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Navigating the market headwinds

The State of Grocery Retail 2022

—Europe—



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Foreword

In the past 24 months, food retailers' sales have reached unprecedented levels, owing to restrictions on consumers' movements during the COVID-19 pandemic. This trend began to reverse course in 2021, however, with the reopening of restaurants and travel and despite the comeback of GDP, but with inflation and energy prices on the rise. The invasion of Ukraine in February 2022 produced a further shock and, although its full impact is uncertain at the time of publication, we expect that because of Ukraine's and Russia's roles in the energy, agri-food commodities, and raw-materials markets, the conflict is likely to exacerbate some of the negative trends that emerged at the end of 2021.

This year's report—although its insights and analysis are based on the situation before the invasion of Ukraine—highlights some of the key trends affecting consumption patterns and considers questions for grocery retailers: What is the impact of inflation, and how can grocers react to it? How have consumer patterns evolved, and which of the trends observed during the pandemic are likely to stay? What will online sales, including instant grocery, look like by 2030? What opportunities arise from the sustainability transformation of food systems? Why are skills and talent taking center stage? What about opportunities in building ecosystem approaches and data analytics?

The State of Grocery report is an annual global publication covering three continents, with dedicated reports for Asia, Europe, and North America. This year's report, "Navigating the market headwinds – The State of Grocery Retail 2022: Europe," is a continuation of a partnership between McKinsey & Company and EuroCommerce, designed to provide executives with a comprehensive view of the market and future trends. In preparing the report, we surveyed more than 12,000 consumers and around 60 grocery executives across Europe. We interviewed six industry thought leaders and pioneers. We combined EuroCommerce's policy and sector knowledge with McKinsey's global expertise and analytical rigor.

We hope this report will offer new insights and perspectives that will help grocers navigate the market headwinds.



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Daniel has been with McKinsey for 15 years and is based in the company's Zurich office. He leads McKinsey's Food Retail Practice globally and advises leading grocery and nonfood retailers across Europe on category management (assortment, price, and promo), advanced analytics, store operations, and strategy.



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Tobias led McKinsey's Retail Practice in the EMEA region until 2020 and currently leads the firm's global activities in growth analytics and tech solutions. He has served grocers in more than 15 countries across a wide range of topics, from growth strategy via analytics to organization and restructuring.

Food and grocery market KPIs in 2021 grew on average.

Year-over-year (YoY) growth in 2021 vs 2019 and 2020, %

		Northern and Western Europe					Southern Europe			Central Europe		Weighted average ¹
		Germany	United Kingdom	Netherlands	France	Sweden	Spain	Italy	Portugal	Czech Republic	Poland	
Food market—segment growth												
Grocery retail² <i>YoY change</i>	vs 2020	+0.9	-1.0	+1.6	-2.2	+0.4	-7.4	+2.3	-0.1	-1.0	+3.2	-0.6
	vs 2019	+13.6	+12.0	+11.4	+5.3	+16.3	+5.4	+8.4	+13.2	+7.3	+10.1	+9.9
Modern grocery retail³ <i>YoY change</i>	vs 2020	+1.5	-1.1	+1.3	-2.3	+0.6	-7.1	+4.4	-0.2	+1.6	+5.5	-0.1
	vs 2019	+14.6	+12.5	+10.5	+5.7	+16.5	+6.7	+13.6	+13.1	+10.5	+17.0	+11.4
Other grocery formats⁴ <i>YoY change</i>	vs 2020	-1.6	-0.4	+3.4	-1.2	-4.5	-8.2	-5.3	+0.6	-8.5	-1.4	-2.3
	vs 2019	+9.5	+9.0	+16.3	+2.2	+10.3	+1.8	-8.5	+13.6	-1.8	-1.9	+4.6
Foodservice⁵ <i>2019 vs 2020, 2020 vs 2021 YTD⁶</i>	vs 2020	-7.7	+32.1	-1.3	+10.5	+4.8	+25.9	+7.6	+10.9	+9.4	+17.2	+11.0
	vs 2019	-36.7	-19.1	-32.2	-25.1	-19.6	-28.1	-33.7	-26.8	-26.1	-1.6	-26.7
Modern retail—revenue growth per format												
Total² <i>YoY change</i>	vs 2020	+1.5	-1.1	+1.3	-2.3	+0.6	-7.1	+4.4	-0.2	+1.6	+5.5	-0.1
	vs 2019	+14.6	+12.5	+10.5	+5.7	+16.5	+6.7	+13.6	+13.1	+10.5	+17.0	+11.4
Hypermarkets⁷ <i>YoY change</i>	vs 2020	-1.5	-5.8	N/A	-1.8	+0.8	-10.0	+3.2	N/A	+0.2	-1.6	-2.6
	vs 2019	+8.1	-1.6	N/A	+1.0	+10.7	+1.9	-3.0	N/A	+4.1	+1.2	+2.4
Supermarkets⁸ <i>YoY change</i>	vs 2020	+4.2	-3.9	-0.9	-4.5	-4.4	-7.4	+4.3	-0.1	-0.6	-2.5	-1.2
	vs 2019	+21.4	+5.4	+6.2	+5.3	+7.0	+4.0	+12.6	+10.9	+9.9	+8.2	+10.2
Discounters⁹ <i>YoY change</i>	vs 2020	-1.0	+1.5	-0.9	-4.1	+5.6	-5.2	+6.4	+1.1	+2.6	+12.2	+0.3
	vs 2019	+7.8	+15.0	+2.6	+3.1	+22.9	+12.8	+23.5	+17.3	+15.5	+25.5	+12.0
Online <i>YoY change</i>	vs 2020	+14.5	+14.9	+28.6	+3.7	+14.1	+3.3	-1.0	-8.7	+18.8	-3.3	+8.8
	vs 2019	+64.5	+91.5	+100.4	+47.1	+129.5	+69.8	+54.9	+44.9	+43.1	+50.2	+67.3
Modern retail—space growth per format												
Total <i>YoY change</i>	vs 2020	+1.0	+0.8	+2.0	+0.9	+2.6	+2.2	+4.6	+2.5	+1.9	0.0	+1.6
	vs 2019	+1.8	+1.7	+3.9	+1.6	+5.8	+0.7	+10.0	+8.4	+3.1	+3.3	+3.0
Hypermarkets¹⁰ <i>YoY change</i>	vs 2020	+0.3	+0.3	N/A	-0.3	+0.5	+1.7	+9.3	N/A	+0.5	-11.1	+0.8
	vs 2019	+1.6	-0.8	N/A	+1.3	+2.5	+0.3	+9.7	N/A	+0.2	-12.7	+1.1
Supermarkets¹¹ <i>YoY change</i>	vs 2020	+0.7	-0.2	+1.4	0.0	+3.4	+2.8	+1.8	+1.1	+1.7	-1.9	+0.7
	vs 2019	-1.1	+0.1	+2.7	-0.9	+8.8	+0.2	+6.6	+9.5	+4.0	-0.2	+0.9
Discounters¹² <i>YoY change</i>	vs 2020	+1.6	+6.5	+3.5	+2.5	+5.9	+1.8	+6.6	+8.0	+6.6	+5.8	+4.0
	vs 2019	+3.7	+13.9	+8.2	+5.9	+9.3	+2.8	+13.6	+13.9	+10.4	+11.2	+8.1
Convenience¹³ <i>YoY change</i>	vs 2020	+3.1	+0.8	+24.4	+4.8	+2.9	+3.8	+1.4	+0.7	+0.1	+4.1	+3.8
	vs 2019	+6.5	+1.4	+27.4	+2.9	+2.9	-4.6	+16.5	+2.4	+0.5	+12.0	+5.8
Modern retail—growth of sales per square meter												
Sales/m² <i>YoY change</i>	vs 2020	+0.4	-1.9	-0.7	-3.2	-2.0	-9.1	-0.3	-2.7	-0.3	+5.6	-1.7
	vs 2019	+12.6	+10.7	+6.4	+4.0	+10.2	+5.9	+3.3	+4.4	+7.2	+13.3	+8.3

		Northern and Western Europe					Southern Europe			Central Europe		Weighted average ¹	
		Germany	United Kingdom	Netherlands	France	Sweden	Spain	Italy	Portugal	Czech Republic	Poland		
Grocery retail—price and volume growth													
Volume <i>YoY change</i>	vs 2020	-2.2	-1.6	-0.7	-3.2	+0.4	-8.3	+1.3	-0.6	-1.6	+0.4	-2.1	
	vs 2019	+4.3	+8.4	+3.8	+4.4	+14.6	+2.1	+8.0	+11.4	+2.7	+3.0	+5.7	
Basket size volume <i>YoY change</i>	vs 2020	+3.3	-2.2	+3.5	-3.9	+3.7	-7.5	-6.5	-2.8	+4.8	+1.1	-1.6	
	vs 2019	+9.0	+23.6	+12.2	+8.7	+16.9	+5.8	+4.4	+9.4	+15.2	+20.2	+12.0	
Frequency <i>YoY change</i>	vs 2020	-5.3	+0.6	-4.1	+0.7	-3.2	-0.9	+8.4	+2.3	-6.1	-0.7	-0.4	
	vs 2019	-4.4	-12.3	-7.6	-3.9	-2.0	-3.6	+3.4	+1.9	-10.8	-14.3	-5.3	
Price changes (inflation) <i>YoY change</i>	vs 2020	+3.1	+0.3	-0.2	+0.6	+0.5	+1.9	+0.5	+0.7	+0.9	+3.0	+1.3	
	vs 2019	+5.4	+1.0	+1.7	+2.7	+2.6	+4.3	+2.0	+2.8	+5.6	+7.6	+3.3	
Up/down trading changes	vs 2020	0.0	+0.3	+2.5	+0.4	-0.5	-0.8	+0.5	-0.2	-0.2	-0.2	+0.2	
	vs 2019	+3.6	+2.5	+5.7	-2.0	-1.2	-0.9	-1.8	-1.3	-1.1	-0.7	+0.7	
Other key grocery indicators													
Online-channel market share <i>2021</i>		4.2	13.0	8.1	8.8	7.5		2.9	3.0	3.2	3.6	1.5	6.6
Private-label share¹⁴ <i>2021</i>		30.5	49.5	41.4	34.2	23.6		27.0	34.4	38.3	25.7	20.3	34.7
Private-label share¹⁴ <i>p.p.¹⁵ share change</i>	vs 2020	-0.2	+0.1	-0.6	-1.0	0.0		+1.2	+6.4	+0.8	+1.3	+1.0	+0.7
	vs 2019	-0.8	-0.5	-1.1	-0.5	+1.4		+1.5	+7.5	+2.3	+3.0	+1.9	+0.9
Promo share <i>2021</i>		18.8	29.8	21.9	15.6	35.9		13.3	34.7	25.1	52.4	26.9	23.4
Promo share <i>p.p.¹⁵ share change</i>	vs 2020	+1.0	-1.2	-0.1	+1.9	+9.0		+0.1	+0.3	+0.6	+1.3	+2.8	+0.9
	vs 2019	+0.6	-3.8	+0.1	+0.7	+8.0		-0.4	-4.3	-0.4	+0.3	+2.6	-0.6
Consumer indicators													
Consumer confidence <i>p.p.¹⁶ change</i>	vs 2020	+4.1	+9.8	+9.3	+5.9	+7.6		+10.0	+9.1	+7.2	-0.9	+4.5	+7.0
	vs 2019	-3.2	-1.8	+3.4	+1.2	+8.4		-6.4	+5.6	-8.6	-11.5	-11.9	-1.4
Eco-active consumers¹⁶ <i>2021</i>		47	29	21	24	N/A		22	26	N/A	14	25	
Eco-active consumers¹⁶ <i>p.p.¹⁵ share change</i>	vs 2020	+9.0	+6.0	N/A	+5.0	N/A		-2.0	+3.0	N/A	-4.0	+3.0	
	vs 2019	+17.0	+7.0	+6.0	+11.0	N/A		+8.0	N/A	N/A	-2.0	+6.0	

¹ Weighted according to 2020 total grocery revenues for each country.

² Europanel revenue data measures only value of purchases that are taken home (ie, excludes value of purchases that are consumed on the go, at work, etc).

³ Consists of hypermarkets, supermarkets, online stores, and discounters.

⁴ Remaining store types not covered by "modern retail." Examples include small corner store, pharmacy, drugstore, and open market.

⁵ Includes food and beverage service activities providing complete meals or drinks fit for immediate consumption (eg, traditional restaurants, self-service, or takeaway restaurants).

Source: Europanel; Eurostat; GfK; IGD Research; Office for National Statistics

traditional restaurants, self-service, or takeaway restaurants.

⁶ Year to date. For the Czech Republic and the United Kingdom, a full year. For France, Germany, Portugal, and Spain, up to November. For Italy, the Netherlands, Poland, and Sweden, up to September.

⁷ Large retail outlets under common ownership with sales area >2,500m² (according to Europanel).

⁸ Smaller retail outlets under common ownership, excluding discounters. Sales area from 450m² to 2,500m² (according to Europanel).

⁹ Limited-range discount retailers such as Aldi, Lidl, Biedronka, Norma, Netto Marken-Discount, Eurospin, Penny, Dia, and Leader Price (according to Europanel).

¹⁰ Sales area between 3,000m² to 6,000m²; substantial nongrocery store offering (according to IGD).

¹¹ Sales area ranging from 300m² to 6,000m²; store offering is predominantly food (according to IGD).

¹² Sales area from 300m² to 1,500m² (potentially up to 6,000m²); narrow range (<4,000 SKUs) with a focus on everyday low prices. Offerings typically

dominated by private label, and stores operate with low-cost business model (according to IGD).

¹³ Stores typically under 300m², with convenience-focused ranges usually up to 6,000 SKUs and long opening hours (according to IGD).

¹⁴ Methodology focused on value (not volume) of what customers purchase across formats (according to Europanel).

¹⁵ Percentage points.

¹⁶ Consumers that take the most actions to reduce their environmental impact, such as using their own bags, bottles, and cups and avoiding plastic.





State of Grocery

Europe: Navigating the market headwinds

In 2021, the COVID-19 pandemic continued to influence the grocery retail market in Europe. Sales in the last three quarters of 2021 were lower than in the previous year but still significantly higher than in 2019, resulting from the partial closure of food services.

Going into 2022, grocery CEOs expected market conditions to deteriorate. Five key themes will likely shape European grocery retail in 2022 and beyond: 1) decreasing volumes and rising inflation; 2) widening polarization with higher price sensitivity and more focus on health, premium, and sustainability at the same time; 3) a slower online growth with more differentiated offers; 4) the search for new profit pools; and 5) a shift in the people model.

Disclaimer: The war in Ukraine is having a deep human, as well as social and economic, impact across countries and sectors. The exact implications for grocery retail are still unclear. This article was written before the war started. Our first analysis of the impact of the war indicates that it mostly accelerates the trends we have identified in this article—particularly that it might increase food and energy inflation even further and, as a result, make the increase in price sensitivity and downtrading more pronounced. We therefore believe the trends outlined in this article gained even more relevance through the current crisis.

by Christel Delberghe, Richard Herbert, Franck Laizet, Daniel Läubli, Jean-Albert Nyssens, Rickard Vallöf, and Tobias Wachinger



Interview with Matthias Wunderlin
on page 24

Looking back on 2021

The European grocery retail market in 2021 was shaped by the ongoing effects of the COVID-19 pandemic, the gradual reopening of the hospitality sector, the emergence of instant-delivery players (also called quick commerce), and price inflation.

Sales decreased in Europe by 0.6 percent in 2021 compared with the previous year, to a level that was still substantially higher than 2019. Volume decreased by 2.1 percent, but this development was partially offset by price inflation of 1.3 percent and slight uptrading of 0.2 percent. The results varied significantly across countries (see “Food and grocery market KPIs,” page 6). The first quarter of 2021

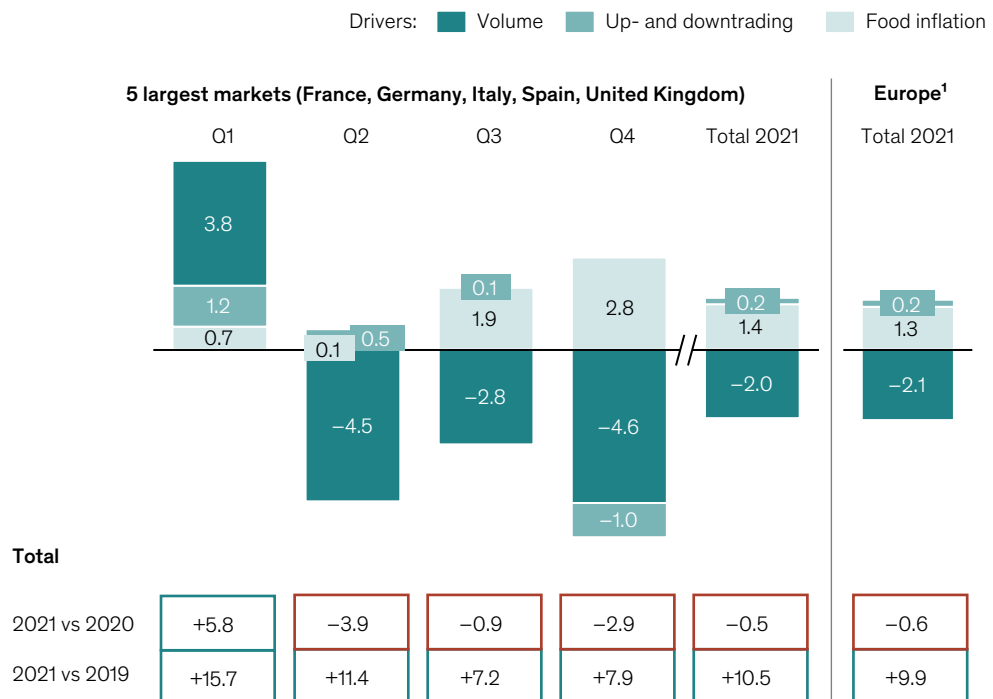
was significantly higher than the prepandemic first quarter of 2020, reflecting the effects of market restrictions. From the second quarter of 2021 onward, hospitality activity began to resume and grocery retail sales stayed below the previous year, though they remained substantially above 2019 levels across quarters and countries (Exhibit 1).

From a format standpoint, online and discounters posted highest results in 2021, growing faster than the market in most countries. Supermarkets and hypermarkets saw a decline in sales as a result. Online revenues across Europe rose by 8.8 percent compared with 2020. Most of online’s growth occurred in the first quarter of 2021; in the

Exhibit 1

In 2021, price inflation and slight uptrading helped offset decreased volume in Europe.

Growth of grocery retail 2021 vs previous year, %



Note: Figures may not sum, because of rounding.
¹ Includes Czech Republic, France, Germany, Italy, Netherlands, Poland, Portugal, Spain, Sweden, and United Kingdom.
 Source: Europanel (volume and up- and downtrading); Eurostat (inflation)

following quarters, online stayed at roughly the same level as in 2020. This growth was quite unequal across Europe: countries in Southern Europe (such as Italy and Portugal) and Central Europe (for example, Poland) saw a decrease in online. On the other end, Germany, the Netherlands, Sweden, and the United Kingdom recorded robust growth in 2021. Despite falling sales in offline formats and even higher declines in offline volume, retailers kept expanding their store networks, with available sales space expanding by 1.6 percent (see “Food and grocery market KPIs,” page 6). Especially for discounters, with store space 4 percent greater than that of 2020, this strategy was successful, resulting in growth and strong results reported by this format.

Within online, instant delivery had a year of substantial expansion, fueled by massive inflows of funding. The top 15 players in Europe had opened more than 800 dark stores by the end of 2021. Further, many traditional grocers formed partnerships with instant-delivery companies to extend their offerings beyond physical stores. Still, the instant market remains in its early days. It is small, lacks transparency, and is unprofitable in most cases. Our research suggests that the instant-delivery market in Europe reached between €3 billion and €6 billion in 2021, accounting for less than 1 percent of the total market but with three-digit percent growth annually.

Market outlook and key trends in 2022

Going into 2022, and before the invasion of Ukraine, grocery CEOs expect market conditions to deteriorate (Exhibit 2). In our State of Grocery CEO Survey, which included 57 European grocery CEOs, 60 percent of respondents said they believe market conditions this year will be worse than in 2021. Top reasons for their pessimism include the shrinking size of wallet for grocery retail as restaurants reopen in many parts of Europe, increased price sensitivity and competition (including from a maturing online market), and rising inflation. Wage increases, labor shortages, supply chain issues, and new regulations in some markets are other factors that affect the outlook of CEOs. The top opportunity cited by CEOs is e-commerce and omnichannel offerings, which remain a key priority for many of them.

Through our consumer research (Exhibit 3), CEO survey (Exhibit 4), and market analysis, we identified ten trends that we believe will shape the grocery landscape in 2022 and beyond. Some of the trends reinforce patterns we identified in last year’s report, while others are new and will likely prompt grocery executives to reassess and adapt their existing strategies.

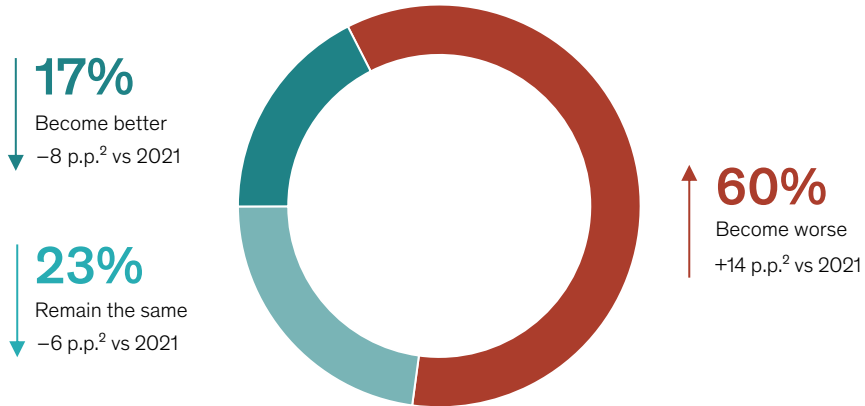
The top opportunity cited by grocery CEOs is e-commerce and omnichannel offerings, which remain a key priority for many of them.

