How CPG companies can sustain profitable growth in the next normal

After safeguarding their employees and businesses from COVID-19, consumer companies must develop new strategies to find micropockets of growth amid changing consumer preferences and market dynamics.

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The arrival of the COVID-19 pandemic suddenly and completely reshaped the consumer landscape at the start of 2020. At the same time consumer-packaged-goods (CPG) companies were looking to break out of a decade of inconsistent growth, many saw their expectations of growth replaced by a struggle for survival, while others had to ramp up production to meet never-before-seen spikes in consumer demand. Channels have also been shaken up: for example, e-commerce and omnichannel grocers have benefited greatly to date, while restaurants and food-service companies are facing the specter of bankruptcies and a major overhaul. All companies must now confront the prospect of navigating the worst economic downturn since the Great Depression.

The transition from responding to the pandemic to recovering and navigating the path forward means that executives will have to manage several priorities simultaneously: tracking changing consumer preferences, identifying micropockets of growth to prioritize in future plans, adjusting commercial strategies, and becoming more agile to pursue opportunities. As CPG companies embark on the road to recovery, a consumer-centric, analytics-driven, and comprehensive approach that increases top-line revenues profitably—what we refer to as predictive growth—has never been more critical. Such an approach must start with understanding the contours of the next normal. Companies should then devise an intentional plan to build the commercial capabilities needed to win in the next normal and permanently adopt the agile decision making that got them through the first stages of the pandemic.

Contours of the next normal

In the immediate response to the pandemic, the wave of lockdowns forced consumers to adjust their daily routines and purchasing habits. A critical challenge for CPG companies is to develop comprehensive strategies that are rooted in the needs of the consumer of the future.[1] This process starts with effectively harnessing all the insights, data sources, and analytics techniques available. Initial McKinsey research into the pandemic's impact explores how consumer behaviors have changed, in many ways permanently, across eight areas (Exhibit 1).

The stickiness of these areas and the degree to which they penetrate a consumer segment will vary by region and market, depending on how the pandemic evolves and how long it takes for consumers to get back to their "normal" ways of life. Similarly, these eight areas' impact on any given consumable category can vary greatly within a market. Further, stickiness will likely depend on the quality of the experience, so the actions that companies take now can have a significant impact in the next normal. However, we believe changes in five areas will have an impact on occasions and influence CPG companies as they plan to achieve the right balance of top-line growth and profitability in the future.

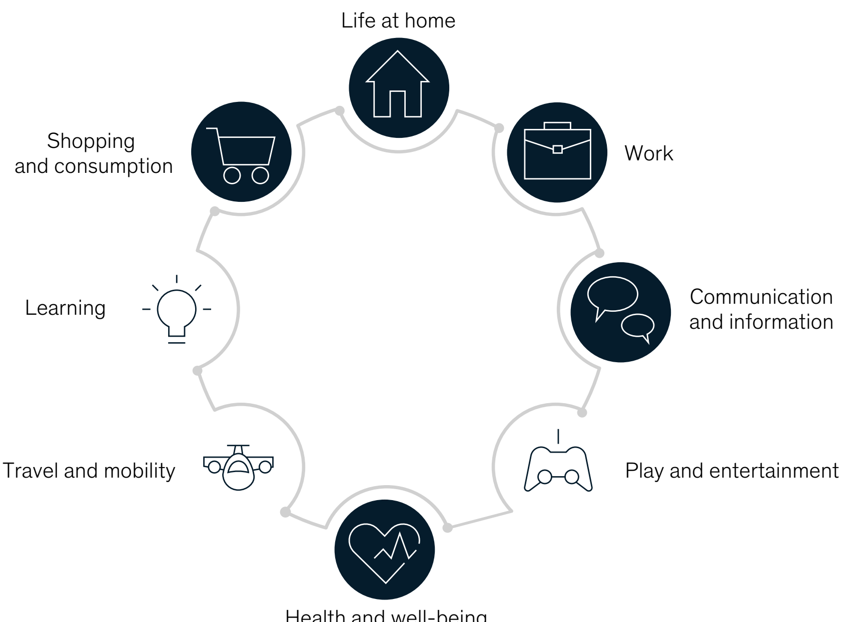
Life at home. During the pandemic, the home has been recast as the new coffee shop, restaurant, gym, and scene of entertainment—leading to an unprecedented increase of in-home activities. Nesting has fueled spending on at-home categories and compelled previously offline individuals to try e-commerce offerings; for example, more than 10 percent of US consumers that had never shopped for groceries online before have started to do so. Globally, people have turned to online sources for entertainment, learning, and communication while exploring contactless and digital alternatives to shopping.

