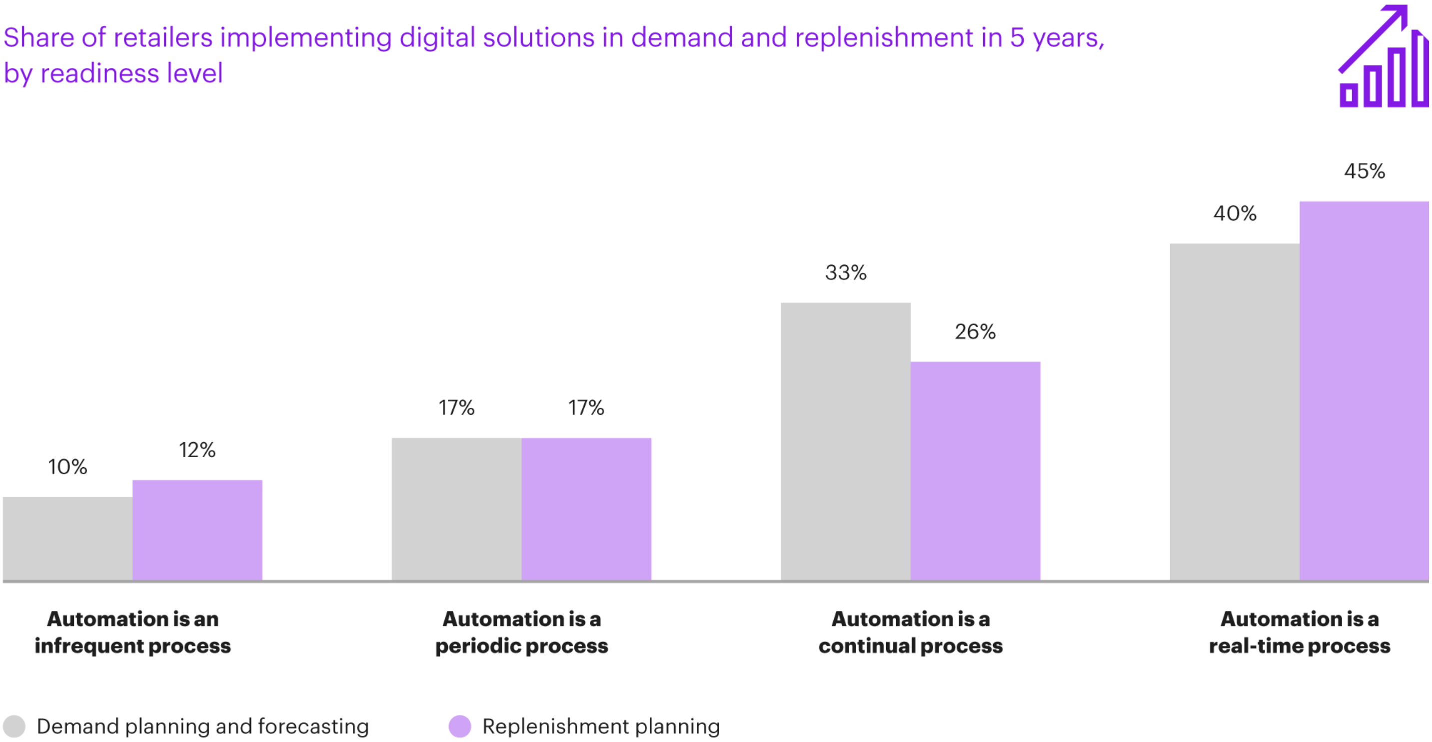
Advancement of supply chain visibility

There has been increased use of AI and automation for demand planning, forecasting, and replenishment planning. A single view of inventory has become crucial for retailers eager to compete in an omnichannel world by giving consumers a seamless experience. More retailers are investing in real-time automation of planning capabilities to build resilience (see figure 7). They're also adopting technology that enables greater traceability of products from tier 1 and 2 suppliers.

Figure 7

In order to build resilience, more retailers are investing in real-time automation of planning activities

Share of retailers implementing digital solutions in demand and replenishment in 5 years, by readiness level



Sources: University of Warwick, BlueYonder, 100 respondents' retailers; Kearney analysis

5G technology for stores and warehouses

5G technologies and edge computing have been hot topics in retail and will continue to be for application points such as warehouses for faster and preemptive stocking and decision-making. They'll be useful in stores, too, to support staff productivity, stock predictability, and the omnichannel consumer experience.