European grocery CEOs have a generally negative outlook on market conditions for 2022.

European CEO survey results, n = 57

Survey date: December 2021–January 2022, before the crisis in Ukraine

Sentiment toward 2022 grocery market conditions¹



Words describing the grocery industry in 2022³



¹ Q: How will market conditions for the grocery retail industry evolve in 2022, in your view?

² Percentage points.

³ Q: Please choose the top 3 adjectives you would use to describe the grocery retail industry in 2022.

Source: CEO Survey 2021, January 2021, n = 48; CEO Survey 2022, November 2021–January 2022, n = 57

While price is a top priority for consumers across Europe, country differences are more pronounced for health and online.

2022 vs 2021 survey

Survey date: December 2021–January 2022, before the crisis in Ukraine

Net intent¹ of consumers toward grocery shopping in 2022 compared with 2021²



Europe average ⁴	Northern and Western Europe						Southern Europe		Central Europe
	Germany	United Kingdom	Netherlands	France	Sweden	Switzerland	Spain	Italy	Poland

More consumers prioritize price

Look for ways to save money when shopping	42% +9	41% +14	41% +3	38% +11	43% +10	36% +10	39% +5	48% +4	42% +3	45% +10
Actively research for best promotions	28% +1	12% -11	21% -1	27% +7	33% +6	27% +8	15% -8	40% +6	38% -2	39% +7
Switch to less expensive products to save money	18% +1	18% +7	19% -5	24% +10	18% +7	13% +4	16% -4	22% -8	8% -9	20% +5
Buy private-label products instead of known brands	14% +4	18% +6	13% +6	27% +14	11% +5	11% +7	14% +3	16% -2	8% -4	5% -3

Healthy and sustainable products remain a top priority

Focus on healthy eating and nutrition	34% +2	29% -8	28% -2	37% +7	38% +7	28% +1	30% +1	42% +7	40% +8	31% -4
Pay a higher price to get a healthier product	6% n/a	1% n/a	-5% n/a	-3% n/a	13% n/a	6% n/a	7% n/a	10% n/a	13% n/a	13% n/a
Pay a higher price to get an environmentally friendlier product	2% n/a	-3% n/a	-5% n/a	-9% n/a	8% n/a	4% n/a	6% n/a	6% n/a	3% n/a	9% n/a
High-income consumers' willingness to pay	15% n/a	14% n/a	11% n/a	16% n/a	21% n/a	16% n/a	16% n/a	10% n/a	16% n/a	16% n/a

Mixed outlook for online growth⁵

Buy groceries online	-1% -11	-9% -14	5% -11	4% -5	2% -10	2% -9	-7% -16	-1% -14	0% -8	-7% -17
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¹ Share of consumers who want to do more of activity minus share of consumers who want to do less of activity in 2022 vs 2021.

² Q: Think about 2022. Are you planning to do more, less or about the same of the following?

³ Percentage points.

⁴ Including all countries shown in this chart; unweighted average.

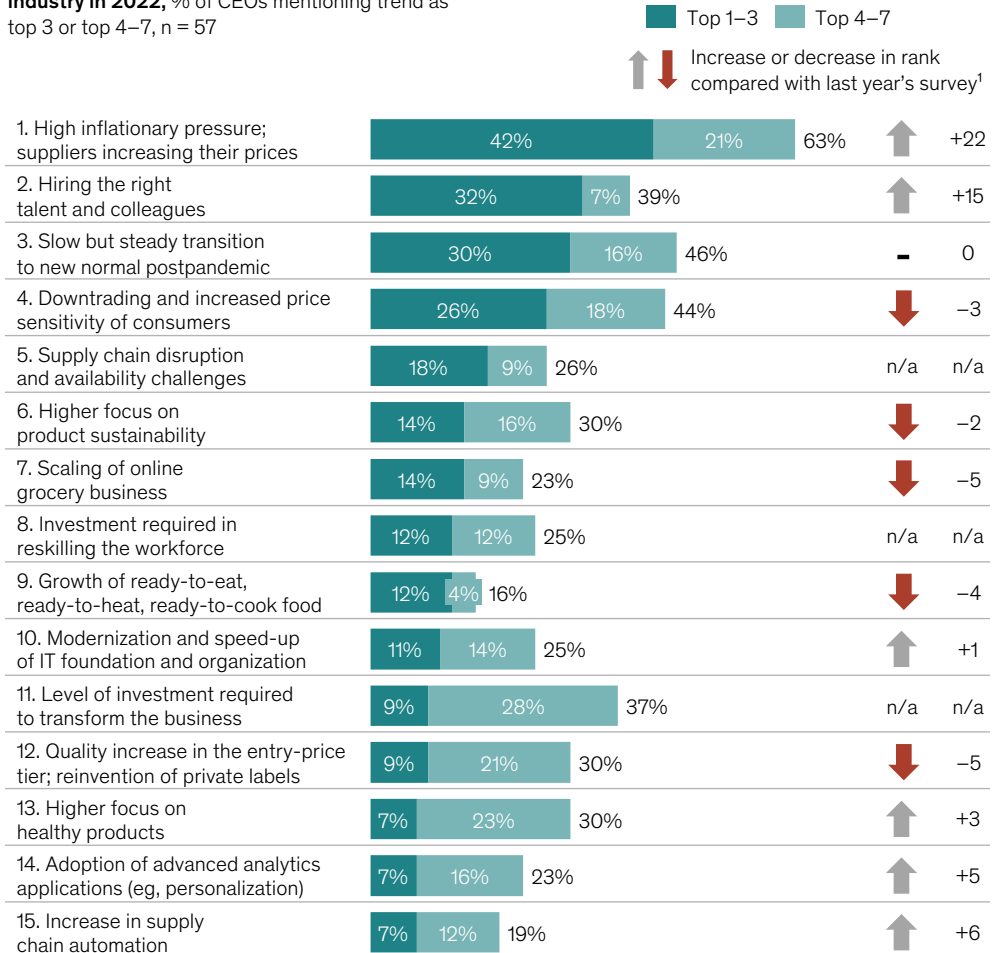
⁵ Excluding negative intent of consumers not regularly buying online (ie, less than once a month).

Source: Consumer Survey, November 6–13, 2020, n = 11,573, including the following markets: France, Germany, Italy, Netherlands, Poland, Spain, Sweden, Switzerland, and United Kingdom (sample to match general population ages 18 and up)

European CEOs expect inflation, talent, transition to a new normal, and downtrading to be the predominant trends in 2022.

Top 15 trends mentioned by CEOs for the grocery industry in 2022, % of CEOs mentioning trend as top 3 or top 4–7, n = 57

Survey date: December 2021–January 2022, before the crisis in Ukraine



Note: Figures may not sum, because of rounding.

¹ Survey in 2021: We asked CEOs to rank the top 7 trends they think will shape the grocery industry in the next 1–3 years on 22 dimensions. Source: CEO Survey 2021, January 2021, n = 48; CEO Survey 2022, November 2021–January 2022, n = 57

1. Economic headwinds put pressure on retailer margins

Several factors could shrink the margins of grocery retailers. Overall inflation in the European Union reached 5.6 percent in January 2022, while food prices rose 3.5 percent. These changes will likely be accelerated by the invasion of Ukraine.

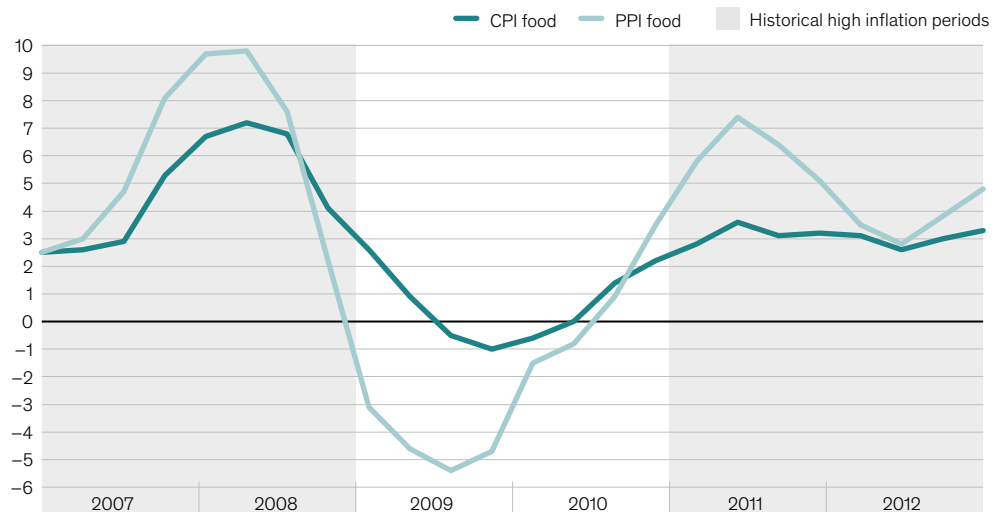
For grocery retailers, inflation has two primary effects: costs increase and consumers' disposable income shrinks.

From 2007 to 2008, food price inflation had little effect on grocery's profitability, because retailers were able to partly pass along rising prices from suppliers to consumers. By contrast, inflation during 2011 and 2012 led to a small reduction in margins (Exhibit 5). This time, heightened price sensitivity among low-income consumers, combined with decreasing overall volumes and competitive markets, might make it more difficult for retailers to pass on price increases. To avoid further losses in volume, some retailers might opt to delay part of the price increases, resulting in lower margins, at least temporarily.

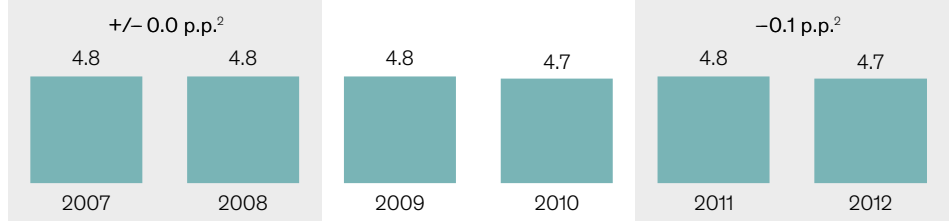
Exhibit 5

Performance of listed EU grocers during historical high inflation periods has been stable.

Quarterly growth rates year over year for consumer price index (CPI), producer price index (PPI),¹ %



Average EBIT margins over the year for selected players, %



Note: Analysis based on publicly listed players for which entire data series was available: Ahold Delhaize, Casino, Carrefour, Colruyt, Jerónimo Martins, Sainsbury's, and Tesco.

¹ CPI and PPI for the EU-27.

² Percentage points.

Source: Capital IQ; Eurostat

Higher inflation also affects consumers. It reduces their available income, as adjustments to wages tend to trail inflation, leaving them with less money for groceries. If inflation stays high, consumers will likely continue downtrading to cheaper products and to actively search for promotions; we saw some of the first effects of this in the fourth quarter of 2021. Discounters and players with competitive entry-level private-label offerings are best positioned to serve these changed consumer needs.

2. Widening polarization with higher price sensitivity and more health, premium, and sustainability at the same time

Our research indicates consumer preferences in 2022 will become even more differentiated—by income, age, and household size. On the one hand, the growth of healthy, premium, and sustainable products is likely to accelerate even more. These attributes will be fueled primarily by high-income consumers, younger generations (particularly Gen Z), and larger households (those with more than three people). For example, in 2022 high-income households are much more likely to increase their focus on healthy, premium, and environmentally friendly goods (Exhibit 6).

On the other hand, the share of consumers who plan to save more money on food and trade down to cheaper products also has risen substantially compared with 2021. Lower-income consumers are the driving force behind this increase.

Grocers could consider trimming the middle of their assortments and further strengthening their entry-price offerings and premium assortment. Adjusting the assortment to the specific needs of a store's catchment area will become even more important.

3. Slower online growth with more differentiated offers

Our research suggests online growth might take a yearlong pause in 2022 in many markets. This pattern could be especially evident in markets that have less-developed online offerings, where consumers might even reduce their spending online. In markets with mature online offerings, consumers declare they will further increase their spending, albeit at a slower pace.

In the midterm, we expect the growth to continue, with e-grocery reaching above 20 percent of share in 2030 depending on the country and scenario (see “The next S-curve of growth: Online grocery to 2030” on page 30).

To create this growth, it is important that online offers become more differentiated and tailored to the needs of additional consumer groups and shopping missions. We already see the first signs, that the online market in the future might consist of several, well-differentiated segments.

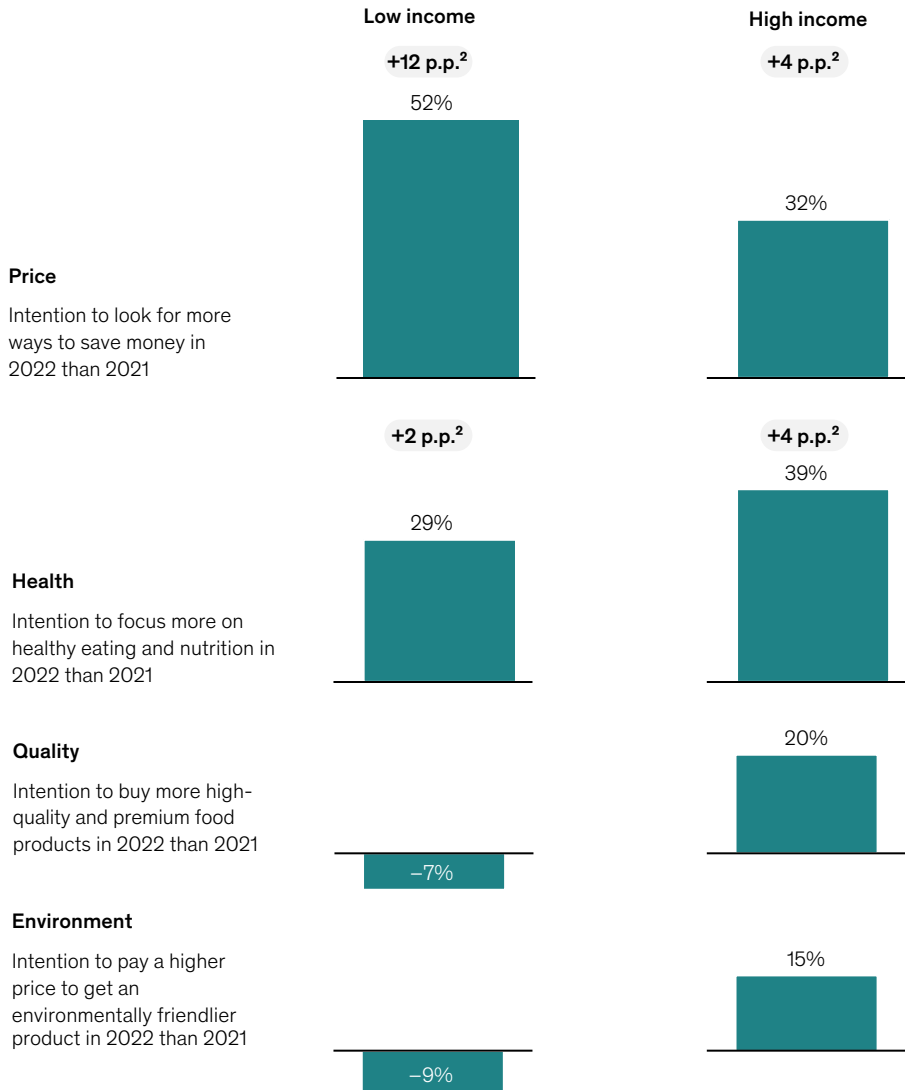
The most prominent new online market segment is instant delivery. It offers the fastest and most convenient delivery of a reduced assortment at a higher price per item, similarly to what convenience formats offer in the offline channel. Other players differentiate themselves through larger assortments (for example, Ocado), local or organic offerings (for example, Farmy in Switzerland and Rohlik), or a lean value proposition (for example, Picnic).

Thanks to these more differentiated online offerings, we see consumers starting to split their online purchases across different online shops. About one-third of frequent online shoppers (that is, those who shop online at least once a week) regularly order from three or more e-grocers. The more often consumers shop online, the more online grocers they use. There is therefore a good chance that as the online market matures, several different online formats and value propositions will coexist and compete for consumer baskets.

There is increasing polarization between low- and high-income consumers regarding attitudes toward price, health, quality, and environment.

Net intent¹ of consumers toward grocery shopping in 2022 compared with 2021, European average, %

2022 Change from previous year



¹ Share of consumers who want to do more of activity minus share of consumers who want to do less of activity in 2022 vs 2021; thus, negative numbers imply that consumers want to reduce their grocery shopping in these categories.

² Percentage points.

Source: Consumer Survey, November 6–13, 2020, n = 11,573, including the following markets: France, Germany, Italy, Netherlands, Poland, Spain, Sweden, Switzerland, and United Kingdom (sample to match general population ages 18 and up)



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4. The search for new profit pools

With their core business under pressure, many retailers are looking for new profit pools—either within their core business, through advanced analytics and artificial intelligence, or outside of their core, by entering new revenue streams.

Leading retailers increasingly master advanced analytics to inform their business decisions, especially around assortment, price, and promotions. Plenty of untapped potential remains in this area. Recent breakthroughs in the field of personalized offers and localized, store-specific assortment could bring a new wave of value that can be captured to improve sales and profitability.

Many retailers are tapping into new revenue streams beyond their core. For example, some are investing more in health offerings and solutions. Another new profit pool with high potential might be retail media networks. Several US players have built dedicated units to sell advertising space to media agencies and brands. These networks use loyalty card data to target the advertising by customer segment and are therefore attractive to consumer brands. Leading US players achieve up to 8 percent of their online sales through retail media networks, with margins of more than 50 percent. Some European grocers, such as Ocado and Tesco, are also embarking on this journey.

5. A shift in the people model

Talent has become a bottleneck for many retailers: 39 percent of grocery CEOs see attracting the right talent as one of their key challenges. In addition to high employee attrition in grocery retail, demand for different skills—such as social-emotional skills and advanced analytical and technical skills—went up. To win in this future landscape, attracting and retaining the right talent while ensuring availability of key skills becomes critical. In the postpandemic labor market, competition for talent is increasing as unemployment levels fall.

To compete, retailers may want to adjust their people models to strategically plan and manage for the required skills for the next three to five years, ensure workforce retention, and offer a robust reskilling program.

Implications for grocers

The market environment in the next 12 to 18 months might be difficult. To overcome the diverse array of challenges while meeting consumer needs, retailers must be prepared to take bold actions and keep investing in key areas such as online, new profit pools, analytics, sustainability, and people.

While the underlying recipe for these actions is not completely new, its complexity increases

The market environment in the next 12 to 18 months might be difficult.

with divergent demands from low- and high-income consumers and more differentiated offerings in the online market. It will therefore be vital for retailers to strengthen their distinct offerings tailored to these different needs—for example, through rebalancing the price tiers, building up private labels, making assortment and prices more store-specific, and personalizing promotions.

Retailers will also likely benefit from exploring new revenue sources (such as retail media networks) by monetizing their traffic and data.

In the short term, the impact of the invasion of Ukraine as well as inflation and energy costs are top of mind for CEOs, putting even stronger pressure on prices and operational efficiency, along with the wellbeing of employees.

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Ten key trends

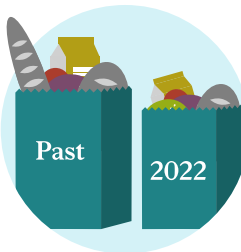
shaping the grocery industry in 2022 and beyond

Economic headwinds

1. Decreasing volumes

Sales volumes are likely to decline in 2022 as the impact of COVID-19 wanes.

Volume fell by 2.1 percent in 2021 compared with 2020. In particular, the last three quarters saw declining volumes, though they were still 5.7 percent higher than those of 2019, leaving room for a further decline. Going forward, we expect volumes to stabilize slightly above 2019 values and revenues to stay clearly above 2019 values, given the high inflation rates.



-2.1%

Fact: Volumes were 2.1 percent lower in 2021 than in 2020 (KPI table, Europanel).

2. Inflation

In January 2022, overall inflation in Europe reached 5.6 percent, with food prices increasing by 3.5 percent. The Ukraine crisis increases the inflationary pressure even more. General inflation reduces available consumer income in the short term (and their confidence for the future), while rising food prices and high energy costs can directly affect margins.

Consumers are expected to trade down and shift their spend to retailers with strong private-label offerings in the entry-price range.



63%

Fact: Sixty-three percent of CEOs see inflation as the top trend in 2022 (State of Grocery Europe CEO Survey, January 2022).

Online

3. Slower online growth with more differentiated offers

Online growth might take a yearlong pause in 2022 in many markets. Still, we expect growth to continue in the midterm. By 2030, e-grocery will make up more than 20 percent of the market, depending on the country and scenario (see “The next S-curve of growth: Online grocery to 2030” on page 30).

At the same time, online offerings will become more differentiated (such as instant delivery versus scheduled delivery), serving the specific needs of additional consumer segments and shopping missions. Consumers will increasingly split their basket across more than one online food player.



1/3

Fact: One-third of consumers who shop online weekly get their groceries at three or more e-commerce players (State of Grocery Europe Consumer Survey, November 2021; McKinsey analysis). See “The next S-curve of growth: Online grocery to 2030” on page 30 and “Instant grocery: Will it stay or will it go?” on page 40.