Shopping and consumption. As lockdowns have naturally reduced shopping frequency and consumers spend more thoughtfully during economic uncertainty, consumers have decreased their overall spending and consumption, with the largest impact on discretionary categories such as jewelry and gum. In Europe and the United States, consumer spending is on track to fall by ten to 20 percentage points for the near future. Importantly—driven by convenience, availability, and affordability—almost 20 percent of consumers

[1] "Survey: US consumer sentiment during the coronavirus crisis," June 26, 2020, McKinsey.com.

Exhibit 1

COVID-19 is transforming every aspect of people's lives.



indicate they have switched from preferred brands and retailers during the pandemic, and about half of those consumers indicate they expect to make these switches permanent.

Health and well-being. Consumer spending has increased in health and hygiene. Health concerns are largest in Brazil, India, Italy, and the United States, suggesting consumers in such markets may prioritize future spend in these and related categories. The higher awareness of personal health has led consumers to embrace brands that they consider safer; some are moving away from products that are manufactured in harder-hit countries and toward perceived healthier options. The United States has seen a tenfold increase in the sales of organic produce and a 130 percent rise in vitamins and supplements. And in Brazil, purchases of fresh food have outpaced groceries overall during the lockdown.

Communication and information. Consumer media consumption has increased considerably, with a focus on social media, digital channels, and TV and radio. This shifting behavior has led companies to adjust their marketing approach: some have reduced their in-person sampling and testing, more than 40 percent have canceled campaigns, and 65 percent plan to decrease ad spending. Consumers have also been drawn to brands with an active response to the COVID-19 outbreak—especially in emerging markets—elevating the importance of communications that matches the prevailing consumer sentiment.

Work. The economic downturn has resulted in rising unemployment and the disruption of traditional business environments. Companies that were able to transition to remote working have fueled spending on collaboration tools and home office categories. Executives are starting to understand the potential of remote-work arrangements as well as the associated challenges and are seeking to find a sustainable balance. After having experienced the full lockdown, 80 percent of employees surveyed in China preferred

a hybrid model where they can work remotely part of the time. Overall, the higher number of people working from home will result in a shift of occasions.

CPG companies must monitor trends in these areas and be prepared to reexamine and adjust their growth strategies accordingly.

Developing a winning growth formula for the next normal

To win in the next normal, where some degree of the changes to these eight areas of life will stick, CPG companies should follow a three-step predictive growth process: predict, rebound and transform, and sustain (Exhibit 2).

Predict consumer demand

Data and analytics have become more critical than ever to accurately forecast demand across product segments. The pandemic has created significant challenges to what was already a difficult task. Time-series data sets have been disrupted, making it more difficult to identify trends, and we don't yet know the extent of a given trend's stickiness in specific regions, markets, or categories. One-off effects that should be considered include work-from-home arrangements, temporary closures of schools and restaurants, brand switching caused by stockouts, and shifting channel and retail-outlet preferences as shopping occurs closer to home.

Consumer responses to the pandemic have made demand more difficult to gauge accurately. The past is no longer a predictor of future demand. In the initial stages, the spike in purchases of certain categories was caused, in part, by pantry loading in preparation for shortages. So while actual consumption during this time didn't rise, spending toward some foods (such as lunch meat) did increase. Other categories (such as beauty supplies) saw a drop-off because of declining consumer confidence. Through the use of analytics, companies should seek to recognize these patterns and plan for a potential second wave of outbreaks.

We believe CPG companies should rely on three principles when developing more accurate category, brand, and product projections for the next normal:

— *Base analytics on the most up-to-date understanding of consumer behaviors.* As countries gradually transition out of lockdowns, CPG companies will need to develop a robust comprehension of the short- and long-term applicability and impact of changes in consumer behavior. This process is usually best informed by a mix of consumer sentiment research, proprietary category-specific research, online search, and digital engagement data.