App-based technology in and beyond stores

The best retailers constantly evolve to make stickier one-stop platforms with features such as cloud-powered checkouts, scan-and-go models, gamified loyalty programs, store and product finders enlivened with augmented reality (AR), AI-based product engagement platforms, and digital catalogs in malls. British retailer Marks & Spencer, for instance, has introduced an AR-powered way finder app in stores, while Brazil's Super Muffato now offers digital catalogs.

Experimentation powered by advanced data and analytics

As retailers improve data and analytics capabilities, they become more adept at conducting scientific experiments and dipping their toes into new experiences that may appeal to their consumer bases. Many are trying metaverse technologies to bring immersive experiences to customers in their retail stores and via applications. Cases in point: Bloomingdale’s has entered the metaverse with a futuristic, interactive storefront, and Nike has launched a virtual line of sneakers called Cryptokicks.

Back in this universe, retail leaders constantly look inside and out to unlock new customer experiences. They offer consumers automated predictable functions (such as product considerations and aisle recommendations) and use massive consumer data and insights for new product development.

Technology for good

Lastly, retailers are turning to technology to help them achieve their ESG agendas, using it to meet diversity and inclusion initiatives. They make their stores and platforms friendly for differently abled customers, and reduce waste and energy across the value chain.

6. Increasing margin pressure

Retailers are no strangers to margin pressure and the current economy has added to it with more expensive debt, rising costs for raw materials and logistics, and a demand for greater value from cost-conscious consumers. To ease the pressure and maintain healthy margins, we urge them to explore alternative revenue streams and cost take-out strategies.

Retailers can tap new growth through opportunities that include:

- **Retail media networks.** Monetize digital properties by offering space to third-party brands and other advertisers to promote themselves to targeted audiences. Walmart has taken this approach, using its consumer data to create a profitable media network that generates additional revenue while enhancing customers’ shopping experience.
- **Partnerships in loyalty programs.** Collaborate with other businesses to offer more rewards, points, and other incentives to consumers, increasing cross-sales and customer loyalty.
- **Private label brands.** Exclusive private brands are more than just a cost play. They generate higher margins and increased customer loyalty. Target’s successful in-house brands, such as Cat & Jack and Goodfellow & Co., have contributed significantly to its growth and profitability in recent years.

- **Monetization of customer data.** Using their first-hand experience with consumers, leading retailers creatively monetize their data, insights, and managed services to strengthen relationships with CPGs and companies in other industries.

Cost transformation is another area shouting for retailers' attention as they strive to be nimble and lean in this economy. Some key areas for cost reduction are:

- **General and administrative expenses.** Get the most out of operating models, carefully weighing options for outsourcing, near-shoring, and in-house functions—balanced with the right level of control and number of layers across all G&A functions.
- **Energy costs.** Use energy-efficient technologies to offset increases in utility costs. Install LED lighting, smart HVAC systems, and energy management software, among other measures. IKEA recently invested in technologies that not only contribute to environmental sustainability but also help it reduce operational costs.
- **Store and warehouse operations.** New store layouts, self-checkouts, and automated warehouses can help retailers cut labor costs and increase efficiencies.

Using these approaches, retailers can address the challenges of today's competitive landscape, creating a positive shopping experience that benefits their customers and bottom line.

Boldness for the future, precedents making history

The six trends we explored may be at different levels of maturity in the retail industry worldwide, but each is significant and pernicious if not addressed with clear eyes. Knowing how they influence a retailer's markets can provide a fresh starting point to evaluate current standing before crafting short- and long-term strategies to support a retailer's goals.

We have addressed the uncertain, yet conceivable, economic conditions affecting retailers and supply chains today. More will arise, as could inconceivable crises as profound as a global pandemic. Successful retailers are bold and make quick, well-informed decisions. They will strive to make a stark difference by prioritizing consumers, speed, and additional revenue sources, and avoid common pitfalls such as surviving for the time being or settling for incremental changes. There is no one-size-fits-all solution, as history has taught us. But with creative thinking and the right execution tools, retailers can overcome the challenges, thrive, and shape the future of their industry.

Whether you're struggling to identify the external factors that might put in danger your businesses or you don't know how to address them properly, we can help you find the right path to overcome these problems. What's more, with our strong experience in the retail sector we can also bring it into practice. Want to know more? Get in touch and let's start a conversation.

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[1] Kearney conducted its Consumer Education Study in 2022 with 1,000+ consumers. Learn more at https://www.kearney.com/consumer-retail/article/-/insights/reconsidering-consumer-education-kearney-consumer-institute-2022-q1-quarterly-brief.

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