Widening polarization

4. Increasing price sensitivity

Price sensitivity is expected to increase further in 2022—especially among lower-income consumers, who will be focusing more on saving money compared with last year (an increase of 12 percentage points). This is strongly driven by the rising inflationary pressure that reduces the income the consumers have available to spend on groceries.



52%

Fact: More than half of low-income consumers (and 42 percent of consumers on average) plan to look for ways to save money while shopping grocery in 2022 (State of Grocery Europe Consumer Survey, November 2021).

5. High-quality entry-price tier

Consumers who shop at entry-price levels are less willing to make trade-offs on the quality of these products. By now, the entry-price tier matches the quality of the main national brands in several markets and categories. This makes differentiating between the entry-price tier and main-price tier increasingly difficult.

To meet these higher expectations, retailers may need to raise the quality of the private label in the entry-price tier or merge it with the main tier.



30%

Fact: Thirty percent of CEOs see increased quality in the entry-price tier and reinvention of private labels as important trends for 2022 (State of Grocery Europe CEO Survey, January 2022).

6. Intensified sustainability and health focus

Consumers are planning to focus even more on a healthy diet in 2022 and to shift their spend to more sustainable products. The trend is primarily driven by high-income groups and younger generations (for example, Gen Z and millennials). Thirty-nine percent of high-income consumers plan to focus more on healthy eating in 2022.

For retailers, this means further widening their assortment of healthy and sustainable products and increasing its visibility.



+15 p.p.

Fact: The sales growth of the ten brands most bought by eco-friendly customers was 15 percentage points higher than market growth (Europanel). See *"Grocers' sustainability opportunity from transforming the food system"* on page 48.

7. Growth in premium

High-income groups are fueling demand for higher-quality, fresher products, whereas low-income groups show a negative net intent for 2022.

Consumers are also shifting to other formats to get the level of freshness they are looking for, as more than 50 percent of consumers already shop at farmers and fresh-food markets or at independent bakeries and delis. We anticipate that those two formats could experience the highest increase in net intent among all formats in 2022.



20%

Fact: Twenty percent of high-income consumers plan to buy more premium products in 2022 (State of Grocery Europe Consumer Survey, November 2021).

Ten key trends

shaping the grocery industry in 2022 and beyond (continued)



New profit pools

8. New revenue streams

With their core business under pressure, many retailers are looking for new profit pools. Retail media networks—in which grocers sell advertising space to consumer-packaged-goods companies using the retailer’s loyalty card data for improved targeting—are among the most promising new revenue sources. Leading US players have built dedicated units to run their retail media network, achieving substantial contributions to their EBIT. The first European grocers have also embarked on this journey, and we expect this to become a must-have element of a grocer’s online business to make it profitable.



Up to 8%

Fact: Up to 8 percent of online sales from leading US players are achieved through retail media networks, with margins of more than 50 percent (McKinsey analysis). See *“Growing beyond groceries: The ecosystem expansion”* on page 82.

9. AA: Personalized and localized

To achieve the next level in personalized promotions, grocers could take a true “customer lifetime value” approach: customers are notified of the right offer at the right time, with the right message and the right discount, through the right channel. The result could be gains of 2 to 3 percent in EBITDA. Furthermore, store-specific assortment could help boost sales by 2 to 4 percent.



23%

Fact: Twenty-three percent of CEOs see the adoption of advanced-analytics applications as a key priority (State of Grocery Europe CEO Survey, January 2022). See *“Pushing granular decisions through analytics”* on page 72.

Talent

10. Shift in the people model

Grocery retailers face two key challenges: high demand for new skills and roles that are difficult to cover because of the shortage of available talent, and high attrition of existing employees. Some companies are reimagining and redesigning roles, with technological and social skills rising in importance—along with a premium on adaptability and the ability to master various tasks—as physical and manual tasks decline in importance.

To navigate the transition to a new people model, companies can anticipate future talent demand and invest accordingly (“strategic workforce planning”), leveraging reskilling and upskilling as key sources of value creation. They can also address attraction and retention by focusing not only on financial incentives but also on employee experience.



39%

Fact: Thirty-nine percent of CEOs cite hiring the right talent as a top trend for 2022 and see an increasing need for reskilling (State of Grocery Europe CEO Survey, January 2022). See *“Crisis or opportunity? How grocers can build stronger people models”* on page 62.





Matthias Wunderlin Chief Commercial Officer, Migros Supermarkets (CH)

*Interview conducted on February 21, 2022,
and amended on March 21, 2022*

Question: How were 2021 and the COVID-19 pandemic for Migros?

Matthias Wunderlin: As with all supermarkets in Europe, our turnover grew substantially. The uptick in Switzerland was probably even a bit larger than in most other countries. Normally, Swiss consumers do a lot of shopping abroad, especially in Germany, France, Austria, and Italy, because of the higher prices in Switzerland. But during the pandemic, the borders with our neighbors were closed for long periods of time, so people did more of their shopping with us. We also saw an increased shift from bigger stores outside the cities to small and medium-size stores in residential areas. Also, many customers intensified their cooking, so we sold a lot of ingredients for making bread or baking cakes.

In January, we saw this COVID-19 effect start to disappear, even before the government lifted all COVID-related restrictions. In-store food sales are back down close to prepandemic levels. We observe the same in our nonfood formats, which are now roughly back to 2019 levels.

Question: Have you also observed a shift to online, and is it lasting?

Matthias Wunderlin: Yes. We had already started to accelerate our investment into e-grocery before the pandemic, but the pandemic helped us to align everybody in the company behind that strategy. Our online sales increased in 2021 by another 25 percent on top of an already strong 2020. We could have grown even more if we'd had the capacity. Every square meter of warehouse space that we added turned into revenue, but regulations in Switzerland make it difficult to build new warehouses. For the time being, we bridge part of the gap with store picking, but that's expensive. Online is a priority for us, and we will keep investing in it after COVID-19. We have clear evidence that e-grocery is here to stay. Unlike in-store sales, online revenue didn't decrease after the restrictions were lifted.

Question: What is your perspective on instant delivery?

Matthias Wunderlin: I don't think it's viable in Switzerland because of the low population density and the high labor cost. It might work in big, densely populated urban areas—in Berlin or New York—but even Zurich is probably not big enough to sustain it. If you charge people what you need to cover the cost, we find that the demand isn't that high. Currently, we are offering free same-day delivery and delivery within 30 minutes for a fee of 5 Swiss francs. We are aware, of course, that a lot of start-ups have much more aggressive propositions, but we don't think their models are economically viable in the long run in Switzerland.

In our experience, what consumers really care about is knowing when their delivery will arrive so they can make plans to be at home. A two-hour window is too long. That's the problem we have to solve for our customers right now. That said, we are monitoring the evolving delivery landscape very closely. Migros is present throughout Switzerland, and if we see that instant delivery is becoming relevant in Switzerland, we will be able to act quickly.

Question: Sustainability is another major global trend. What is your take on it?

Matthias Wunderlin: Sustainability is growing in importance, but we don't just jump on a trend; sustainability is in our DNA, and we have always been very proactive about it. Not only are we reducing our carbon footprint, but we are also empowering buyers and producers to reduce their own. We see it as our job to change consumption habits. One of several important elements in the long term is decreasing the amount of animal products. The challenge is to give consumers attractive alternatives. We focus on two areas: milk alternatives and meat alternatives.

Milk alternatives are already well established. Oat milk, rice milk, almond milk, soy-based yogurt—you name it, we stock it. This isn't a hipster phenomenon anymore. Plant-based milk alternatives have arrived in the mainstream, even in rural areas. Switzerland isn't as advanced as, say, Sweden, where half the dairy section of many supermarkets is already stocked with milk alternatives, but we are getting there. In many stores, we are adding or reallocating alternatives to cooler spaces to satisfy the growing demand. Milk-free cheese isn't as popular as plant-

based milk and yogurt, but it's also growing. And recently, we brought the first vegan boiled egg into the market.

We are also investing significantly in meat alternatives. Meat alternatives are more challenging, but we have to find them because meat, especially beef, is such a big driver of CO₂ emissions. However, despite growing carbon consciousness, consumers like meat, and they won't stop buying it unless we give them good alternatives. You have to get the flavor and sensory qualities right, and you have to keep additives in check.

Question: You say you see it as your job to change consumption habits. That's very strong wording.

Matthias Wunderlin: As I mentioned, sustainability is in our DNA. We have an obligation to society to curb climate change and get to net-zero emissions in the next 30 years, and we find that shoppers share our mission. They are already bringing their own bags for fresh produce, but they realize that's not enough, and they want to do more. Our job is to give them sustainable options. The great thing is that we are in a better position to drive change than many of our competitors because we have such a high share of private labels in our assortment. We also produce a large share of our private labels in our own manufacturing unit. This gives us much greater control over farming and processing than most regular retailers. We work closely with our suppliers to promote sustainable practices all along the value chain, and we are also looking at new players for innovations, especially regarding plant-based substitutes for cheese, meat, and fish.

In our stores, we keep increasing shelf space for plant-based products across categories, and we were one of the first grocers worldwide to introduce comprehensive CO₂ labeling. Online, every product is already labeled with a CO₂ rating, and we're in the process of putting these labels on packages as well. By the end of 2023, all products will have CO₂, animal welfare, and Nutri-Score ratings on the package. We want to make it easy for shoppers to do the right thing. If we don't do it as a retailer, who should do it?

Question: Don't you get pushback from farmers and producers?

Matthias Wunderlin: Not as much as you would think. They're in the same boat as everybody else. Meat consumption has been declining in Switzerland for many years. This isn't something that Migros has invented, and it isn't triggered by the coronavirus, although the pandemic may have accelerated it. It's a long-term trend; farmers understand that they have to adapt to prosper. If we design the transition responsibly, with a clear vision, and give it time, everybody wins. Again, as an integrated player, we work closely with our farmers. For example, we support them in their efforts to shift their focus from producing meat and milk to growing ingredients for milk and meat alternatives, such as oats and peas.

Question: We talked about e-grocery and sustainability. What are some of the other shopping trends that you observe in Switzerland?

Matthias Wunderlin: The assortment in the middle-price range is shrinking, and we are reducing our range in that area. Instead, we work more on developing the upper and the lower end. Price sensitivity remains high, and it now cuts across the entire assortment, partly driven by the fact that discounters have extended their offerings beyond the entry level. They might not be strong in plant-based alternatives yet, but they have quite a big organic offering now, and it's competitively priced.

As another trend, we observe that people want to shop closer to their homes, so we are adding smaller and medium-size stores with smaller assortments in or near residential areas. More broadly, we have a vision of getting people out of our stores as quickly as possible. I know it sounds counterintuitive. Everybody is talking about the in-store experience, and nonfood players will probably roll their eyes when they read this, but we believe that people have better things to do than shopping for groceries. We want to make it as convenient and as quick as possible for them to get the groceries they need. If the layout is good and the assortment is structured well, shoppers will keep coming back. Right now, we are working on a new store concept to further improve on this.

Question: How is inflation as a trend affecting you?

Matthias Wunderlin: Luckily, as of today, inflation isn't as high in Switzerland as it is in other European countries. We also get requests from producers for higher prices. But prices in Switzerland are already high compared to other markets, and we just recently joined a buying alliance. This allows us to keep price inflation lower than the rest of Europe. Still, we are also affected by higher purchase prices and have to adjust consumer prices selectively.





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The next S-curve of growth: Online grocery to 2030

While stores remain the key channel for most grocers, online grew dramatically during the pandemic, with many retailers quickly adjusting their offerings and operations to meet consumer demand. The coming years will present new opportunities. Fueled by evolving customer expectations, increased competition, and technological advancements, online could account for up to 18 to 30 percent of the food-at-home market in some leading European countries.

Online propositions will differentiate and likely mirror today's offline formats—for example, convenience-store visits or top-ups will be covered by instant delivery services, and discount purchases by no-frills offerings. Online shopping will also likely consolidate based on scale efficiencies and winning consumer offers. With online pure players disrupting markets, traditional grocery retailers should now determine which value propositions to focus on, define a scalable operating model, and consider partnerships to complement their historic strengths.

by Virginia Simmons, Julia Spielvogel, Björn Timelin, and Madeleine Tjon Pian Gi



Interview with Melanie Smith
on page 36



Tracking the trajectory of online grocery

One of the major effects of the COVID-19 pandemic has been a boost to online grocery. Consumers migrated rapidly to online channels, whose greater convenience altered consumer behaviors and expectations over time. The shift also reordered the competitive landscape as new players flooded the market, often backed by large investors.

A McKinsey survey of European consumers reveals most respondents plan to use online grocery services almost equally often as in 2021 (a net intent of –1 percent).¹ The results vary significantly by country, however; customers plan to shop more online in advanced online markets such as the United Kingdom (a net intent of +5 percent), the Netherlands (+4 percent), and France (+2 percent). In these countries, online's share of the grocery market stood at 8 to 12 percent in 2021,² and its broader offerings have helped to increase customer satisfaction and adoption.

Our analysis segmented selected European countries into leading countries (the United Kingdom, France, the Netherlands, and Sweden) and those still catching up (Germany, Italy, Spain, and Poland). In leading countries,

online grocery could make up 18 to 30 percent of the food-at-home market³ by 2030 in our aggressive scenario (exhibit). Scheduled delivery (with the promise of same-day service) will still account for the majority of this share, while instant delivery (defined as delivery on demand, typically with a 15- to 30-minute lead time) could reach 3 to 7 percent of the total food-at-home market in leading countries.⁴

Sources of future growth

What are the sources of growth that will determine whether online tracks more closely with the conservative or aggressive scenarios in a given country? We expect that online grocery will continue to extend its reach through 2030, with several factors poised to influence demand.

Evolving customer behavior

Online has extended its reach to new customer segments. Before the pandemic, online grocery had a more concentrated appeal, such as among young, urban, affluent families seeking the convenience of large-basket delivery to their home. Now, offerings have expanded to address more shopping missions (such as top-up shopping) and customer segments (such as younger and elder generations).

¹ Net intent is the share of customers who indicated they want to increase use of online services minus the percentage of customers who said they want to decrease or stop the use of online services. Neutral customers who want to keep purchasing at similar levels are not included.

² Based on Europanel data.

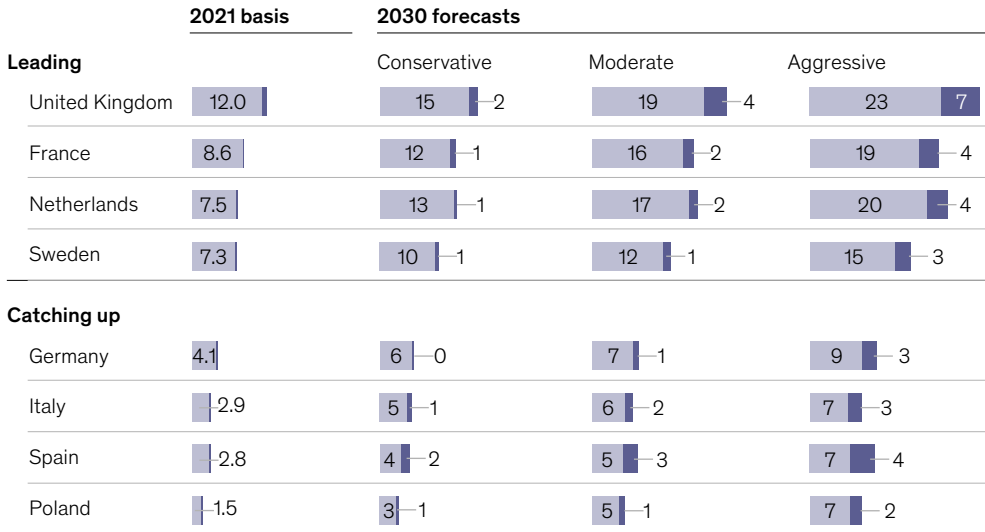
³ The food-at-home market includes the grocery market (fast-moving consumer goods [FMCG], fresh) and the meal delivery market (for example, Deliveroo, Just Eat, and Uber Eats).

⁴ The forecasts use the observed prepandemic development rates as the baseline. For countries still catching up, we assume they will either follow the development path of France and the United Kingdom (moderate) or the Netherlands (aggressive), adjusted for market fundamentals (customer adoption, latent demand, economic viability, and the grocery market's characteristics). For leading countries, the aggressive scenario assumes market share gains from 2021 could partially endure, adjusted for market fundamentals. For scheduled online delivery, the scenarios depend primarily on the level of investment by players and potential new market entries. For instant delivery, our analysis considers the share of population living in densely populated areas, indications that consumers will shift channels, and the current level of investment for this business model.

The United Kingdom, France, and the Netherlands are expected to continue leading in online grocery.

Share of online grocery in the food-at-home market, % by country

Scheduled delivery Instant delivery



Source: McKinsey analysis based on Euromonitor, Europanel, IGD, and own estimates

Click-and-collect models began to see rising demand during the early phases of the COVID-19 pandemic, when delivery slots were limited and customer demand was high. These models also helped grocers reach customer groups beyond urban centers in suburban areas, small cities, and even rural areas. Overall, countries that have been slower to adopt online offerings will see increasing penetration, thanks to the ability of disruptive players to change customers' expectations and behaviors across propositions.

Increased competition and investment

The online market is still in the process of taking shape. Currently, a multitude of propositions are partly overlapping, but the market's future state will likely mirror existing offline propositions and replace or improve on them:

- **Full-basket offerings are akin to supermarkets.** For example, players such as Ocado, Rohlik, and Tesco typically have a very large assortment, same-day service (delivery usually within a few hours), precise delivery windows, and competitive pricing on core basket-building items. Extensions to the current offering include farm-to-table concepts (such as Crisp and Frischepost) or meal kit options.
- **Instant delivery is online's convenience store and small supermarket.** Players such as Flink, Getir, and Gorillas cater to customers who order small baskets from a more concentrated assortment. The competitive battleground is focused on speed and user experience, primarily for immediate and unplanned needs.

Instant players are also increasingly adding different categories, including (warm) meals to increase their “share of stomach” and take-out options from the restaurant market or meal delivery providers.

- **No-frills offerings are the discounters of online.** Companies such as Picnic offer low-minimum-order values and no delivery fees while emphasizing value for money in product pricing, but their customers must often accept trade-offs in assortment depth, delivery options, and additional services.

The growth of the online market has attracted a record level of investment. Venture capital (VC) funds and consumer-packaged-goods (CPG) companies seeking to develop their own direct-to-consumer offering have joined the fray. Players that can secure funding for future growth will likely lead the disruption. However, other factors could shape the market's development, including new regulations (for example, the current freeze on new dark stores in Amsterdam) that could make online grocery less attractive to investors.

Technology

Technology is in the process of disrupting several parts of the online value chain, from user experience to order preparation to the last mile. With technological advancements, business models and operations that are unprofitable today could become more sustainable in the future. For example, advanced personalization could further increase order size for large-basket delivery, and automation has the potential to transform the cost model for order preparation and last mile.

In the longer term, technological advancements could make online grocery less costly to operate than physical grocery—enabling grocers to offer lower prices online than in stores. If that were to happen, physical retail would lose a significant part of its advantage, and we could see new consumer segments—such as value seekers—shifting online and creating a boom for the online grocery market.

Implications for traditional retailers and their physical network

Incumbent retailers that are not currently playing in online might be at risk of losing market share, especially in urban areas. For example, in the aggressive market forecast for the United Kingdom, online scheduled grocery would be the largest channel in the country by 2030, overtaking supermarkets. Executives should consider several actions.

View online as a future driver of growth

Grocers should define strategies that determine where they want to play and choose enabling investments in areas such as fulfillment, last mile, technology, and talent. This includes devising the most suitable approach, which could combine new capabilities and ways of working (for example, data-driven decision making and agile product development) with historic strengths (such as sourcing or a dense store network). When determining a new strategy, grocers' decisions could include whether to build their own end-to-end offerings or partner with third parties to address specific parts of the value chain.

Assess the impact of online on physical stores

Online growth will have significant implications for stores, so offline incumbents with existing store networks also need to rethink their omnichannel strategies. While offline might remain a grocer's largest channel, the role of the store will need to change beyond adding a click-and-collect offering—for example, by creating a distinctive experience that brings customers to physical locations. Overall, grocery stores might need less physical space and might need to reduce costs as offline formats lose sales volumes. The store network can also be a source of differentiation against pure players as incumbents manage their omnichannel offerings.

Chart a path to profitability

Profitability has traditionally proved elusive in online, but some companies have cracked the code. Big-basket delivery players such as nemlig.com, Ocado, Rohlik, and Tesco have achieved break-even or marginal profitability in selected geographic areas. Scale and excellence in all business areas are prerequisites, so players must be prepared to undertake targeted transformations to turn around unprofitable businesses. While online pure players have advantages—they are more flexible, agile, and not bound to parity with the offline offering—incumbent players can benefit from scale and existing brand and infrastructure, among other attributes.



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Achieving profitability in the online business while continuing to grow will require management to focus on the following set of levers⁵:

- **Retention efforts.** Build personal relationships with the customer by reestablishing a social connection and achieving daily engagement.
- **Optimized category management.** Create assortment choices that allow for sourcing optimization and decoupled pricing and promotions from the offline business for omnichannel players, allowing more frequent changes and optimization.
- **Enhanced user experience during shopping.** For example, use personalization to increase convenience and support cross-selling and upselling to build the basket.
- **Media monetization.** Generate a new income stream in an advanced ecosystem play.
- **Automation of order preparation.** Reduce costs and increase order quality

through microfulfillment and other solutions.

- **New last-mile models.** Use models such as autonomous vehicles and technology-enabled logistics optimization to lower costs while offering excellent service levels.
- **An agile operating model.** Allow for fast product development and constant testing of improvements in the customer proposition and user experience.
- **Partnerships.** Create partnerships in many business areas, from assortment and range extension to automation and last mile, to manage costs and capabilities. Access to customer data and exclusivity will largely determine the attractiveness of a partnership for different players.