— *Harness a wide range of data sources as inputs for fit-for-purpose machine-learning techniques.* The pandemic has forced companies to aggregate and process more data and data sources than they likely have in the past. By

Exhibit 2

Revising and iterating on three predictive growth elements can help refine and clarify scenarios over time.

Predict
What growth goals should we target after COVID-19? What is the full potential across the three growth cylinders considering each company's unique evolution during COVID-19?

Rebound and transform
Which levers should we pull to drive profitable growth in a COVID-19 world? In which sequence? Where and how much should we invest given changing consumer preferences?

Sustain
What operating model changes will be required to sustain profitable growth in the mid- to long-term in a postpandemic world?

casting a wide net, executives can create an up-to-date snapshot of category, brand, and competitive dynamics. To accurately predict demand, we believe analytic practices should not only track historical sales trends but also stitch together offline and online data with dozens of macroeconomic variables—such as GDP and the consumer price index. Consumer sentiment, social listening, search trends, and category-specific data (for example, products that tie in with movie releases) should augment these data sources. Finally, machine-learning techniques can identify underlying predictors of consumer trends.

— *Translate insights into scenarios that help provide corridors for the unknown.* Since there are still degrees of unknown (for example, the future progression of COVID-19 in a given market or the effectiveness of government stimuli in jump-starting economies), CPGs must navigate multiple scenarios—and concentrate on the most likely ones as time passes and certainty increases. Companies should use data and analytics to explore a range of scenarios and determine the demand elasticity of specific categories.

To some extent, these three elements should be iterative as frequent revisions will contribute to refined, more precise scenarios over time. A set of scenarios developed in a given month should be regularly updated with new data and insights (Exhibit 3).

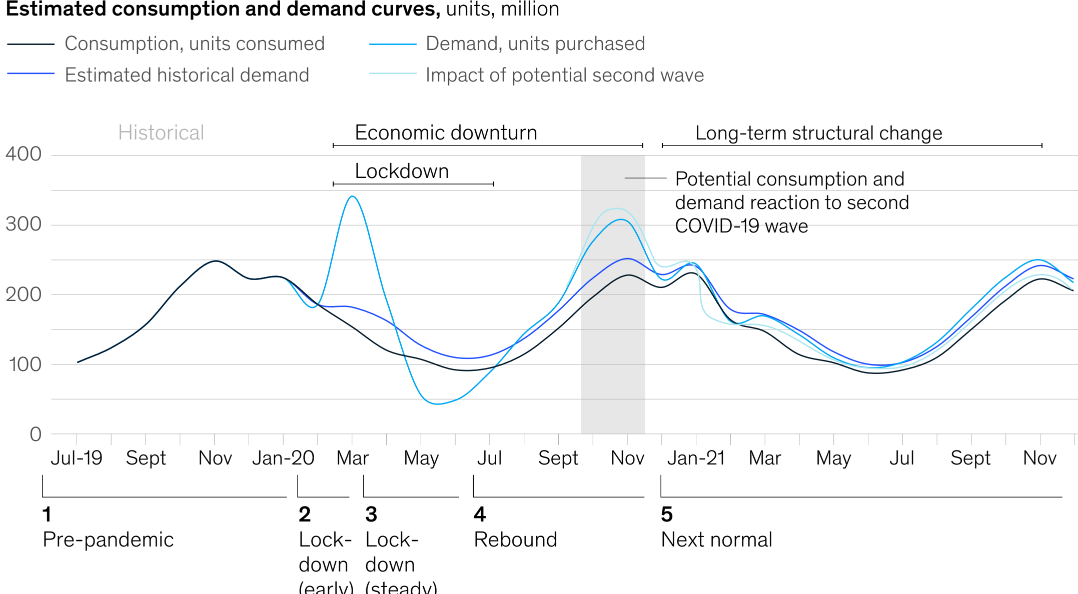
Rebound and transform to thrive

As lockdowns lift and detailed demand forecasts help identify growth opportunities, companies should prioritize rebounding and transforming. Plans to boost organic growth should include four core commercial capability areas: portfolio and innovation strategy, marketing, revenue growth management (RGM), and sales (omnichannel and in-store excellence). Any or all of these areas could apply for

Exhibit 3

Predictive growth can produce a real-time snapshot for a specific brand in a specific market.