Despite the rapid growth of online grocery and the sector's increased number of players, European markets are still in the early stages of development. Retailers that take decisive action and make strategic investments today will be well positioned to carve out a winning and sustainable market position in the future.

⁵ For more on profit parity between offline and online channels, see Julia Spielvogel and Madeleine Tjon Pian Gi, "The e-grocery challenge: Moving toward profitable growth," *Disruption & uncertainty: The state of grocery retail 2021*, March 2021.



Melanie Smith

CEO, Ocado Retail (UK)

Interview conducted on February 2, 2022

Question: How will market conditions for grocery retail evolve in 2022, in your view, and what does that mean for Ocado?

Melanie Smith: We expect the shift to online to be sustained. In the UK, where there's been a drop-off in online sales, it's not because there's been a drop-off in demand—it's because the retailers have reduced capacity. During the pandemic, a lot of brick-and-mortar players ramped up store-pick offerings, where shoppers order online and a picker goes to a regular store to fulfill the order. Now, these players are backing off. We can tell from our data that several multichannel players have scaled back their store-pick offering, and a lot of that, in my view, is because the store-pick model isn't economical when you consider including the fully loaded store and labor costs. The other thing is—you order something on a website or through an app, but the app doesn't know what's available in the store, so when the pickers go into the store, they might not find what you ordered. As a consequence, a lot of shoppers are disappointed. But they still like the idea of getting groceries without having to go into a store, and many of them turn to Ocado.

What's different about us is we don't pick from stores. Our model relies on what we call CFCs [customer fulfillment centers], our superior fulfillment is the reason we tend to win. Our order accuracy was about 98 percent during COVID-19, and we're at about 99 percent today, so you basically get what you order. Right now, we have a share of about 1.8 percent of the overall UK grocery market, which is tiny. But we've grown faster than any other grocery retailer in the UK over the past two years because our proposition is so much better than everybody else's, and that's a big reason why I believe we can get to 5 percent share in the next few years. We have big ambitions, and with the best proposition, there is no reason why we should not aspire to become the number one grocer in the UK over time.

Question: What are some of the other changes you observe, now that the peak of the pandemic seems to be behind us?

Melanie Smith: In 2021, demand was spread out across the day and the week. Everybody was at home every hour of every day, and they were happy to get their deliveries in the afternoons and even late at night. Now that people are starting to go out again, they want their deliveries in the morning. Last year, we also often had peaks on weekends. That is over. People are happy to get their groceries in the morning on Saturdays and Sundays, but in the afternoons, they're out doing other things. At the same time, basket sizes are declining, although they are still bigger than pre-COVID-19 levels. Behaviors are starting to normalize to some extent, but we're confident the shift to online is here to stay.

Question: Looking ahead, what do you think will be the most important trends shaping the grocery retail industry in the coming one to three years?

Melanie Smith: This year, I think we're going to see a lot of competitive behavior around price. Some competitors are taking on discounters—or at least they claim they are, although our data show they are not always as affordable as they claim to be, at least not across the entire assortment. We monitor competitor sites daily, so we know where market pricing is and ensure we are competitive and delivering fair value.

More generally, I think consumers are really going to struggle this year, particularly in the UK, when the retail energy price cap comes off and price inflation continues. And although their budgets will be constrained, consumers want health and sustainability. We can win in that space because we have more organic and vegan options than our competitors. The fact that we have a range of more than 50,000 products gives us a lot of flexibility. Our online-only approach means we're taking cars off the road. Instead of our customers traveling to a brick-and-mortar supermarket, our delivery drivers bring groceries to doorsteps across the nation. And our routes are optimized, bundling together deliveries to the same areas and reducing mileage where possible. The products go from the supplier to our fulfillment center and from the fulfillment center to the customer's home. In addition, our food waste is the lowest in the industry and up to ten times lower than what some traditional retailers are throwing out. And what little waste we have, we give to food banks to make sure it's eaten. Let's say fresh milk comes in with ten days of shelf life. Once it's down to five days, we give it to a food bank.

Question: What are your thoughts on instant delivery?

Melanie Smith: It all comes down to basket size and delivery promise. If you have a big enough basket with good gross margins, you can cover the cost of the last mile. With a small basket and a 15-minute delivery promise, there's just no path to profit. Some of the instant players have very limited assortments, so it's difficult for their customers to get to a big basket even if they want to. I think there's going to be a lot of consolidation among the immediacy players. At Ocado Zoom, our express offering, we have an assortment of 10,000 products, and our

promise is to deliver ASAP or later the same day, although we normally deliver in half an hour. Our economics are unbeatable, and we have the highest customer satisfaction—measured by NPS [net promoter score]—in the UK. If we have one barrier to consideration, it's probably that consumers think we're more expensive than we actually are, so one of our priorities for 2022 is to draw more attention to the good value we are providing.

Question: How do you see the competitive landscape in online grocery evolving in the near future?

Melanie Smith: People talk about lots of things that I think are probably not going to happen. Everybody tells me that Amazon is going to take over fresh. I don't see that. They are very good at delivering a package that doesn't need to be cold and that can arrive at any time in a 24-hour window. They're not as good at delivering 40 items in three temperature regimes in a one-hour window. If they optimized their business to do this, of course they could pull it off, but right now, I just don't think that's where they are.

Another trend that people talk about is delivering hot food along with other groceries. I love that idea. I'm from New Zealand, and I love roast chicken. Walk into any supermarket in New Zealand or Australia, pick up a hot chicken and a fresh loaf of bread, and you're set for dinner. I'd love to be able to pull that off at Ocado, but operationally, it's a real challenge. How do you deliver a mixed order without the hot food getting cold or the cold food getting hot? We're good at solving problems, though—so never say never.

Question: We see lots of partnerships happening not only in the UK but also around the world. What is Ocado's strategy for partnerships?

Melanie Smith: At Ocado Retail, we have a unique ownership structure because we're jointly owned by Ocado Group and Marks and Spencer [M&S]. We buy all our technology from Ocado Group, and Marks and Spencer is our most important sourcing partner, which our customers love, with M&S products accounting for roughly 30 percent of an average customer basket. In terms of other partners, we have great deals with Daylesford Organic and Natoora, and we're in the process of bringing in more specialized suppliers. Generally, we look for partners who can contribute unique products to our range while also providing great value to our customers. We want items in shoppers' baskets that they can't get anywhere else and that will keep them coming back to shop with us. And again, we can do that because we've got a bigger range than almost everybody else. It's a very interesting role to be in.

Question: What are your thoughts on data as a driver of value creation?

Melanie Smith: When I took over as CEO, Ocado already had the best data in the world, but we were not yet fully exploiting the asset. In the past two years, we have built an entire data business at Ocado, and we now have more clients than the longtime market leader for shopper data. Our data is entirely pure because it's 100 percent online and logged in. Every other grocer's data is split across different channels and payment methods. We know so much about

our customers—not just what they buy but also what they put in their baskets and take out later, or what they put in three minutes before they finalize their order. We're also ramping up our capabilities to develop new propositions for advertisers, such as real-time bidding for search terms. Retail media is already an important source of revenue for us, but I think it has the potential to create even more value for shoppers, for suppliers, and for Ocado.

Question: What are some key learnings from Ocado's online grocery journey?

Melanie Smith: One of the biggest lessons is how different an online-only grocer is from a brick-and-mortar grocer. I talk to a lot of veteran grocers. They know how to run stores, and then they try to figure out how to run an online business by tweaking what they do in the stores. It doesn't always work. With online, everything is different. In a store, you change your promotions once a week or once every two weeks. We don't do that. We have different cycles for different types of products. For example, people typically buy washing detergent only once every six weeks, so we only need a six-week promo cycle for that. On the other hand, if we're having a slow week, we can do a meal deal for the next day, and we can turn that on in five seconds.

A big transition has, of course, been shifting from the Waitrose partnership to establishing the joint venture between Ocado Group and M&S. Not only did this mean completely replacing the Waitrose range with M&S overnight—which was a huge and unparalleled achievement on its own—but it also meant completely rethinking how we approach things and getting more control over our range and buying. Unsurprisingly, the key thing is always being customer focused.

We also have the ability to range our assortment much more than a traditional store, so we can experiment with new products and quickly test what works and what doesn't. Rather than having to trial a product in 200 stores, we can range it in six CFCs [customer fulfillment centers] and know within a few days if customers like it. We can also figure out which products are in our most loyal customers' baskets and make sure we are the go-to grocer where customers can buy things they can't get elsewhere.

As we have scaled Ocado Retail, we continue to improve our economics. We have always had the best pick and delivery economics in the industry. Now that we have scaled, we have built our own buying capability, which has enabled us to lower our prices and still improve our gross margin. We also invested in strengthening our brand, leveraging the scale we now have, to try new marketing approaches based on a rigorous understanding of our target audiences. Ocado Retail is the largest online-only supermarket in the world, and we still have significant opportunities ahead. An example is continually driving more personalization for customers; we have all these levers that you can pull if you're online. The pace of innovation and the scale of the opportunity are what makes it so exciting. I honestly think I have the best job in UK grocery.



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Instant grocery: Will it stay or will it go?

Consumers embraced instant delivery during the pandemic because of its convenience, making it one of the fastest-growing segments in grocery. Although it still has a small share of the market, retailers must now determine whether and how they want to capture market share in instant delivery and how they want to further differentiate their other e-commerce propositions. The market is likely to continue to grow and evolve at a quick pace, requiring an agile response and an evolved business model from both incumbent retailers and (instant) delivery players.

by Virginia Simmons, Julia Spielvogel, Björn Timelin, and Madeleine Tjon Pian Gi



Interview with Kağan Sümer
on page 44



Instant grocers, often backed heavily by venture capital, private equity, and technology investors, have rapidly disrupted the EU online-grocery landscape. In the first nine months of 2021, nearly \$5.8 billion was invested globally in “dark convenience stores.”¹ The instant-grocery boom raises numerous questions: How big will instant be, and how will it evolve? Will customers continue to use it? How will retailers respond? And will there be a road to profitability for the business model?

Consumer needs are trending toward ultraconvenience

Instant grocers offer immediate delivery (typically within 30 minutes), often delivered by drivers on electric bikes or scooters

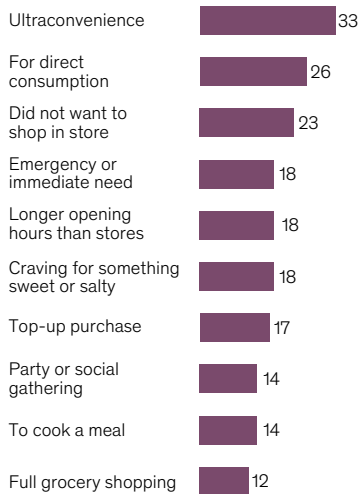
and fulfilled from urban dark stores or microfulfillment centers. In our European-consumer survey,² 33 percent of instant-grocery customers in France, Germany, the Netherlands, and the United Kingdom indicated they value this service because it offers ultraconvenience (Exhibit 1). They perceive instant delivery to be faster than shopping at a store, and they see it as a solution for their direct-consumption needs and cravings when they are unable to leave the house, typically from the hours of 4 to 10 p.m. Our analysis also found that respondents’ instant-grocery shopping replaced purchases in other channels; just 9 percent of respondents indicated their purchase was additional (for example, for extra snacking, a special celebration, or a seasonal event).

Exhibit 1

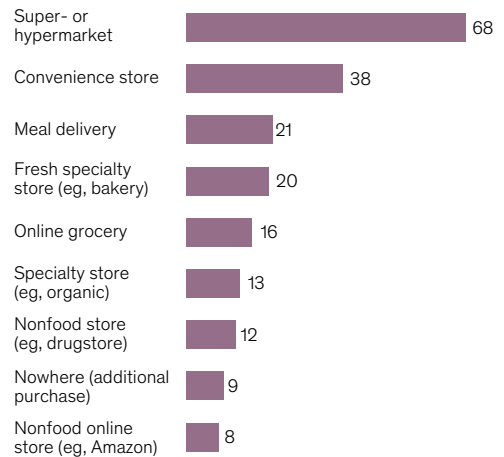
Ultraconvenience and direct consumption are the leading reasons for using instant delivery in several countries.

Responses to instant-delivery questions from consumers in France, Germany, the Netherlands, and the United Kingdom, % of total responses¹ (n = 2,900)

Why did you use instant delivery for your groceries?



Where did you purchase the items before instant commerce was offered?



¹ Multiple answers per respondent possible.
Source: McKinsey Instant Grocery Consumer Survey 2022, January 7–19, 2022

¹ Lizette Chapman, “When Same-day delivery is too slow,” *Bloomberg*, December 2, 2021.

² Instant Grocery Consumer Survey, McKinsey, January 7–19, 2022.

Consumers prioritize the following criteria when choosing an instant grocer: an intuitive shopping and user experience (32 percent); the fastest delivery (30 percent); reliable, high-quality delivery (29 percent); availability of products (27 percent); and a relevant assortment of products (26 percent).

A critical question is whether consumer demand for instant delivery will endure after the pandemic abates. In contrast to scheduled e-commerce shopping, respondents in our instant-grocery survey indicate a positive net intent³ of four percentage points. In all, more than three-quarters expressed an intent to maintain or increase their current use of instant delivery (Exhibit 2).

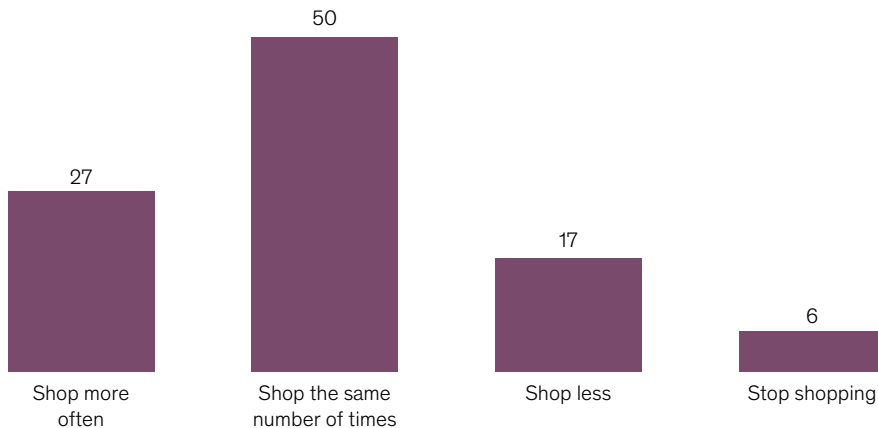
Competitive responses reflect growth and consolidation

Several instant players—such as Flink and Gorillas—have grown rapidly, adding a combined total of about 350 locations through the end of 2021. Some players are reporting revenues of approximately €500 million and claim they have achieved profitability in certain urban hubs. Most customers (47 percent) have used just one instant provider to date. But a significant group of customers (42 percent) use two or three providers, switching between providers for rational and opportunistic reasons.

Exhibit 2

More than 75 percent of respondents plan to continue or extend doing instant grocery.

How respondents in France, Germany, the Netherlands, and the United Kingdom plan to shop with instant players, % (n = 2,900)



Source: McKinsey Instant Grocery Consumer Survey, January 7–19, 2022

³ Net intent is the share of customers that indicated they want to increase use of instant-grocery services minus the percent of customers that indicated that they want to decrease or stop the use of instant-grocery services. Neutral customers that want to keep purchasing at similar levels are taken out.

Incumbent grocers have responded with instant propositions (for example, Ocado Zoom, Sainsbury's Chop Chop), partnerships, or even "VC-like" investments in instant players (for example, Carrefour and Cajoo, and Rewe and Flink). Meal delivery platforms such as Deliveroo and Uber Eats have added groceries onto their platforms and sometimes also offer white-label partnerships to incumbent grocers.

We also see that the instant-delivery industry is consolidating faster than the meal delivery industry did initially. DoorDash acquired Wolt and Gopuff bought Dija in an attempt to internationalize their footprint, while instant players such as Gorillas have purchased local heroes (for example, Frichti). Furthermore, meal delivery platforms have made strategic acquisitions, such as Delivery Hero's purchase of a majority stake in Glovo. This could reflect increasing scrutiny on the next rounds of investment.

Sustainability of the business model and economics

Instant delivery's business model is still evolving. Most instant players are improving their basket economics by improving their average order value with attractive assortment additions (for example, including over-the-counter health and beauty products, specialty food and alcohol, seasonal products, and select nonfood items) and by optimizing fees, pricing, and personalized offers. We also see attempts to improve fulfillment costs and the cost of goods sold (COGS), often through direct sourcing from manufacturers and retailer sourcing collaborations or through an increased share of private-label goods. Additional opportunities include extending

Given the track record of growth and attraction of funding levels of instant players, more innovation is likely on the way.

assortments with relevant goods, adopting technology, and evolving the business model toward profitability. For example, companies could differentiate the proposition of a given location to make it suitable for different demand density, move toward a platform or marketplace model, or develop an advertising or data monetization platform. However, this would happen in an environment with many uncertainties on future financing, with technology and regulation requiring players to anticipate changes and stay agile.

Consumers indicate some of their instant-delivery needs are still unmet (such as meal delivery, pharmacy product options, local food shops, and pickup services). If providers succeed in addressing these additional convenience needs, they could further improve their share of the market and attraction to consumers. Given the track record of growth and attraction of funding levels of instant players, more innovation is likely on the way.



Kağan Sümer CEO, Gorillas

Interview conducted on February 9, 2022

Question: How do you view the trajectory and growth potential for instant grocery delivery?

Kağan Sümer: Every crisis spurs disruption and innovation. In the short term, the COVID-19 pandemic has accelerated instant grocery's penetration. The question is, what will happen next?

Before the pandemic, people were slow to adopt online for two reasons: they wanted to touch the products before buying them, and they hated the long wait times for delivery. As we return to some sort of normalcy, I expect a transition from scheduled delivery to Q-commerce [quick commerce]. People will still want the convenience of online, but because they are no longer confined to their homes, they will want a model that offers a tactile experience and delivers immediately. This is Q-commerce, and it is exactly what we are doing at Gorillas.

Instant delivery is transforming the grocery industry. Our value proposition is perfect convenience—whatever you need, delivered immediately. This is a natural evolution of grocery, and I fundamentally believe this is the model of the future. If you draw an S-curve, Q-commerce is moving faster than any other industry.

Question: How do you expect the business model and competitive landscape to evolve?

Kağan Sümer: We envision this evolution taking place in three successive phases, each requiring a different focus for our business model. The first phase revolves around building a core platform that can deliver what the customer wants. Our current business model is focused

on achieving operational excellence and efficiencies across our logistics platform and supply chain. This will be critical to gaining market share and access to limited capital.

Today's capital markets, the recent supply chain crisis, labor shortages, and growing inflation are placing a huge amount of pressure on capital-intensive industries and technology companies. Therefore, I think in the second phase, over the next two to three years, we will have a race for capital in the Q-commerce industry, as investors become more selective and concentrate their funding into a smaller number of companies. The winners will be the ones that will achieve greater scale and drive better top-line and bottom-line performance—and therefore a better ROIC [return on invested capital]. These players will likely fuel market consolidation.

In the third phase, I expect more business model evolution in the industry, based on unique consumer data, installed platforms, logistics networks, and ecosystems.

Question: What is your vision for Gorillas?

Kağan Sümer: We will aim to reach 100 percent penetration, democratizing instant delivery, like Nike did with sports and Apple with iPhones. We believe that we could help our customers to consume fresh, healthy food; be the best version of themselves; and make their lives easier because they will no longer have to worry about their day-to-day shopping needs.

In the longer term, Gorillas's business model will evolve. After establishing our platform and increasing our share of the market, we will likely develop our own unique assortment and brands with purpose—either by developing private-label products or by partnering with retailers or brands. Once we have the platform and the products, we will leverage our unique consumption data and enrich it with other data sources to provide the best personalized offers and service to customers. For example, connected monitoring devices like sleep rings and smart watches can help us predict what you need, and those products can be automatically ordered and immediately delivered to your door. At this point, we will have the infrastructure to create a society that “needs nothing.”

Question: What are the “unlocks” for your company to achieve this vision for the future?

Kağan Sümer: First, we need access to capital, which I spoke about earlier. We also need to continue developing the technology, which will improve our bottom line. Our technology serves us for now, but we have only scratched the surface. Today, we are a tech-enabled retailer—a company that uses technology to support its processes. We are in the process of transitioning into a tech company—a company that creates value for its ecosystem and stakeholders through the solutions it builds.

Question: How have you expanded your customer base and increased penetration?

Kağan Sümer: We have created a movement and momentum around our brand. It's quite viral. Our enthusiastic customer base is not only the foundation for our top-line growth but is also, and more important, a community for change. We've found that our model has a universal appeal reflected in the breadth of our customer base. As an example, I recently delivered groceries to a hipster and a clergyman, both in one day.

When it comes to increasing penetration, we split the market into three segments. Our brand was embraced by the top 1 percent, the trendsetters—a community of very early adopters who don't really care about price but want to be associated with the promise and ultraconvenience of the brand. Then there is the next 9 percent consisting of rapid followers; they want to follow the trendsetting 1 percent and change the industry. They are only a little more price sensitive. They care about the environment, the planet, and their own consumption. When we look at the data, we see that we have successfully captured these two groups.

Now we are at an inflection point. The last 90 percent of customers are more practical; they want lower prices and the right product selection. If we completely adapt our proposition to this 90 percent, the early adopters may decide that it's no longer exclusive enough for them. We therefore need to find a way to reach this large segment now, and we will consider these types of trade-offs as we grow.

Question: How do you approach the increased regulation of the industry—for example, limits on the presence of dark stores in city centers or protections for flexible workers?

Kağan Sümer: We are 100 percent compliant with regulations. At the end of the day, regulations exist to protect the people our model serves: neighbors, customers, suppliers, and employees. In the short term, of course, our model will attract some regulatory attention. It has a huge potential impact on our everyday lives, and it should be pressure-tested by regulators and authorities. This is a good thing for the industry, and I believe it will promote a people-first approach for Q-commerce companies.

Question: What do you believe gives you a competitive advantage over more established retailers?

Kağan Sümer: We know we cannot match the purchasing power that traditional retailers have built up over the course of 60 years. However, the data-driven insights we generate through our platform are extremely valuable to CPG [consumer-packaged-goods] companies, and we can help both global brands and local suppliers gain visibility into customer trends and behaviors. At the same time, our scale opens the door to new revenue streams, such as retail media networks, that are extremely valuable and could therefore enable us to pursue innovative retail partnerships.

We are in a prime position to create new brands and even shape future product assortments. Just look at oat milk as an example of an amazing go-to-market strategy that exploded into a new category. The future of assortment is not yet defined, and we have the right people on our platform—the 10 percent who are trendsetters and rapid followers—to become the initial advocates of these products. In other words, we have the brand equity, the distribution channel, and the scale to accelerate brands and shape demand.

Question: What have you learned from the journey so far?

Kağan Sümer: In many ways, I built this company in a way that resembles my leadership style—bold, edgy, and authentic. But the next phase of Gorillas is about creating a sustainable business model. I realized that I needed to change myself to change the company, so I've been working with a coach and corporate psychologist to adapt myself to what the company needs for the next phase. We are reexamining every pillar of our operating model—strategy, process, structure, talent, and technology—and are working to build an organization that will stand the test of time.

On a personal level, this journey has been a humbling experience. It taught me that I cannot do everything on my own. I have never been afraid of failure; this mindset has been incredibly helpful as an entrepreneur to keep learning and experimenting, but it often made me feel like I could do anything. My biggest learning was that I need an ecosystem to set myself and the company up for success. You are only as big as your ecosystem and your relationships.



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Grocers' sustainability opportunity in transforming the food system

Consumers, investors, regulators, and nongovernmental organizations are pressuring companies in the food system to make tangible steps toward sustainability. Grocers need to develop strategic sustainability transition plans focused on value creation and think more broadly about the role they can play in encouraging change across the full value chain. We're at a moment of truth that requires leadership from CEOs and a transformational focus throughout organizations.

by Sebastian Gatzer, Nikola Jakic, Bartosz Jesse, Bill Mutell, and Daniel Roos



Interview with Marina Caprotti
on page 58



Increasingly severe global weather events and the urgent tone of the 2021 UN Climate Change Conference (COP26) have made it crystal clear: now is the time to truly prioritize sustainability. And while climate may be top of mind, it can no longer be separated from other concerns about how we live and make supporting economies more sustainable. To address these problems, it is crucial to consider the food system, which accounts for 34 percent of global greenhouse-gas (GHG) emissions.

It's not simple to reform a system that more than 500 million farmers, workers, and employees around the world depend on, and that plays a critical role in people's health. Yet pressure from stakeholders has never been stronger: consumers are demanding sustainable products and services, investors are shifting to sustainable investments, regulators are implementing new and tighter sustainability regulations, and pressure from nongovernmental organizations (NGOs) is increasing.

We believe grocers are in a unique position to be a driving force in this much-needed sustainability transformation. They're ubiquitous—even the smallest town has a grocer. They're integral to local and national economies, often being the largest private employer in an area. They have the power to both influence consumer choices and collaborate with farmers, suppliers, and even—under particular circumstances—other grocers. Finally, they can benefit from the transition, because sustainability can go hand in hand with value creation. In fact, our analyses show that while sustainability presents potential risks, it also offers opportunities for grocers' top lines, margins, and costs—adding up to around 30 to 35 percent of EBITDA until 2030 for a typical European grocer.

Making sustainability a strategic imperative

Many food retailers have already kick-started their sustainability efforts with portfolios of initiatives that typically span

decarbonization, packaging, assortment, and social sustainability. A recent survey of sustainability leaders from European and North American grocers suggests two-thirds of grocers have quantified their starting point (baseline) and defined concrete actions to address sustainability topics, and 50 percent have defined concrete targets. Yet only half the respondents were confident they could achieve their sustainability targets.

The problem? Grocers associate sustainability with significant costs and have not solved the challenge of creating value through "commercialization" of green activities, which has slowed progress. They are simultaneously juggling other critical strategic transitions, such as digitalization. And it is difficult to set up much-needed upstream collaboration with farmers and suppliers.

We believe grocers need to make sustainability an integral part of their businesses with a strategic perspective based on value creation and tailored to their circumstances. We have identified three areas of focus that will help grocers succeed:

1. the five key sustainability themes for holistic impact
2. levers grocers can use to capture efficiency, growth, and margin improvement opportunities while managing potential downsides
3. an operating model enabling grocers to successfully manage the sustainability transformation

1. Focusing on the five sustainability topics that matter

While looking at the food system's sustainability from an environmental, social, and governance (ESG) perspective is a good start, grocers can go further. We sought to create a framework for grocers to provide insights about the most important dimensions. Our research into stakeholder requirements and external costs of the food system suggests

grocers focus on five explicit dimensions: health, the environment, the economy, animal welfare, and livelihoods (HE²AL). Within this

framework, we further identified 15 topics that should matter most to grocers (Exhibit 1).

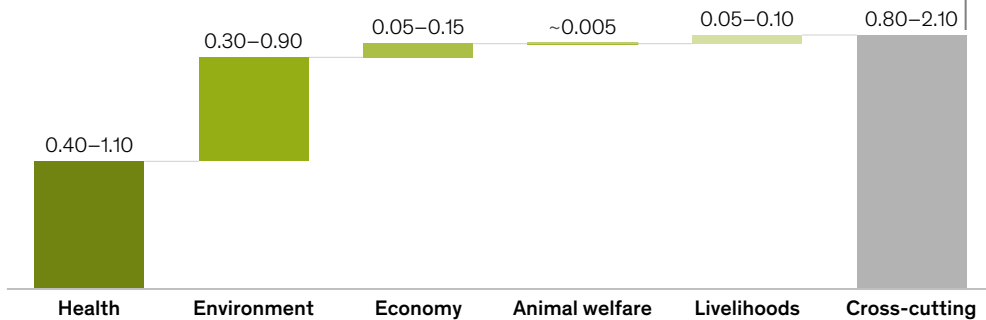
Retailers should focus on all HE²AL dimensions and look at the full value chain to maximize

Exhibit 1

Grocers can help mitigate the external costs to society from food through 15 sustainability levers.

Cost to society per € spent on food, €

For every Euro spent on food, there is an estimated €0.80–€2.10 in external costs



Sustainability levers for retailers



Health

- 1 Enable healthy lives through healthier assortment (incl private labels)
- 2 Ensure food safety



Economy

- 8 Secure food access and affordability
- 9 Increase supply chain resilience



Livelihoods

- 11 Protect human rights
- 12 Ensure fair pay



Environment

- 3 Decarbonize own operations and value chain
- 4 Achieve plastic waste and packaging circularity
- 5 Eliminate or reduce food waste
- 6 Reduce biodiversity impact, incl deforestation
- 7 Increase resource efficiency (eg, water)



Animal welfare

- 10 Strengthen animal welfare



Cross-cutting

- 13 Create product transparency and traceability
- 14 Champion standards, certifications, and sustainable policies
- 15 Market sustainability activities

Source: Food and Land Use Coalition; Perotti; Rockefeller Foundation; Sustainable Food Trust

value creation and sustainability impact. Looking at the full value chain is important because many value-creation opportunities and much of the sustainability impact come from interactions with suppliers and customers.

Let's take decarbonization as an example. While the food system accounts for more than a third of global GHG emissions, only about 4 percent of grocers' direct contribution is from grocers' own operations (Scope 1 emissions) and from purchased electricity and heat (Scope 2 emissions). Most emissions are generated along the value chain (Scope 3), with about 80 percent stemming from land use (32 percent), agricultural production (39 percent),

food processing (4 percent), and packaging (6 percent) (Exhibit 2).

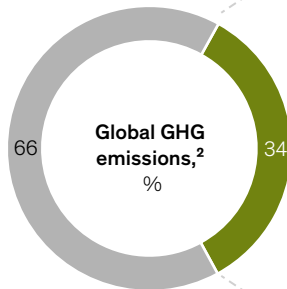
This means grocers need to focus on two elements. First and foremost, they should work on their own footprints and optimize their own operations. This can be a significant—and expensive—investment of time and resources, requiring anything from making thousands of stores energy efficient to sourcing green energy and reshaping cooling technologies and logistics. But it holds the potential for grocers to both make a sizable contribution to sustainability and create value. With exceptionally high energy prices due to the invasion of Ukraine, this is becoming an even higher priority.

Exhibit 2

Food systems account for more than a third of global greenhouse-gas emissions.

The global food system is a key contributor to global greenhouse-gas (GHG) emissions, accounting for 34% of emissions.

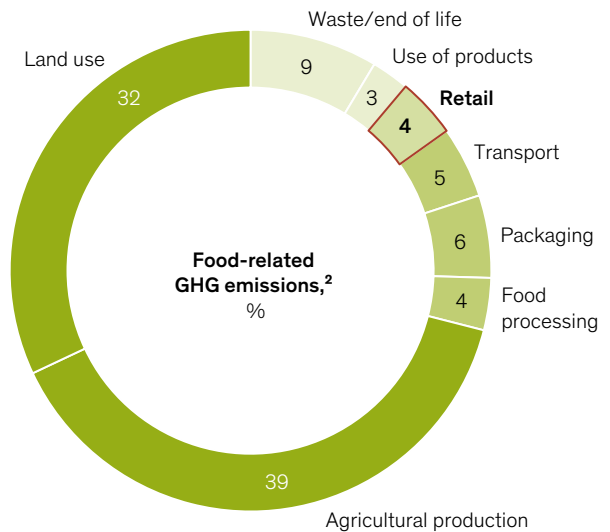
■ Nonfood ■ Food



While grocers directly contribute only 4% of food-related GHG emissions, they are uniquely positioned to influence and support the decarbonization of suppliers and farmers upstream and enable sustainable consumption choices of consumers downstream.

Stakeholder with direct influence

■ Consumer ■ Grocer ■ CPG¹ ■ Farmer



Note: Global top-down perspective; figures may not sum to 100%, because of rounding.

¹ Consumer packaged goods.

² CO₂ equivalent.

Source: Crippa et al., "Food systems are responsible for a third of global anthropogenic GHG emissions," Nature Food, March 8, 2021, Volume 2

Second, grocers should take a holistic view of GHG emissions created along the entire value chain, reviewing how their assortment, sourcing choices, and policies contribute to them. Reducing Scope 3 emissions while creating value can include actions such as introducing transparency requirements for all products, changing product assortment (for example, introducing lower-emissions alternatives), adjusting specifications, supporting farmers who want to develop emissions-reducing agricultural production, or improving supply chain financing based on the GHG footprint of the supplier. Tackling Scope 3 emissions can be quite complex, because grocers need to collaborate with their partners in the value chain. However, given the large share of total emissions and grocers' central position in the value chain, this step is required to decarbonize the food system.

Along the five HE²AL dimensions, grocers should identify opportunities to fundamentally—and credibly—differentiate themselves and create competitive advantages, allowing them to maximize sustainability impact and value creation. This does not imply grocers need to be sustainability leaders across all 15 topics, but they should make conscious choices about where they want to lead, where they want to benefit from resource productivity gains, and where they just want to comply with regulations. The following five factors can help grocers prioritize their efforts:

- the company's starting point (baseline)
- the position of competitors
- stakeholder expectations, especially those of (future) consumers and regulators
- the company's "appetite to do good," reflecting its purpose
- the overall resulting potential for value creation, including upsides and downsides

These opportunities then need to be translated into concrete targets that can be communicated internally and externally.

2. Creating value from the sustainability transformation

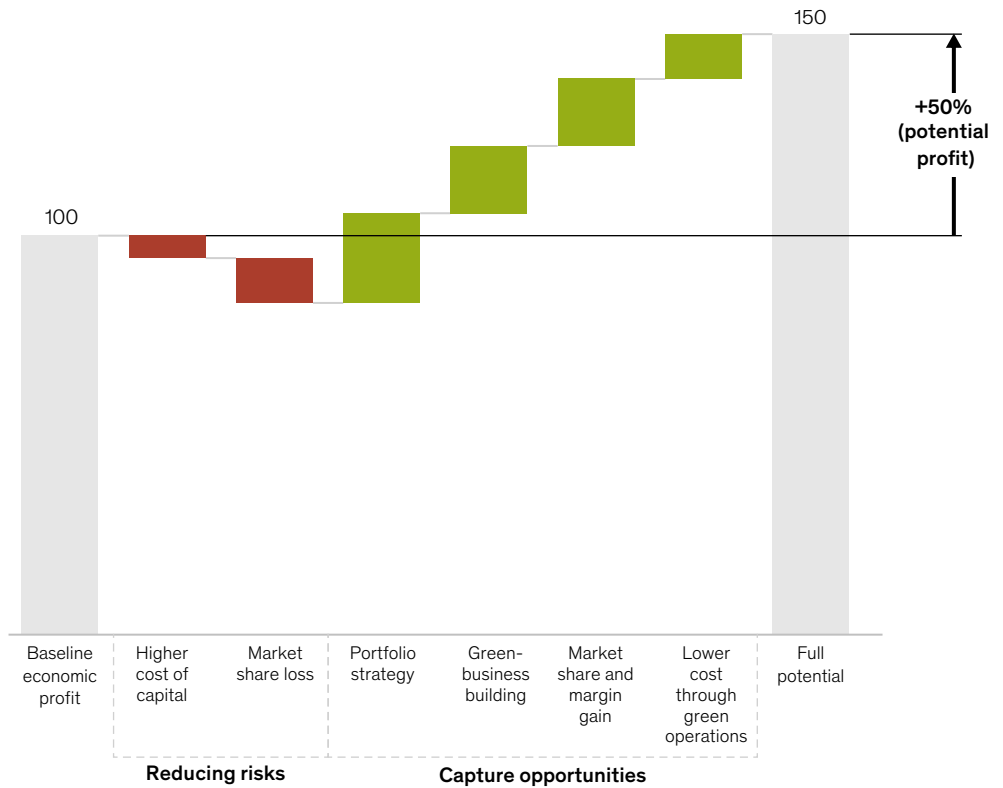
Grocers can generate significant value from a well-positioned sustainability transformation. The value generated can come from six types of value-creation levers, which can be further grouped into reducing downside risks and capturing the opportunities sustainability offers (Exhibit 3).

Reducing risks

A strong sustainability strategy reduces several downside risks companies might otherwise face, meaning it can provide an important source of value. Companies with a low ESG rating will face increasingly higher costs of capital as capital is moved to sustainable companies. By improving their ESG ratings, grocers can ensure access to capital at better rates. Several NGOs are also lobbying regulators to extend the carbon tax to food, increasing the cost of these products. By proactively working across the supply chain to reduce GHG emissions, grocers can avoid these additional costs. In addition, as consumers increasingly favor more sustainable companies, there is a risk of losing market share to sustainability leaders. By offering a wider range of healthy and sustainable options and by decarbonizing their own operations and the value chain, for example, grocers can gain market share. Although there is still considerable uncertainty around how sustainability will play out, there's a clear business case for acting to mitigate downsides.

Sustainability value-creation levers can drive economic profit.

Illustrative economic profit, modeled with top-down assumptions, baseline = 100



Source: McKinsey analysis

Capturing opportunities

Sustainability strategies can do more than mitigate risk and reduce downsides; they can also give grocers a competitive edge and allow them to take advantage of new opportunities. We outline some potential strategies for grocers below.

Portfolio strategy: Grocers can begin reorienting portfolios toward sustainability at the level of their broader ecosystems. They can rigorously allocate capital—for example, by investing in sustainable parts of the business, managing unsustainable parts through cash

flow, or scaling down and divesting—and think about organic and inorganic moves. There are many attractive sustainability value pools beyond grocery, often with significantly higher growth and margin potential. Grocers can evaluate their potential to extend beyond their core business, whether by focusing on adjacent segments that strengthen the core business (such as Germany’s Schwarz Group, which recognized the importance of recycled plastic as a strategic resource¹) or by leveraging consumer data as an ecosystem backbone to provide highly valuable services.

¹ Annual detailed enterprise statistics for trade (NACE Rev. 2 G), Eurostat, February 28, 2022.

Sustainable business building: Disruptive sustainable innovators are emerging in the food system, from vertical farming (such as AeroFarms and Infarm) to protein alternatives (Planted or Beyond Meat) to packaging circularity (TerraCycle's Loop). Yet established grocers typically struggle to build new sustainable businesses successfully. While they face real challenges, such as brand credibility and incubating agile new ventures within larger corporate structures, established grocers are also held back by a lack of ambition and an unwillingness to disrupt themselves before someone else does. These are missed opportunities. Established grocers have significant advantages that should make them the natural owners of sustainable-business building. Migros in Switzerland is leading on this front, with its Cultured Food Innovation Hub driving the development of cultured meat, seafood, and more.²

Market share and margin gain: Consumer companies are increasingly gaining market share and margins by differentiating through sustainability. The three principal levers are branding and marketing, sustainable value propositions and differentiation, and green pricing—especially as sustainability premiums begin to materialize. For example, sustainability leaders disproportionately allocate shelf space and resources to sustainable products, which are outgrowing conventional products by a factor of seven.³ Others have introduced new loyalty programs, such as Ahold Delhaize's SuperPlus program in Belgium. These programs encourage customers to buy healthier products and can differentiate a grocer from its competitors.

Sustainable operations and supply: More sustainable operations can be value accretive and significant drivers of better performance. Often, we find up to 50 percent of operational levers can be net present value—positive

(NPV-positive) or NPV-neutral and can improve financial performance through cost reductions. Grocers should therefore approach sustainability investments as they approach other investments: by prioritizing the most economically efficient options. Grocers can use marginal abatement cost curves to prioritize NPV-positive or NPV-neutral levers (Exhibit 4). Such cost curves show the cost of each investment and rank them by their return on capital.

3. Setting up the sustainability transformation for success

Maximizing sustainability impact and value creation requires a holistic transformation approach with the right operating model. Like any business transformation, sustainability is hard to do because it requires a substantial number of changes to the business and to cross-functional collaboration. As mentioned above, only half of retailers that set a sustainability target are confident they will reach these targets.

Sustainability efforts should therefore be anchored by the CEO and board, who should model a green culture. They should be supported by a central team led by a chief sustainability officer who reports to the CEO and acts as the main orchestrator and know-how provider across the organization. Business units should take the lead in developing and executing specific sustainability initiatives, with sustainability embedded in performance management as a measure of progress that can ensure accountability both internally and externally. Moreover, grocers should invest in data collection and reporting across the value chain to be able to manage upstream and downstream impact (Exhibit 5).

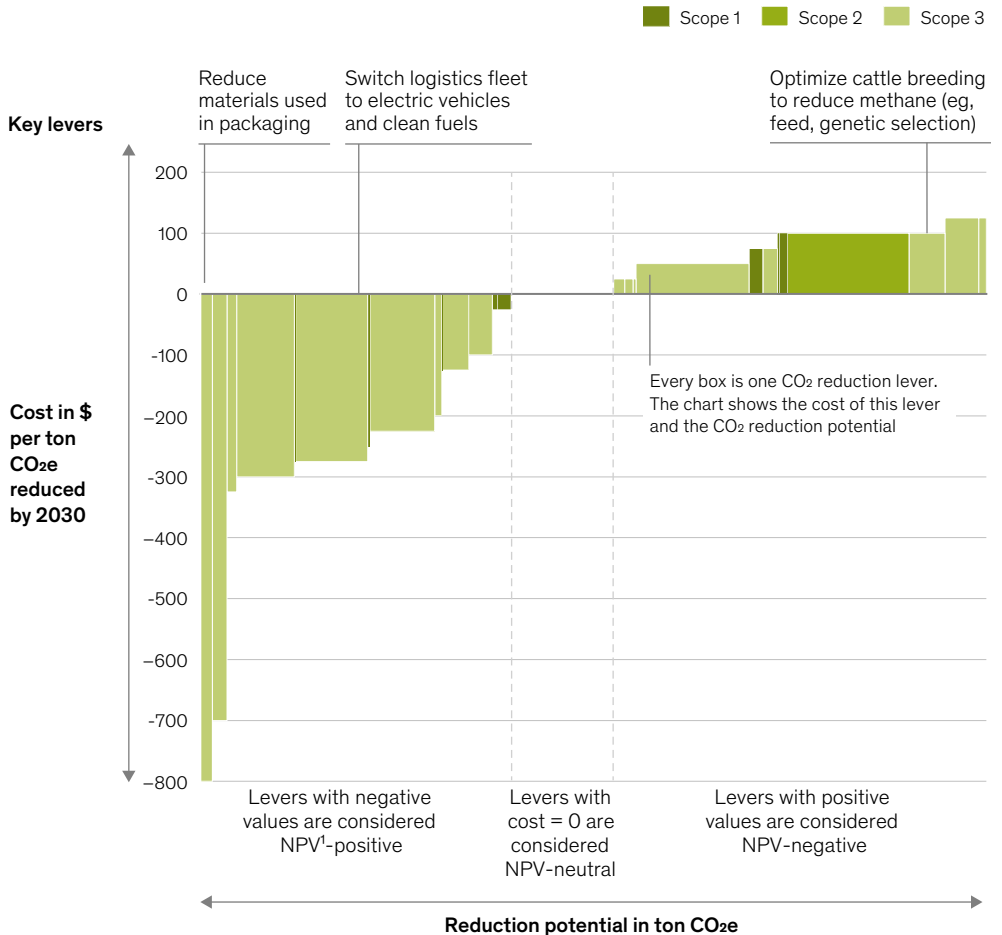
² Enterprise statistics, February 28, 2022.