Example output of integrated model across five phases



every company, but their mix will vary by context—the timing of the transition to the next normal, geography, product categories, share position, and existing capabilities, among other factors. As part of efforts to achieve profitable growth, executives should evaluate, at a minimum, all four capabilities.

Portfolio and innovation strategy. In the wake of the pandemic, CPGs will need to realign their product portfolios and innovation engines with changing consumer needs; this capability will be more critical than ever in the next normal. Companies too often rely on commoditized data and insights, settle for small moves that don't meaningfully improve the top line, or struggle to scale disruptive innovation sustainably. By contrast, winning companies deploy multiple capabilities, including consumer-back analytics (that is, growth maps or other granular views into consumer behavior) and "right brain" creative thinking early in the portfolio-strategy process. They build new full-stack-innovation operating models that lead from insights to strategy to execution, and they redesign products using a renovation-to-value approach to better meet true consumer needs. Last, leading companies establish integrated-delivery mechanisms such as innovation garages—cross-functional teams empowered to develop disruptive innovations end to end.

With these insights in hand, companies should reassess their portfolios against next-normal trends and rapidly accelerate their innovation pipelines to meet consumer preferences for affordability, health and hygiene, and packaging. Big brands, which once again have momentum, should channel "small brand" test-and-learn capabilities and focus on renovating and innovating bigger platforms. Such moves will enable big brands to respond to evolving consumer needs across new product development, package configuration, and sustainability.

These companies must also look to portfolio simplification and streamlining R&D processes to increase speed to market, cut small projects with low returns on investment, and refocus investment on high-ROI projects—as well as build the organizational muscle to assess their overall portfolios and core SKUs in each channel on a rolling basis.

Marketing. COVID-19 reset the way consumers view products and brands. In a time of uncertainty, companies that demonstrate both empathy and how their products could provide comfort and security are the ones to excel. Executives also have the opportunity to translate potentially temporary effects (such as pantry loading and brand switching) into more sustainable gains. Accelerating investments in selected areas can create more stickiness. Media consumption has shifted to digital even further than in the preceding decade. Meanwhile, with many companies cutting back on media spending, media rates have plummeted, offering a window to connect with consumers in a moment of captive attention.

Leading CPG companies have looked to data-rich industries that had once raised the bar in areas like contextual personalization and targeting. This new approach moves away from the "mass reach with mass waste" model to embrace personalization across products and messaging in digital platforms such as video on demand. Speaking to customers through their preferred channels and addressing their current needs—with the right tone, language, and brand promise—will be critical to success in the next normal.

Data-driven marketing yields three valuable tools: granular consumer audience creation, which entails developing a 360-degree view of the consumer and identifying relevant target groups with different needs; a content-creation model that enables more personalized (or at least segmented), engaging content to outperform "mass" efforts; and dynamic placement and measurement, which allocates and optimizes spending across channels.

Ongoing cost pressure will compel leading companies to look for opportunities to find efficiencies (for example, reduce nonworking spending and reallocate resources from low-ROI channels) to fuel growth. As CPGs deploy funds back into high-ROI marketing channels in the

next normal, they will require a more-dynamic, hypercustomized approach to provide consumers with the personalized experience they expect.

Revenue growth management. Over the past five to ten years, most CPG companies have built basic capabilities in RGM—the discipline of achieving sustainable, profitable growth through a range of strategies focused on assortment, promotions, trade management, and pricing. More recently, companies that have generated outsized impact from RGM have done so by supplementing basic and tactical capabilities with a long-term strategic focus; scaling capabilities across markets, divisions, and categories; and relying more heavily on data and advanced analytics.

The best companies in a post-COVID-19 world will continue these efforts while also elevating RGM to adapt in several ways.[2] To take the right action, CPG companies will need to rapidly understand changes in consumer preferences, such as trading down on products and brands, and the implications of these changes on assortment by channel and corresponding price architecture. In addition, adapting quickly to changing shopping occasions and missions requires a reassessment of promotion strategy. And the pandemic's impact on the channel and retail landscape will necessitate adjustments to assortment and trade-management practices.

At many CPG companies, RGM functions and capabilities are currently ill suited to achieve the expected outcomes for several reasons. The companies' processes are often too bogged down by overall corporate-planning processes, the skill sets of RGM team members are not sufficient to accommodate rapid updates, and organizations lack access to sufficient data. CPG companies must begin addressing and potentially transforming now. Without urgent action, they risk losing share to competitors with RGM capabilities that are nimbler and more advanced.