³ "Sustainable Market Share Index," NYU Stern Center for Sustainable Business, March 2021.

Carbon-abatement cost curves can support decisions about the sequence of implementation.

Exemplary marginal abatement cost curve (MACC) for grocery retailers

Levers to abate CO₂-equivalent (CO₂e) emissions, 2030 view



Note: Additional potential from Scope 3 downstream levers not included.

¹ Net present value.

Source: McKinsey Decarbonization Lever Library; McKinsey GreenGauge; McKinsey analysis

When they have the right focus, key elements of the operating model can improve the overall sustainability of an organization.

Structure



1 Role of leaders

The CEO and board of directors establish sustainability as business priority, set the ambition, and sponsor and model the sustainability agenda. The chief strategy officer is the orchestrator across functions and business units (BUs).

2 Activity scope

Centrally led activities embed sustainability in the core of the business (eg, sustainability strategy, reporting). **Initiative-based activities** across the HE²AL dimensions must be business-led.

3 Teams

BUs have ownership of initiative delivery and collaborate with a **dedicated central sustainability team**, which leads and coordinates activities across the organization.

4 Governance

Executive committees and **steering committees** enable C-level alignment and oversight.

Processes



5 Performance management

Sustainability ambition and targets are set and translated into specific **KPIs per initiative**.

Internal incentives—specifically variable compensation—are tied to sustainability performance.

Data collection and reporting must be established as key enablers, with a focus on product traceability and transparency.

6 Linkages and collaboration

Central team ensures rigor and discipline, with BU leaders taking business ownership from the start.

Cross-functional and cross-BU teams, governance, and processes enable and steer delivery.

People



7 Capabilities

Key sustainability skills and knowledge on environmental science, climate change, and specific domain knowledge across HE²AL dimensions are considered foundational.

Core enabling skills are required: strong leadership, ability to influence, effective communication, and data collection, integration, and analysis.

8 Culture

A proactive and holistic view is shared across the organization, with sustainability serving as an integral part of company vision and strategy, as modeled by board of directors, CEO, and executives.

The food system requires fast, systemic change to become sustainable. Grocers can be a driving force and create significant additional value, but this is a multiyear challenge requiring leadership and focus throughout the organization, as well as investments. We recommend three steps leaders should take now:

- Assess your sustainability baseline and define your sustainability ambition with concrete impact targets (such as financial, carbon abatement, waste diversion, and supplier engagement). These should be based on your starting point, your purpose and internal “appetite to do good,” the behavior of competitors, your stakeholders’ expectations, and, last, the resulting potential for value creation.
- Implement a well-defined and prioritized set of sustainability initiatives that maximize your sustainability impact across the HE²AL dimensions and generate value for your business across all five types of value-creation levers. Think strategically about how to involve suppliers, differentiate through sustainable own brands, and invest in transparency.
- Adapt your operating model to anchor sustainability in the day-to-day business decisions most relevant to your articulated ambition across the value chain. This enables consumers to make sustainable choices, optimizes your operations, and allows you to collaborate with farmers, suppliers, and peers.



Marina Caprotti Executive Chairman, Esselunga (Italy)

*Interview conducted on February 3, 2022,
and amended on March 22, 2022*

Question: How would you describe the current market conditions for European grocery retail?

Marina Caprotti: There is a lot of tension around prices, especially because of the volatile cost of many raw materials. We're obviously concerned about inflation and a possible slowdown in consumption in the coming year. The terrible Ukrainian crisis is worsening an already complex and critical situation with the risk of structurally prolonging inflation and the slowdown of consumption. The energy crisis is also proving to be extremely challenging in Italy, and this risks plummeting sustainability in the overall priority agenda.

Also, new stores are constantly opening, and the industry remains highly competitive. At the same time, COVID hugely accelerated the growth of e-commerce, and we expect this to continue in 2022 because shoppers value the convenience of ordering grocery online, or through an app, and having it delivered to their homes. We also notice that health and sustainability are increasingly important to consumers.

Question: How is Esselunga responding to these challenges and opportunities?

Marina Caprotti: We recently launched a dedicated program to keep prices competitive and stay close to our customers in these difficult times. We aspire to maintain our leadership across all channels—online, click-and-collect, and in-store. We are also experimenting with smaller store formats. Generally, it's very important for us to strengthen our relationship with our

customers, whether through pricing and promotions or by providing the products and services they want.

Our loyalty program, Fidelity, is the anchor of this commitment to customer-centricity. Fidelity covers 95 percent of our customer base. We use the data generated through the program to analyze shopping patterns and refine our propositions constantly. Knowing what customers value is a huge asset for us. For example, we see that healthy ingredients, food safety, and sustainable packaging are continuously becoming more important as purchasing factors. A lifestyle of health and sustainability used to be a niche. Now it's a mainstream phenomenon.

Question: What does your sustainability agenda look like?

Marina Caprotti: In 2018, we approved a five-year sustainability plan for 2019 to 2025. It rests on five pillars: our customers, our people, the environment, our suppliers, and our community. Based on the input of our stakeholders, we identified 27 very realistic but challenging goals that are linked to the UN Sustainable Development Goals, such as responsible production and consumption. Reducing greenhouse-gas emissions is a priority for us. Animal welfare is another important aspect. We continuously monitor our sustainability targets and publish our progress in our annual report. We have actually met many of our targets ahead of schedule, while some others have been delayed by the pandemic.

Question: What are some of the specific initiatives you are pursuing to drive sustainability?

Marina Caprotti: It starts with our stores. For example, we have recycling bins for different types of materials, which aren't as common in Italy as they are in Northern Europe. We also minimize food waste by donating fresh produce and fresh bread to local communities through our partnership with Banco Alimentare, the pioneer of a movement committed to reducing food waste and hunger. In 2021 alone, we donated three million meals. We also support local schools, with donations of €100 million in the past seven years through our Amici di Scuola program. But the store is only the starting point. Three years ago, we launched our Super Foodies campaign to educate children and their parents on food nutrition and healthy eating. We also partnered with Disney to create CheJoy, a private-label brand that promotes healthy food for kids.

We have always been committed to supporting humanitarian aid wherever an emergency occurs. Last week we sent three trucks to Poland on the Ukrainian border to help refugees, and we have started a fundraising campaign with the Red Cross in collaboration with our customers, who are responding with great generosity.

We have believed in the value of the private label since the 1970s. Today, through private labels, we can control all stages of the production processes, and we can influence all the elements of sustainability, such as packaging materials, origins of ingredients, and nutritional elements. We use this influence to promote energy efficiency, organic farming, animal welfare, social responsibility, and other sustainable practices all along the value chain.

We also work closely with other stakeholders, including the suppliers of branded products and regulators. For example, in Italy, every town has a different waste-management regulation. We would like to do a lot more to reduce and recycle waste, but we are held back by local authorities, even when it comes to something as simple as recycling coffee cups. We are trying to push this through the retail association, but changing the system is a long and difficult process, and we need the support of policy makers.

Question: How do customers respond to your commitment to sustainability?

Marina Caprotti: They love it. Reducing plastic is especially important to them. In response, we are changing the packaging of our products from plastic to organic materials wherever possible, and we give shoppers clear instructions on how each piece of packaging should be disposed of. Our customers also care a lot about local sourcing. It's important for Italians to buy Italian products. This is why we recently introduced a QR code on many of our private-label products so customers can find out where our ingredients are sourced and how they are farmed. In addition, we're reviewing the recipes for all our processed products to promote healthy eating and food safety.

Not every shopper cares about all the details, but we believe that our transparency and the consistency of our behavior over the years have guaranteed us the confidence and trust of our customers. That said, only a small fraction of them are willing to pay more for health and sustainability. Because of the high inflation rate, customers are very focused on price right now.

Question: Is that kind of mindset a new development at Esselunga?

Marina Caprotti: On the contrary. As a family-owned company, we have long been committed to sustainability and social responsibility. We have been offering organic products for 20 years, and we have always been closely involved with local communities. It's in our DNA, and it has to be. Our philosophy is to do things first and then talk about them, not the other way around. There is so much noise out there, and there is a high risk of coming across as superficial. We see our current sustainability strategy not as an add-on but as an expression of something that has long been deeply rooted in our corporate culture.

Question: How do you make sure everybody is on board?

Marina Caprotti: We have 25,000 employees. Our people are one of our most important assets, and we involve them in everything we do. There was some resistance in the beginning—maybe a bit of a generational divide. To drive sustainability throughout the organization, we created a group of employee ambassadors, a diverse group that represents every department and includes people of all generations. The key was letting everybody know that sustainability is part of what we do, not just a side project. We also put in place a lot of training for our employees and amplified our commitment to sustainability through our internal communication platforms. Now, our people understand the importance of sustainability, and they believe in it. We also keep bureaucracy around target setting and tracking to a minimum, and it pays. Today our people are proactively developing their own sustainability initiatives, even if it's not in their job profiles or incentives. For me, this is the most incredible change to watch.

Question: How do you think the grocery sector will develop in terms of sustainability?

Marina Caprotti: You cannot do business without thinking about sustainability. Ten years from now, sustainability will be integrated with every aspect of our industry. However, we face a challenge because consumers are not willing to absorb the entire cost of transitioning to a fully sustainable system, and grocers can't do it alone. We definitely need the support of other industry players, such as food producers, and of government institutions. Together, we will need to solve the problem of how to balance sustainability with affordability. This must be our priority.



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Crisis or opportunity?

How grocers can build stronger people models

Grocery retailers can't find the people they want for the jobs they need, and some workers are leaving. For an industry driven by people, the challenge is enormous. Yet, in a highly competitive postpandemic labor market, evolving the sector's talent model focused on the employee experience, digitalization, and reskilling can make the grocery workforce an even more valuable source of competitive advantage—if retailers invest in getting it right.

by Rahul Mathew, Beatriz Rastrollo, Patrick Simon, and Raphaël Speich



Interview with Cláudia Azevedo
on page 68



While grocery retailers employ more than 5.6 million people in the European Union,¹ they face two critical problems: high demand for new skills and roles—made even more difficult by a shortage of available talent—and high attrition rates for existing employees. It's a labor spiral that presents a huge challenge, but an enormous opportunity to create value if grocery retailers evolve their talent models to the new reality.

The grocery sector faces long-term challenges on three fronts:

- **Cost pressures are increasing.** Some of the factors behind today's tight labor market are well documented, from pressure for wage increases amid inflation, talent shortages, and increased competition, to the rise of absenteeism and attrition in the wake of COVID-19, to the need for more flexible labor scheduling. These challenges, combined with lower market growth, point to a need for greater efficiency and productivity.
- **Automation opportunity is high compared with other industries.** More than one-third of grocery retail tasks could be automated over the next eight years.² Yet very few jobs can be *fully* automated, meaning the challenge is not about eliminating jobs but about determining how much they will change—and how workers can change with them.
- **The value model is shifting.** The way value is created in grocery retail is being transformed by analytics and the rise of digital, notably by e-commerce and new propositions such as instant delivery, and by demand for sustainability, requiring greater collaboration with suppliers as well as new product skills. These and other dynamics, including partnerships

and ecosystem collaborations, are forcing employees to learn new skills as roles evolve and pushing companies to adapt their operating models.

The pandemic has dramatically accelerated these trends, leaving grocery retailers with little choice but to transform their people models. The upside? The sector can not only address these challenges but also drive sustainable competitive advantage with talent.

How the grocery workforce is changing

These trends have upended the grocery retail industry. Companies are being forced to reimagine and redesign grocery roles as physical and manual tasks have declined in importance and the need for technological and social skills, adaptability, and the ability to master various tasks continues to rise (Exhibit 1).

These skills are central to the ways in which grocery workers' responsibilities are changing. How companies equip and empower employees will determine their success in attracting and retaining talent.

New and changing roles

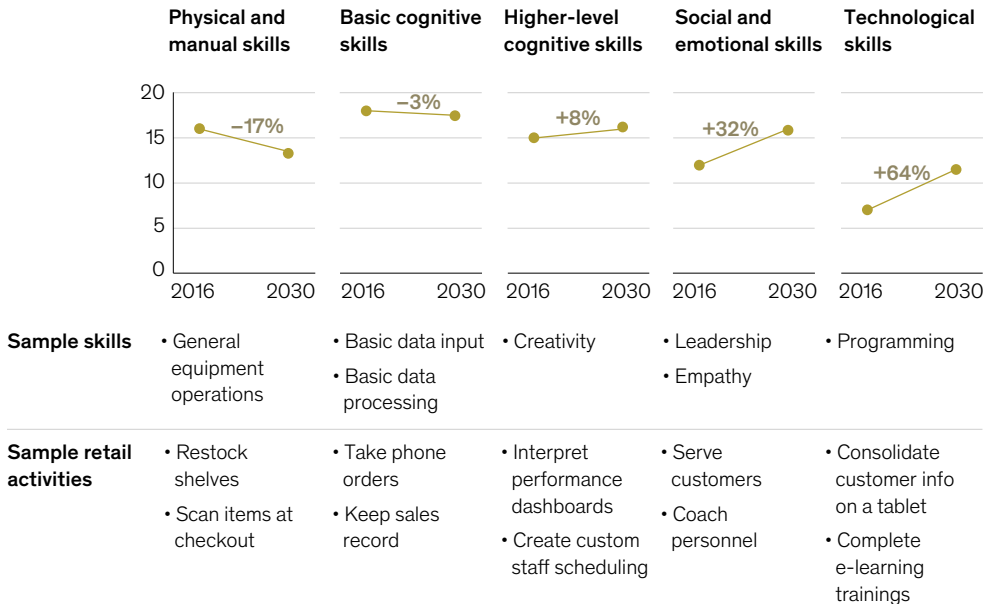
New roles are being created as the grocery sector evolves, expands into adjacent business areas, and introduces technology and automation. The acceleration of online sales and instant delivery, for example, brings a need for in-store logisticians and last-mile delivery workers. At the same time, some roles are growing and evolving, requiring different skills than they did in the past. In the areas of commercial, digital, and logistics, there's an increased demand for more advanced technical and analytics skills in pricing, digital marketing, and planning roles. Due to increased adoption of self-checkout, for example, the demand for cashiers has long been believed to be declining. However, in

¹ "Annual detailed enterprise statistics for trade (NACE Rev. 2 G)," Eurostat Data Browser, European Union, February 28, 2022.

² Patrick Simon, Caroline Tufft, and Pierpaolo Zampella, "Closing the skills gap in retail with people analytics," McKinsey, August 28, 2020.

Social and technological skills are becoming more important in retail.

Retail hours worked by activity, US and Western Europe,¹ billions



¹Western Europe includes Austria, Belgium, Denmark, Finland, France, Greece, Italy, Netherlands, Norway, Spain, Sweden, Switzerland, and the United Kingdom. Source: McKinsey Global Institute

practice, cashiers’ social and emotional skills can bring a human touch to customer service, and tech savviness can lead to quickly taking on new tasks, such as online-order fulfillment. Still, physical work is very relevant in the role.

Workforce retention

Global attrition in grocery retail jumped from 40 percent in 2019 to about 60 percent in 2020, according to the Food Industry Association—despite an increase in average wages and benefits for full-time employees. While the industry has spent upward of €13.5 billion to keep workers, it’s clear transactional pay is not sufficient: workers are looking for deeper relational elements and are placing significant emphasis on feeling valued by managers and organizations, on schedule flexibility, and on greater potential for career advancement.

Talent attraction

All industries are seeking new roles and skills, vexing an already tight labor market in which grocery retailers are already battling margin pressure. The sector has responded with significant salary increases. Lidl, for example, announced it was allocating more than €20 million toward pay raises in the United Kingdom as part of its investment strategy for talent attraction and retention. Meanwhile, Mercadona announced a 5 percent salary increase for its workforce. While attracting talent presents a challenge for grocery retailers, its importance also speaks to the value of the experience and training people receive in this sector. Other sectors often value grocery workers’ skills, from customer service and people management to emotional and social intelligence.

What grocery retailers can do

Against this backdrop of short- and long-term challenges, it's no wonder that according to our research, around 40 percent of grocery CEOs spanning the industry identify people as a priority topic today, compared with around 25 percent last year. Grocery retailers have no choice but to transform their approach to talent, and we've identified six strategic moves they can take to navigate the transition to a new people model.

Reduce short-term attrition by addressing the employee experience

There's a disconnect between the factors employees regard as important and those employers think are important (Exhibit 2). If the past 18 months have taught us anything, it's that employees are craving investment in the human aspects of work: better pay, benefits, and perks have become table stakes. What employees are really seeking is to feel valued by their organizations and to have social and interpersonal connections with colleagues and managers. To achieve this, proper onboarding and ongoing motivation for in-store personnel are critical. Leaders should take note: you can't fix what you don't understand, and truly investing in the relational elements that make employees feel valued and comfortable at work is the key to arresting the slide.

Anticipate future talent demand, and invest accordingly

The nature of all grocery roles is shifting—not only due to elements within the control of companies, such as the degree of automation, but also due to changes largely beyond their control, such as consumer behavior. For example, few grocers would have anticipated such rapid growth in e-commerce channels, and most are still trying to understand how to attract and retain talent with experience in this field. It's critical to invest early in quantifying and planning for talent needs over a three- to five-year time horizon. With a plan in place, it's easier to be proactive and adjust if needed, rather than reacting to events as they happen and always

playing catch-up. For example, one Southern European grocery retailer plans to double the number of people in certain positions, such as data scientists and digital-store-picker operators. At the same time, it is also recruiting for roles not previously available in the company, such as robotics technicians.

Differentiate investments in attracting and retaining core digital talent

Grocers able to attract and retain digital talent, such as data engineers, data scientists, and full-stack developers, have realized the needs and expectations of digital talent are unique and specific. Organizations that win in this space focus on anticipating digital-talent needs, on linking compensation and benefits to the value digital roles bring to the organization, on developing communities of practice with effective technology talent functions, and on investing in digital-specific career paths to highlight growth opportunities.

For example, one retailer created a differentiated employee value proposition for digital roles. The digital employee value proposition was focused on three pillars: a renewed company culture (“a great company” that fosters agile ways of working and develops digital communities), digital-specific learning and career development (“great opportunities” built on the foundations of an exciting and future oriented technology stack), and tailored incentives (“great benefits” including nonfinancial benefits such as participating in external digital events and forums and flexible location rules).

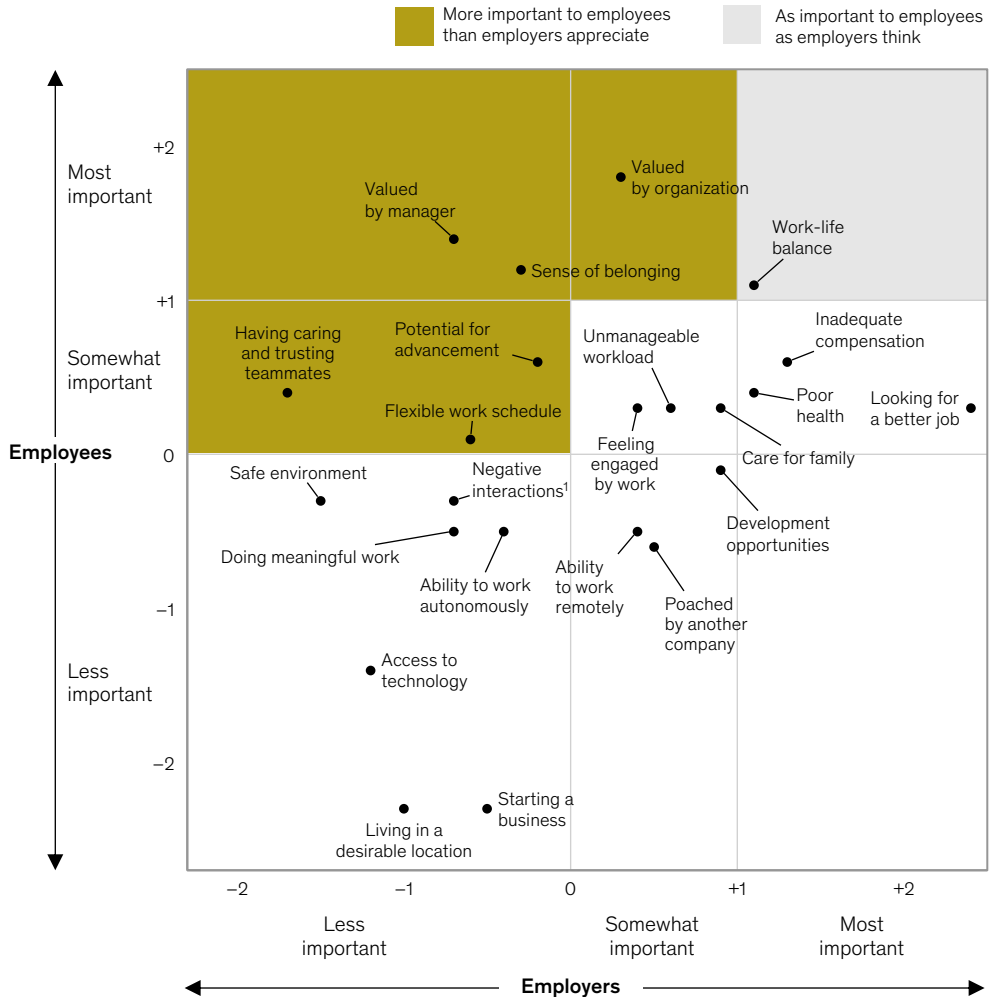
Reskill and upskill, which are key value-creation levers

There are different levers to manage the transition to the future workforce, including talent acquisition, redeployment, and partnerships. Today, organizations are increasingly investing in upskilling and reskilling talent, as according to our research it can be about 20 to 30 percent more cost-effective in the long term than layoffs and hiring—and these efforts also strengthen employee engagement and overall productivity.

Employers do not fully understand why employees are leaving.

Factors important to employees versus what employers think is important

Employers seem to overlook relational elements that are key factors in why employees are leaving, such as lack of belonging or feeling valued at work



Note: Standardized scores are reported for both employee and employer perspectives. Employees were asked to respond to the following question: "To what extent did the following factors impact your decision to leave your last job?" (Possible responses: "not at all," "slightly," "moderately," "very much," "extremely.") Employers were asked to respond to the following question: "Why do you think employees are choosing to leave your organization now? (Select all that apply.)"

¹ Includes interactions with clients, customers, patients, and students.

Source: "Great Attrition" or "Great Attraction"? The choice is yours," McKinsey, September 2021

One Southern European grocery retailer conducted a strategic workforce transition effort to ensure availability of resources and skills to deliver on its business priorities. Around 50 percent of its workforce required upskilling, with a particularly pronounced need in functions such as commercial and in-store. In response, the retailer created an at-scale reskilling program and complemented it with a talent acquisition initiative for key areas such as logistics.

In our experience, successful reskilling and upskilling programs include:

- a well-defined, long-term strategic workforce plan anchored in the business strategy that outlines the demand for existing and new roles and skills
- investment in redesigning roles for the future, in understanding how automation and other trends will affect each position's key activities, and in aiming to reduce time spent on non-value-added tasks
- focused capability building for talent in low-demand, high-supply roles to transition those employees to high-demand, low-supply roles
- mechanisms to deploy talent and to support the professional development of talent over the long term
- partnerships with external skilling organizations, which can significantly accelerate these efforts and provide more scale and cost efficiencies

Consider how Walmart invested \$4 billion in a reskilling program over four years. Frontline hires are now required to start with a certificate program in basic retail and emotional skills. In addition, tenured employees can take part in Walmart Academy and the “dollar per day college,” which allows associates to earn

college degrees in retail management. There has also been a shift in the past few years from hourly wage roles to more full-time roles in Walmart's retail stores, improving work-life balance for associates, building more team-based ways of working in stores, and providing opportunities for better mentorship. These moves are intended to signal to the labor market that Walmart cares about growing and developing its workforce, making it a “career building destination.”

‘Acqui-hire’ to accelerate the time to impact

Partnering or acquiring companies with key capabilities is one of the fastest ways to accelerate talent acquisition at scale, although it has certain risks that need to be managed, including cultural integration. For example, Ahold Delhaize acquired FreshDirect to expand its omnichannel competitiveness in the US.³ On the back of this acquisition, Ahold Delhaize aims to double online capacity and increase its market penetration.

Make people a strategic priority for the C-suite

When talent management becomes a strategic priority that affects value creation and the long-term sustainability of business models, it's no longer just an HR responsibility. It should be a priority for the C-suite, with leadership from the very top.

Companies have increasingly focused on people since the outset of the pandemic, and grocery retailers are no exception. Yet as an essential industry, the sector is under particular scrutiny. Transforming the people model is challenging but necessary, and getting it right can deliver sustainable competitive advantage.

³ “Ahold Delhaize and Centerbridge Partners successfully complete acquisition of FreshDirect after receiving regulatory clearance from the FTC,” Ahold Delhaize, January 5, 2021.



Cláudia Azevedo CEO, Sonae

Interview conducted on February 9, 2022, and amended on March 23, 2022

Question: How do you see the grocery retail industry evolving in the next year?

Cláudia Azevedo: I'm not sure I can make any predictions because nearly every prediction from the past two years has turned out to be wrong! And this is made worse when we have a war on Europe's doorstep. My thoughts are with the Ukrainian people, as they are the ones who are suffering the most.

This situation severely impacts energy and food supply for families and businesses. We don't know what course it will take. Here's what we do know: supply chain issues will likely persist. We are aware that general price increases are a problem for families, who will need to make compromises in their budgets. We will do our best to reduce the impact of rising costs, namely in energy and food stuff, and find creative ways to secure supplies for our customers.

At the same time, there's a huge push for sustainability from both our customers and our employees. As an industry, we know we have a huge role to play in the ecosystem: in transportation, supply chain, agriculture, and packaging. Consumers also want convenience, and we have seen the acceleration of e-commerce, digitalization, and competition from new players.

When I step back to look at the bigger picture, I see all of these trends forcing us to become more efficient—and I think that's a good thing. If we're more efficient, we have a lower impact on the planet, we can respond faster to innovation and changes in the external environment, and we can concentrate our resources on what matters. Efficiency is a key enabler for us to evolve, both as an industry and as a company.

Question: So what are the key factors that will enable you to respond?

Cláudia Azevedo: Flexibility. The pandemic enabled us to develop new skills and build that muscle. In Portugal and throughout Europe, the laws were changing every day. But we learned to react very quickly, which has made us even better prepared for the year ahead. We gained market share in both online and offline for our main assets, so we're starting off this year with a very positive growth mindset. But, most important, we stayed together. It is with this same spirit that we will tackle any constraints arising from the conflict in Ukraine. Then we were very united as a company, and we will continue to be. This cohesion and loyalty will serve us well moving forward.

Question: There are lots of headlines about the global competition for talent, and the industry is struggling with high employee turnover and attrition. What's your approach to attracting and retaining talent?

Cláudia Azevedo: Everybody has a different idea of what they want from their job, but I believe that there's one thing in common: we want purpose. At Sonae, we've focused a lot on our purpose. We have been very clear about who we are as a company, the kind of attitude we seek in our people, and what they can expect from us. These values are consistent across our portfolio, regardless of whether you work in food or electronic retail. Let me give you an example. Sustainability is embedded in our purpose. We give our employees opportunities to get involved and contribute through a group sustainability forum. And because we've taken a collaborative approach, our employees take pride in what we do. We have found that our sustainability efforts can create a shared sense of purpose that connects our people not only to the company but also to our customers.

Now, day to day, people want a good leader, a good work environment, competitive pay, and a merit-based reward system. That's the minimum we provide to all our employees. Then it's about providing opportunities for employees to develop their careers in many different directions. Traditionally, commercial and marketing roles have a faster track to management compared with in-store operations roles. We're trying to change that. We recruit so many people across all of our functions, and we must be able to identify top talent—no matter where it comes from. It could be a student working part-time to earn money on the weekends. If they show a lot of potential, we need to recognize that, tap them, and pull them up through the ranks.

The final thing I'd say is to recognize the importance of career breadth. We like to “zigzag” people around the company to give them exposure to many different businesses and professional experiences. It's incredibly important. My own career path is an example: I started at Sonae working on a cobranded credit card before moving to telecommunications and then investments. The diversity of our business means that we can offer incredibly rewarding career paths that attract and retain the best talent, and people don't feel the need to go to another company to keep moving up or to keep learning new things.

Question: That gets into reskilling and upskilling, which is something we hear a lot about as the nature of grocery retail work changes and automation increases. How are you preparing for that?

Cláudia Azevedo: We did a strategic workforce planning project to understand what this means for us, and we know exactly which jobs are going to be lost to automation and which jobs we need. But how do you get from point A to point B? I actually think that point B is much better than where we are today because automation humanizes jobs—we can automate routine tasks but not work that requires creativity and real human interaction.

But you're right—reskilling and upskilling are critical to this transition. We're leading an initiative—Reskilling for Employment (R4E)—with the objective of reskilling one million unemployed and “at risk” workers in Europe by 2025. There are many skills that we will need in the future, especially in computing, engineering, and data science. And the shortage is exacerbated in Portugal, which has one of the lowest rates of higher education and STEM education in Europe. As the largest private employer in Portugal, we have a responsibility to lead the way, but we can't do it on our own. We need to partner with universities, governments, public entities, and retail associations. And the incentives must be aligned so that it makes economic sense for people to enter reskilling programs.

At the end of the day, I'm an optimist. I believe people will continue to work in services. They won't be at the cash register, but they may be working at any number of our growing in-store services—for example, walk-in clinics at our health and beauty retailers. Today in our stores, people typically have one or two jobs; in the future, I think they may have three or four jobs. And that requires a mindset shift from “My position is at the cash register” to “My position on Monday is at the cash register, on Tuesday it's helping people make better choices at our health and wellness counter, and on Wednesday it's assisting our elderly customers to shop.” That's why we need people who are flexible, willing to learn, and open minded, and who have a growth mindset. Our responsibility is to support them and help them develop the right skills.

Question: And that has obvious implications for the talent agenda at Sonae. How do you set up that agenda?

Cláudia Azevedo: It's now a core part of everybody's job because we're a people-centric organization. A few years ago, talent was only the responsibility of HR—and you went to HR only when you needed to hire someone. Now, all that's changed. At our board meetings and executive meetings, there's always an agenda item related to talent. It may be an open role that's critical to fill, or maybe we need to discuss our retention strategy for young people.

As CEO, one of my main responsibilities is to ensure that I have the right people with the right mindset in our leadership positions and on our boards. And this is true throughout the organization, too. From the front line to the C-suite, we know we need the best people. We are rethinking our remuneration strategy and our career progressions to adapt to what workers today care about. Because if we don't adapt, we will lose our top talent.

Question: Any major lessons from the experience of the past couple of years?

Cláudia Azevedo: I have absolutely no doubt that our success over the past two years is because of our people. The initial risks associated with the disease were overcome and we were able to ensure that, despite the uncertainties, our people showed up at our shops. We had very low levels of absenteeism. What motivated them to be there was a sense of purpose. We were feeding Portugal and all the people at home. Obviously, we gave them extra bonuses and discounts, but you can't place a value on that level of purpose and commitment.

Now, with all the constraints we are starting to feel because of the war in Ukraine, and with people starting to arrive from the conflict, needing our support, I believe we will be up to the task, both in integrating these people and in responding to the market needs.



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Pushing granular decisions through analytics

Every facet of grocery retail is becoming more personalized, a trend that is jeopardizing established operating models rooted in a one-to-many mass approach. Advanced analytics has the potential to transform grocery operations, but many retailers struggle to harness these capabilities to improve performance. Out of at least a hundred documented use cases, just a small number generate a significant impact. In our discussions with grocery executives, two emerging use cases—personalized promotions and store-specific SKU selection—reinforce the value at stake and could enable grocery retailers to truly differentiate themselves in the market.

by Gokmen Ciger, Andreas Ess, Jake Hart, Holger Hürtgen, and Maura Goldrick



Interview with Adam Manikowski
on page 78



Grocery seems to be in an ideal position to harness analytics: it boasts high purchase frequency, rich customer data, and a focus on efficiency. Yet with at least 100 documented analytics use cases in grocery, retailers can have difficulty determining which pockets of innovation matter most. In our experience with leading grocers, just a fraction of use cases represent most of the value (Exhibit 1). In this article, we examine two of the highest-potential use cases: personalized promotions and store-specific SKU selection. For both, we will examine how to unlock the full value through four elements: strategic fit, data and analytics, execution, and continuous evolution.

Personalized promotions

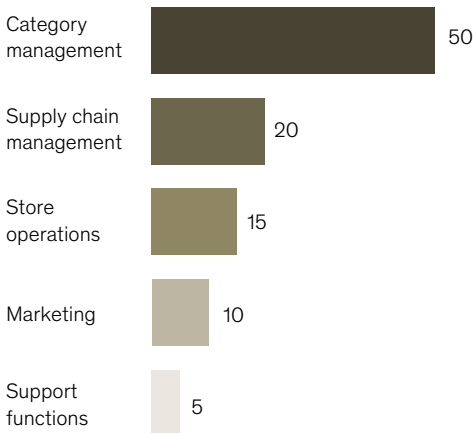
Leading grocers recognized long ago the need to reevaluate the true incremental impact of mass promotions. Analytics now enables complex views of mass promotions, controlling for stock-up, cannibalization, and even the halo effect that promotions have on other products. When taking these factors into account, even the best grocers can expect 10 to 15 percent of promotions to dilute sales and margins.

Personalized promotions have become more relevant and higher priority. Retailers can operate these at scale because technology has evolved, and customer touchpoints for

Exhibit 1

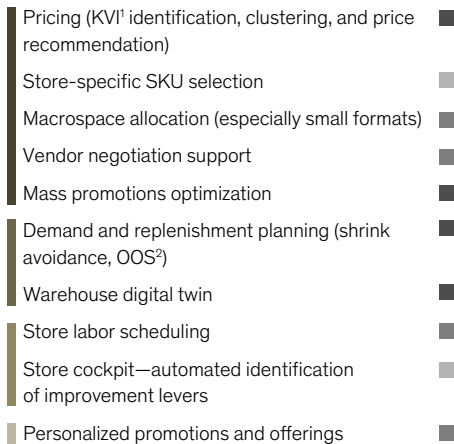
Across more than 100 use cases, ten opportunities account for just over 80 percent of the value at stake.

Value of analytics by domain, % of total EBIT impact from analytics



Use cases that make up 80% of value

Existing pilots and tests In use at a few players Becoming standard



¹ Key value items.
² Out of stock.
 Source: McKinsey analysis

Consumers, especially younger segments, have started to accept and even expect personalized discounts based on their shopping habits.

data collection and communication (especially through e-grocery and loyalty apps) have increased in recent years. When done right, promotions can provide a substantial benefit of 4 to 8 percent sales increase and 2 to 3 percent net income and EBIT uplift.

Consumers, especially younger segments, have started to accept and even expect personalized discounts based on their shopping habits. Recognizing this trend, many grocers now offer simple personalization—either through segmented promotions (selected campaigns targeted to segments with similar preferences) or by matching predefined offers with the customers who have the highest propensity to buy. These efforts typically increase sales by less than 1 percent.

To achieve the next level, grocers should take a true “customer lifetime value” approach, in which customers are notified of the right offer at the right time, with the right message, and through the right channel.

Strategic fit

Personalized promotions can increase customer lifetime value by tailoring campaigns that shift customer behaviors. For example, some campaigns are geared to win customers

back, others encourage more top-up sales, and others aim to increase store visit frequency. Optimizing discounts alone will not be sufficient. Instead, best-in-class players choose the best timing, the most appropriate channel, and even the most appealing communication to increase the likelihood of changing customer behavior over time. Recurring interactions generate more data, which grocery retailers can use to design increasingly relevant promotions that generate long-term customer lifetime value and loyalty.

In addition, collaboration and negotiations with consumer-packaged-goods (CPG) partners will be critical—not only to maintain overall funding levels (which requires careful tracking of granular promotion redemptions) but also to increase overall effectiveness. When done well, collaboration results in a mutually beneficial arrangement for CPGs and grocers.

Data and analytics

To support high-quality mass promotions, grocers need a robust data lake (containing data on offers, transactions, and products), an analytics environment, and executional tools. For personalized promotions, these elements need to be combined with permitted data from customer-relationship-management (CRM) and loyalty systems, including customer purchase behavior, app interactions, and profile information. Supporting mass promotions also requires navigating compliance issues around the use of personally identifiable information (PII) data: depending on the geography, consumers need to be presented with an explicit opt-in feature. Our research has revealed that consumers are becoming increasingly intentional about the types of data they share and with whom.¹ The way companies handle consumer data and privacy can become a point of differentiation and even a source of competitive business advantage.

Next to data, assessing the impact of personalized promotions on customer lifetime

¹ Venky Anant, Lisa Donchak, James Kaplan, and Henning Soller, “The consumer-data opportunity and the privacy imperative,” McKinsey, April 27, 2020.

value calls for a wider set of models. For example, there will be two models to increase store visit frequency: one model pinpoints the potential for increasing a customer's frequency, while the other recommends the best product to drive that customer to a store. Yet another model could help in selecting the right channel or message.

Execution

To properly execute personalized promotions and gain better access to cheap channels, retailers will need to augment their analytics capabilities with appropriate technologies and a suitable operating model.

Channels: To reach digitally adept customers, grocers will need to use a wider variety of distribution channels, including point-of-sale coupons, loyalty apps, email, and SMS messages, along with third-party apps such as Instacart. Retailers can launch separate initiatives (for example, gamification) to increase reach, particularly in cheaper channels. Connecting with digital-averse customers could require collaboration with direct-marketing agencies for a more tailored set of mail offers. To finance these investments, grocers could scale back spending on traditional circulars and other mass-promotion items over time.

Technology: To run thousands of individual campaigns, grocers need to implement an appropriate marketing-technology stack and potentially make changes to the underlying infrastructure—for example, allowing traditional point-of-sale (POS) systems to print individual coupons.

Operating model: Personalized promotions create a level of complexity that strains the management capabilities of traditional merchants. To be successful, retailers must encourage collaboration among marketing, category managers, analytics, and sometimes representatives of vendors. They should also establish dedicated centers of excellence (CoEs)—for example, to design and target offers. Grocers might also need to reevaluate

the decision-making process around promotions (for example, CoEs could assume decision rights for specific campaigns while category managers maintain decision rights on the overall budget).

Continuous evolution

One shortcoming of mass promotions is the inability to conduct anything beyond high-level experiments. By adopting personalized promotions, grocers can massively increase the robustness of tests (such as using A/B tests on specific customer holdouts). This approach can be used to improve statistical models, eliminate unprofitable promotion types, and create a test-and-learn mentality throughout the commercial functions of the grocer.

Store-specific SKU selection

Consumers increasingly favor stores that are nearby, a trend that spawned many small-format stores in recent years. In turn, the limited store size has made store-specific assortments a higher priority and more relevant for small-format retailers. With advances in data and analytics, retailers can now provide consumers with an assortment tailored to their unique needs. The result could be sales gains of 2 to 4 percent, presenting grocers with another substantial EBIT opportunity.

Recognizing this, many grocers take an approach based on optimizing assortment modules by store cluster (that is, one assortment module for all stores in a cluster) mostly based on price tiers (premium versus entry) and store size. However, the many dimensions of local customer preferences cannot be addressed by simple clusters.

There are three steps to achieve store-specific assortment: space allocation, SKU selection, and planogramming (Exhibit 2). Today, many grocers have already customized space allocation to local customer demand, but only a few players have achieved automated store-specific SKU selection and planograms to date.

For example, in 2020, German grocer REWE announced the implementation of automated, optimized planograms to support localized assortment at the store level. Similarly, Żabka, a Polish convenience-store chain, perfected store-specific assortment for the chain's 8,000 existing stores and all stores in development. For each address in the country, Żabka can identify the right store-specific SKU selection for the nearest location and—at extremely high confidence levels—how much sales and margin it would drive. This has allowed Żabka to grow substantially over the past few years.²

In the future, we expect many players to adopt such approaches to tailor store-level assortment to unique community tastes.

Strategic fit

A major risk when localizing assortment is introducing additional complexity without a clear benefit. Grocers should aim to develop targeted, specific visions for how localization will generate value for their business—especially when there's a high share of small-

format stores.

For many brands, localization involves changes to distribution, so grocers need to ensure their terms with CPG companies are flexible enough to allow for regular assortment changes on the local level. Many players already have a combination of general terms and existing flexibility to accommodate store differences and varied planogram sizes.

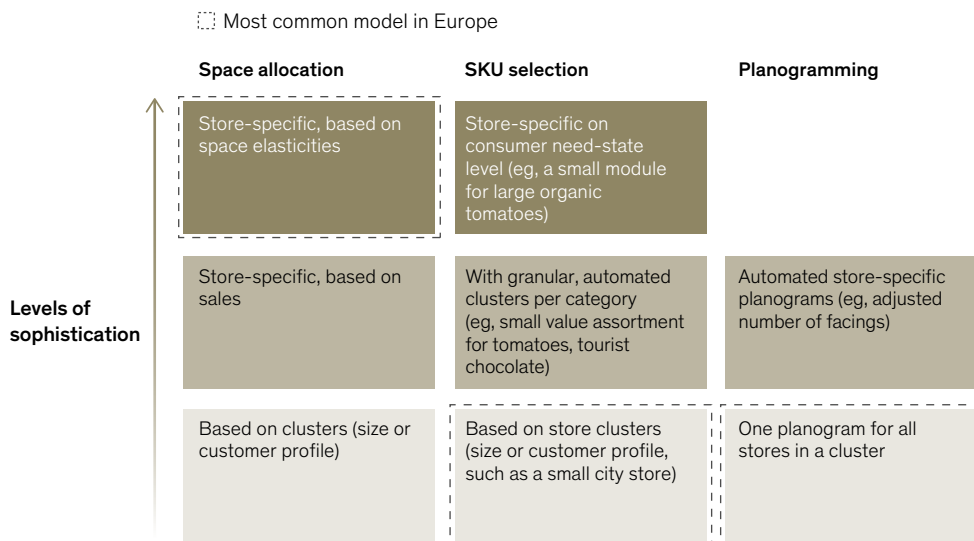
Data and analytics

Entirely localized assortment down to the store level requires more complex models; these have been conceptually and technically defined but not yet tested at scale. Grocery retailers need a wider set of algorithms to develop sophistication across the three elements.

For space allocation, a combination of category elasticities given targets (sales or margin) and a set of business rules (such as available space and refrigeration) helps to automatically find the optimal shelf space per store and category. Store-specific SKU selection requires an

Exhibit 2

Store-specific assortment requires sophistication for all elements.



² For more detail on Żabka, see "Interview with Adam Manikowski" on p. 78.

understanding of customer needs, which can be gained through customer decision trees. After defining the full assortment per customer need, retailers can calculate sales potential and rank SKUs per store. Similarly, planogramming can be automated to select the best number of facings and order on the shelf.

Execution

To offer an automated SKU selection per store, grocery retailers will need to enhance operating-model and technological capabilities.

Operating model: The complexity of store-specific SKU selection can outstrip the ability of a typical merchant or category manager to manage it effectively. Currently, category managers have clear visibility for how to optimize assortment modules per store cluster. However, in a store-specific SKU selection, category managers lose sight of local demands, which limits their steering capability. Organizations will need to adapt the way analytics CoEs and category managers work together, moving from actual selection to setting guidelines.

Technology: Grocers should also pursue planogram localization, which requires them to manage a larger number of designs and versions. This will require enhancement of enterprise-resource-planning (ERP) systems and new planogram software solutions.

Store-level execution: Once a retailer settles on an assortment and creates a planogram, individual stores will need to be given

directions to design the planograms in their stores. In a tight labor market, care must be taken to send modular instructions to in-store employees.

Continuous evolution

One of the most challenging aspects of localizing assortment is accurately measuring the impact. Moving to full store-specific localization will require retailers to embrace more advanced statistical techniques for gauging impact rather than relying solely on one-off tests or same-store sales comparisons. Even at the store level, A/B testing is crucial to learn and continuously improve. There are challenges to conducting these tests—including operational difficulty in setting up test-and-control stores and the additional need for statistical variability to measure results with fairly small samples—but the results are worth it.

Advanced analytics is perhaps the largest emerging source of net value creation for grocers; when done right, it can generate benefits of up to one percentage point of EBIT for the next three to five years. While there are more than 100 use cases for advanced analytics, just ten of them account for 80 percent of the value at stake. As technology continues to evolve, the next wave of use cases will be personalized promotions and store-specific SKU selection—each of which can bring more than 5 percent uplift in sales.



Adam Manikowski Managing Director, Żabka

*Interview conducted on February 22, 2022,
and amended on March 22, 2022*

Question: What do you think will be the most important trends shaping the grocery retail industry in the next one to three years?

Adam Manikowski: We see time becoming the new currency. Customers are stretched for time, so they appreciate fast shopping and want quicker delivery, within 15 minutes. This shift to instant delivery in e-commerce is the next level of convenience that customers want and what we need to respond to quickly. That is especially important to us as a convenience chain. But today, even discount retailers, through partnerships, offer instant delivery in cities. A few years ago, this was impossible to even think about. Today, any retailer in Poland can react to this trend. We also see technology and data becoming much more important for retailers.

Question: How do you address these trends at Żabka?

Adam Manikowski: We are investing significantly in innovation, especially around digital. Today, more than 15 percent of Żabka's employees work on designing and implementing innovations, from new business models to cloud computing and machine learning. We organized these employees in a separate unit called Żabka Future, including specialized career paths and benefits to attract proper talent. This was a big step up for us compared with when we considered digital as part of the traditional business model. The Żabka Future team thinks only about the future, creating new products that we then integrate into our core business to further organically grow our business. These competencies are extremely useful, especially as we now see many trends accelerate.

For example, we established our own offer for quick delivery within 15 minutes. To implement this project quickly, we created a start-up with a new agile operating model, heavily supported by digital technology and analytics. We built this offer from scratch. By controlling the value chain through to the last mile and by investing in dark stores,¹ we can deliver a consistent customer value proposition, which is a big advantage over other players that partner up with delivery services.

Since customers want a seamless shopping experience, we also opened 30 unmanned stores that are open 24/7, making us the largest unmanned-store operator in Europe. Right now, we see this as a growing trend that we want to accelerate as the leader in this space. We spent a significant amount of time on finding the best replicable technology that could also deliver a positive EBIT contribution. The problem with unmanned stores has historically been that the technology was too expensive to scale. With a partner, we developed a cost-effective solution that works with our business model. The upside of this technology is that it's very accurate, and we now have a rollout plan. Already this year we are planning to double, or perhaps even triple, the number of autonomous stores.

Question: Some grocery CEOs might say that instant delivery within 15 minutes will never make any money. What would you say to them?

Adam Manikowski: The Polish consumer is very tech savvy, and as a leader in the convenience sector, we cannot ignore the instant-delivery trend. It fulfills our mission to address the needs of customers, such as the ability to buy and consume almost immediately. It's important to see this trend holistically from the perspective of the overall lifetime value of customers. We know that offering instant delivery as part of our ecosystem leads to more loyal customers and overall bigger baskets.

The last mile is creating an incremental value from total value of the customer, as well as profits for Żabka and its franchisees. Our franchisees even see bigger baskets offline with these customers. We have measured this and can see it reflected in our numbers. You cannot look at each channel separately; you have to look at customer behaviors across every channel.

Question: How did analytics help you change Żabka's operational and commercial models?

Adam Manikowski: First, analytics has revamped how our expansion team operates, helping us open 1,100 new stores in 2021, an improvement from 1,000 new stores in 2020. We started a digital transformation in 2016, focusing on artificial intelligence and special algorithms to help us grow faster. We built an AI engine that analyzes nearly nine million postal addresses in Poland. It allowed us to go after the right locations in a very targeted way and open an increasing number of stores per year, even while we already covered a large part of the market in Poland.

¹ A dark store is a retail store that is not open to the public, used as a warehouse for quick-commerce deliveries.

Second, we use AI to manage our assortment segmentation, allowing us to deliver profitably to both a small city with 5,000 inhabitants and downtown Warsaw. AI helps us manage different assortment and pricing segments to those customers, depending on the catchment area. For every address in the country, we know what the optimal assortment for a new store would look like and what sales it would generate. We currently have 14 segments of assortment in Żabka, so we apply approximately 250,000 variants of planograms to determine the best assortment and merchandising for each store. You can't manage such complexity without technology. AI allows us and our franchisees to serve our customers better and grow profitably.

Third, we operate the biggest loyalty program in Poland, with more than eight million subscribers to our loyalty app, and we have an ambitious plan to grow this program to ten million users this year. We can do customer segmentations and offer hyperpersonalization in real time to target customers with specific offers. Unlike with traditional marketing tools, with the app's hyperpersonalization we can produce a higher ROI with targeted campaigns because we know exactly whom to target. The key to its success is making sure the app is user friendly, provides a positive experience, and gives customers access to real benefits. We are investing a lot into this. Your commitment can't be halfhearted—you need to go all in with the proper investment in these tools.

Question: Besides the nano stores, all of your 8,000 stores are franchisees. How has technology helped Żabka to successfully recruit and manage new franchisees and stores?

Adam Manikowski: Żabka needs to recruit thousands of franchisees every year. We use tools like Optiplan and the Cyberstore app to help franchisees to understand and plan all the store activities and get real-time analytics on the business overall. This allows us to target franchisees that have little or no prior retail experience; these tools make it easy for franchisees to manage their stores in an efficient way.

The Optiplan tool informs managers of how many people should work in a store and what they should be doing. It can also support daily functions such as looking for expiring products and advising on the best time for a baker to bake. Optiplan also supports automated replenishment and the ordering process across all 8,000 stores. What was formerly taking up to six hours per week now takes minutes.

The Cyberstore app has all the data concerning a store from the cloud in real time. This means franchisees can also see real-time profitability—sales, margin, and profits—in the app. Some of our competitors still need to wait for the next day to see sales; we see it in real time and can act on it.

Question: Can you talk about what it took to make technology at Żabka a success story?

Adam Manikowski: Żabka is an ambitious company with a strong entrepreneurial culture. When we started this journey, we did not have much; we were able to leapfrog other retailers

by starting from scratch. We didn't have legacy systems that could slow us down. We could immediately implement the best solutions that existed at any given time.

When you invest in technology, you need to make sure that the technology ultimately supports your people. Our expansion and sales teams, who deal with those solutions the most, saw that the tech brings efficiency and allows them to focus on things that matter: growth, value for customers, and value for franchisees. Imagine all the processes necessary to come together to open one store—and then how much you need to automate to do this 1,100 times.

But it's not just about the technological solutions. We had full alignment from the start with key stakeholders, top-notch partnerships, and the right organizational structure to allow further autonomy and investment with the creation of Żabka Future. This end-to-end approach has been extremely important to our success. With the full commitment of the board, we were able to properly allocate the resources to grow these projects.

Question: What's next on your radar for big opportunities in retail?

Adam Manikowski: There are three areas we are already exploring: automation, improving customer data to be even more precise in what we offer and how we offer it to customers, and e-commerce focused on real-time convenience.

Technology is helping us to stay fully aligned and can also provide new growth opportunities. For example, using our supply chain data, we know when and where to invest in new distribution centers years in advance. We're planning to open one of the most modern automated distribution centers in Europe near Warsaw. We started building it a year and a half ago, and it will be opened this year. This distribution center is intended to service approximately 3,500 stores, with the potential to service more than 5,000—subject to possible future expansion. While we didn't have automation knowledge from the onset, our company culture really helped here: our digital expertise helped in mapping out the process, and our start-up approach helped us to create focused, agile teams. Without this prior investment in technology and know-how, we wouldn't have been able to accomplish this so quickly.

As for future plans, we need to grow the network and find new ways to be closer to customers. For example, analyzing the data from our apps and our supply chain can potentially help us identify the gaps or white spaces of opportunity like profitable concepts where people have low price sensitivity. We also expect instant delivery to expand beyond Warsaw, where we will also need to work on profitability. Overall, we want to be top of mind for our customers when they think about quick delivery. Last, automation and unmanned stores will need to be an integral part of our business model.

As we look to the future and continue to grow Żabka, the challenge is to avoid becoming a bureaucratic company that reacts very slowly. They say retail is detail, but speed is everything, so we cannot lose our speed.



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Growing beyond groceries: The ecosystem expansion

Grocers play a central role in our lives, and it leaves them in a unique position to expand beyond their core retail offerings. It can be challenging to build an ecosystem extending into nonfood marketplaces, pharmacy retail, financial services, and other sectors. But the rewards may be worth the effort.

by Steven Begley, Jenny Hu, Jonatan Janmark, and Tom Youldon



There are few locations more central to our lives than grocery stores. Whether we grab items daily or stock up weekly, we visit these stores so regularly that no other retail business has nearly as many consumer touchpoints or generates as much user data. And with their vast store networks, supply chains, and last-mile setups—along with the trusted relationships they have with consumers—grocery retailers have an enviable platform to build on to expand beyond their core business.

For many decades, grocers have been actively leveraging their store networks, frequent transactions, and brand strength to grow beyond food into areas including nonfood retail (such as hypermarkets), pharmacy retail, financial services, and more. Yet today the opportunity to grow beyond these core services is greater than ever. Through digitalization, expanding the grocery business

into other domains has become much more scalable because the industry is no longer tied to physical stores.

The most ambitious version of leveraging this platform is to build an ecosystem (see sidebar, "What is an ecosystem?"). Digital-first retailers such as Amazon and Alibaba have led the way, building what many consider the most successful ecosystems in the world. Leading traditional grocers such as Walmart, Loblaws, and Ahold Delhaize have followed, moving in the ecosystem direction. Still, many grocery retailers have yet to take full advantage of today's digital technology. These grocers could unlock opportunities for both additional revenue streams and higher valuations by thinking through whether their unique assets—their customers and traffic, brand, physical assets, and so on—can provide attractive growth opportunities beyond the core.

What is an ecosystem?

An ecosystem is an interconnected set of products and services through which customers can fulfill a variety of needs in one integrated experience. In grocery, that could include being able to buy not only food but also alcohol, pharmaceuticals, and home goods. It could mean being able to bank at the grocery store or use its distribution network to receive at-home meal-kit deliveries. At the core of everything, though, is the customer connection, which creates additional value for all stakeholders. A successful ecosystem typically builds on several pillars:

- frequent usage and engagement with stakeholders beyond pure commerce
- a network of services provided through expansive partnerships
- strong network effects that compound value for customers and participants—the larger the ecosystem, the more value to each participant
- rich, data-enabled experiences

How leading grocers are building ecosystems

The pattern is clear: grocers venturing beyond grocery generate higher returns for shareholders. In fact, the world's top eight retailers by revenue market share—five of which are grocers (Amazon, Costco, Kroger, Schwarz Group's Lidl, and Walmart)—are all experimenting with such expansions. Our analysis finds publicly traded grocers pursuing some form of ecosystem strategy have been rewarded with higher enterprise values (EV) relative to the broader grocery sector. We have identified about 15 grocers with some ecosystem activity that have an average EV to EBITDA multiple of 15.3, compared with an overall average multiple of 10.7 for the grocery companies in our data set. Even if some expansion activities may dilute earnings margins in the short term, they can still drive value for shareholders.

In essence, the value creation from ecosystem activities is delivered in three ways:

- driving more revenue in the core grocery business in stores and online thanks to increased loyalty (from the value of participating in the ecosystem) and a boost in adding new customers (from the large set of touchpoints in the ecosystem)
- adding new revenue pools, including by monetizing loyalty data, creating new media platforms, tapping into categories adjacent to groceries, and delivering new fee-based services
- market repositioning from traditional grocery to a technology- and data-enabled platform with many potential growth vectors, increasing the valuation multiple

Consider the US-based grocer Walmart. It has a vast, integrated, compounding ecosystem intended to engage and deepen its share of wallet beyond retail for its 150 million weekly customers. Walmart provides healthcare services through a network of primary health clinics, offers in-store lab testing in partnership with Quest Diagnostics, and works with insurer Humana to sell Medicare drug plans.¹ In financial services, it provides prepaid cards in partnership with Green Dot, money-transfer services through MoneyGram, and tax services through Jackson Hewitt. Its Walmart+ membership program includes benefits such as free shipping and cheaper prescriptions, while Walmart Marketplace competes with Amazon and is growing rapidly through its expanding network of third-party sellers.

Similarly, Netherlands-based Ahold Delhaize has built an ecosystem that includes different business models in food, such as food service through FreshDirect and partnerships in Europe, e-commerce full-basket delivery, and a variety of store formats, including supermarkets and convenience. Ahold Delhaize has also scaled bol.com, its nonfood marketplace, and is making steps in media monetization and personalization across its food and nonfood propositions, leveraging its consumer data and insights.

Two primary ways to grow: B2C and B2B

There are two major routes for ecosystem expansion: entering new business-to-consumer (B2C) verticals and touchpoints, or externalizing and monetizing internal capabilities and offering them as business-to-business (B2B) services (Amazon's AWS arguably being the most famous example).

Broadening into B2C markets

When we examined the 24 largest global grocers to see the most prevalent B2C expansions, we found (unsurprisingly) that all of them had ventured into online grocery. In

¹ The ability to extend services into pharmacy and healthcare are dependent on national regulations.

addition, the vast majority had built loyalty programs, expanded into retail categories beyond grocery, and offered financial services (exhibit).

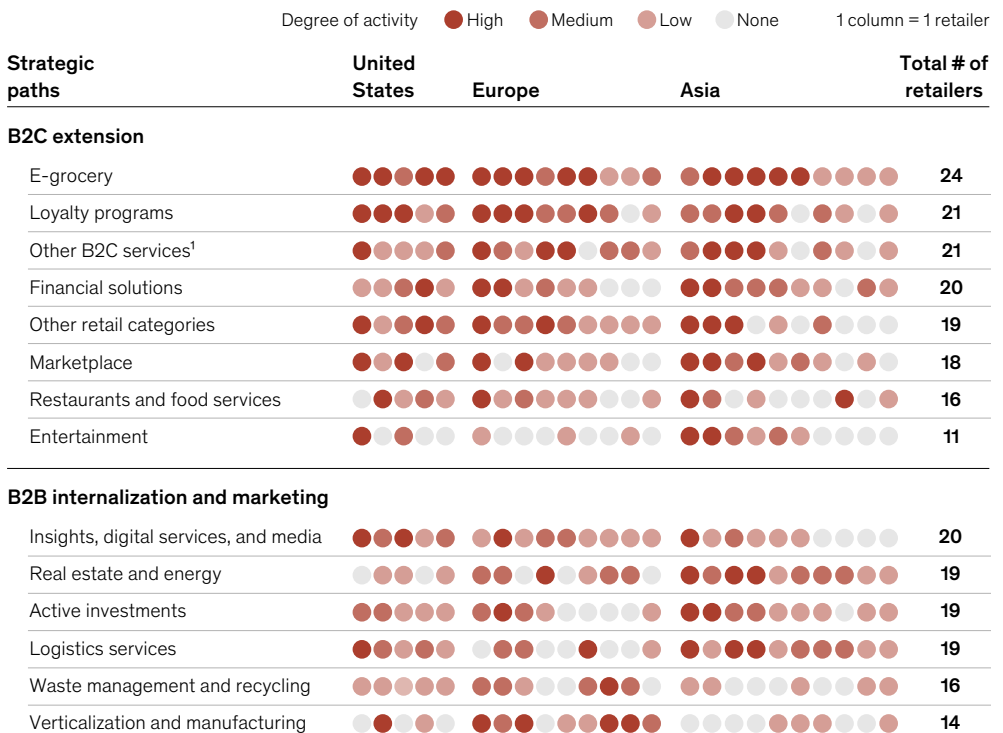
Next on the list after these common (and fairly traditional) expansion verticals comes a rapidly growing expansion play: marketplaces. In essence, marketplace platforms facilitate retail by allowing third-party sellers that own inventory to sell to consumers through the marketplace interface. This has proved to be a tremendously successful business model that has shaped some of the most valuable companies in the world, notably Amazon and Alibaba. The (not so) secret sauce behind the success of the marketplace model is anchored

in the ability to offer an expansive range at the best prices without the associated inventory risk and capital requirements.

While early marketplace activity was driven by online-only players and nonfood retailers, grocers are increasingly exploring the model. This enables retailers to broaden their food offerings (for example, with local or niche ethnic brands) and to quickly expand into more nonfood offerings. For example, Kroger announced an expansion of its Kroger Ship program to add 50,000 items to its offerings, including natural and organic food, international food, specialty items, houseware, and toys.²

Exhibit

Global grocers are following several ecosystem paths.



¹ Services offered outside traditional grocery retailing (travel, picture services, pharmacy, laundry, flower shop, etc). Source: McKinsey analysis

² Jeff Wells, "Kroger goes for endless aisles with new marketplace strategy," Grocery Dive, August 11, 2020.

Engaging not only with large companies but also with start-ups is important to build a thriving partner portfolio.

The move was intended to increase convenience to the customer and to offer an augmented one-stop-shop experience to compete against more diverse retail marketplaces such as Amazon and Walmart.

The marketplace model carries risks, such as the difficulty of vetting product assortments and of providing a consistent customer experience. But the benefits of a well-developed marketplace can be immense in terms of better serving customers, expanding online traffic, and gaining additional data and insights on customers, as well as through the financial benefits from seller commissions and monetizable services to the seller community.

Deepening within B2B services

For B2B services, the most common areas of expansion are insights, digital services and media, real estate and energy, logistics, and active investments. One of the most extreme examples within grocery is Ocado. What started as an online grocery business in the United Kingdom evolved into a B2B technology business with customers such as Groupe Casino in France, ICA in Sweden, Kroger in the United States, and Sobeys in Canada.

The current blockbuster use case for expanding into B2B services is retail media networks. Grocery retailers have historically been good at monetizing their substantial exposure to consumers—either in-store or through leaflets and magazines—by selling space to consumer-packaged-goods companies. Retail media networks (RMNs) are the digital equivalent of this. When done well, they can unlock a positive EBIT contribution of 2–4 percent of online sales.

Grocers are in a unique position to build RMNs: the high shopping frequency they enjoy provides ample advertising opportunities across assets such as websites, apps, and email; the vast amount of data enables accurate personalization; and the fact advertisements appear when consumers are in a shopping mode enables very high—and, importantly, measurable—conversion. To capture this opportunity, grocers are increasingly developing in-house teams that engage directly with brands on marketing opportunities and effectively operate as advertising agencies.

While North American grocers such as Walmart and Kroger were early adopters of this approach, we're seeing European players such as Tesco and Sainsbury's take meaningful steps into this area. To date, it's mainly large retailers with the technology requirements and new capabilities that are set to pursue the retail media network opportunity. But we expect that smaller and regional players will increasingly be able to use plug-and-play solutions and that third parties will provide the same services to vendors and monetize accordingly.

The keys to growing beyond retail

We see several grocery retailers expanding beyond the core and building ecosystems that generate additional value for stakeholders. But pursuing an ecosystem strategy does not necessarily lead to success; the reality is that many more companies have experimented with ecosystem strategies than have succeeded in using them to create substantial value.

Based on what we've learned from examples of both success and failure, the fundamentals for success are clear (and similar to other endeavors): ambitious senior leadership with willingness to pursue big bets and accept risk, a vision and strategy with rigorous prioritization, and an organizational model that fosters the right collaborations and agility. Once these fundamentals are in place, it comes down to execution. Key actions will then include the following:

- Cultivate a relevant portfolio of partners. This portfolio must include capabilities along the whole partnership life cycle, from aligning strategically to scanning partners, structuring deals, onboarding them, and eventually managing partner relationships. Engaging not only with large companies but also with start-ups is important to build a thriving partner portfolio.

- Develop technology capabilities that ensure scalability, security, and responsiveness to customer needs—with business use cases guiding data and technology efforts.
- Implement relevant principles for capital allocation (for example, a dedicated fund to support rapid growth), undertake continuous performance measurement and evaluation, and ensure timely stakeholder communication.

The world's largest grocery retailers are making moves, but that doesn't mean midsize or regional grocers can't develop ecosystems. First, it's not necessary to take a leading role. Grocers can partner with others that have the capital or capabilities to orchestrate a robust ecosystem approach while still reaping the benefits that come with stickier, more cost-effective customers. Second, grocers can find a niche to own. Is there a segment of customers that can be uniquely served? For instance, regional and smaller banks target specific segments—such as newcomers to a country—with tailored services to meet their needs. Similarly, pet ownership and care have emerged as powerful niche ecosystems within the consumer-packaged-goods sector. What we're saying is grocers don't need to seek to replicate the Walmart playbook—there may be sizable, underserved groups to service and own.

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