Holistic omnichannel sales strategy. CPG sales models have been under pressure over the past five years as a result of retailer consolidation, the emergence of buying groups, and a continued shift to omnichannel and value channels. In the next normal, sales employees will have to embrace more frequent and agile decision making and increased omnichannel partnerships to respond to potentially permanent shifts in shopping and consumption (such as increased digital usage and new retailer and brand preferences). We believe the CPG sales model needs to fundamentally transform.

Sales leaders will determine how to serve an increasingly differentiated market. Doing so will require them to develop a granular view of omnichannel growth priorities and identify opportunities in outlets, micro markets, or consumer segments. These opportunities can't be assessed in isolation; instead, executives must take into account their organization's competitive differentiators. Variances in channel and customer profitability mean that sales leaders will need to make trade-offs: companies using a portfolio approach can capture the most valuable pockets of growth while balancing margins on lower-growth accounts.

The pandemic accelerated the shift to online channels by three to four years, so omnichannel must now function as way to engage with consumers broadly. Depending on the organization's starting point, CPG sales leaders might focus on forging more omnichannel partnerships, creating clear channel strategies, and improving e-category management. At the same time, they should be developing new capabilities—performance marketing, customer journeys, and direct-to-consumer supply chain management—that can be shared with other functions in the organization.

Across key account management, we expect the new, agile ways of working developed during the early stages of the pandemic to become the next normal. The quick adoption of digital processes and agile decision making led to a faster commercial cadence and reduced planning—from quarters to weeks. Frequent ad hoc sharing of insights and category reviews will offer a way to jointly create

[2] Simon Land, Sheldon Lyn, Ryan Murphy, Pieter Reynders, and Joel Saa-Seoane, "Revenue growth management in the COVID-19 crisis," May 15, 2020, McKinsey.com.

value and respond to rapidly changing consumer trends and shopper behaviors. In the medium to long term, we see winning sales leaders developing additional mechanisms to tailor customer engagement based on individual characteristics; for example, joint business planning could evolve to focus on deep, long-term joint value creation with a few selected partners while transitioning to B2B online portals for all other customers.

Last, for in-store sales excellence, leaders will digitize and automate route to market (RTM) and their direct sales force to super-charge activation at the point of sale. Companies will need to adapt their service models to changing retail restrictions. For example, route-to-market models have incorporated more contactless modes, which often proved more cost effective. The use of B2B platforms for distributors and end customers will become an integral part of the value proposition, and competition with digital disruptors and aggregators will intensify.

Companies should seek to dynamically define the RTM model for each customer segment, basing the frequency and mode of service on the growth potential and ROI. They can then redeploy sales efforts from underperforming segments to other value-added activities and adjust over time to accommodate for changes in demand and possible disruptions.

Sustain performance with agile new models

COVID-19 forced CPG companies to accelerate the pace of operations because their very survival depended on moving quickly. Decisions that used to require months of deliberations were made in just weeks or days. Executives, having seen what's possible, have no reason to go back. An agile operating model will change the ways of working to achieve better outcomes more rapidly. Agility and a test-and-learn philosophy can sustain the organizational strengths that emerged during the pandemic and enable CPG companies to respond to evolving consumer needs in real time.

For instance, agile war rooms that use data to target consumer segments on a microlevel can contribute significantly to growth. Even companies with advanced marketing functions have increased revenues by shifting to agile marketing. Organizations are now experimenting with similar agile teams to go after opportunities for joint business planning that could yield double-digit growth from the companies' most strategic customers. Across commercial functions, the response center that was formed to lead the pandemic response should evolve to become the new model to deliver growth and instill obsessive performance tracking as the new way of working.

When everything changes, business as usual isn't an option. In times of crisis, companies can gain a robust competitive advantage with a razor-sharp focus on identifying pockets of growth. CPG companies that were preparing for incremental growth this year are now focused on navigating toward the best position in the next normal. Predictive growth, fueled by data and analytics, can give them the insights and tools they need and help transform core commercial capabilities to excel.

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Revenue growth management in the COVID-19 crisis

The fundamentals of revenue growth management remain, but CPG companies will need to pivot fast to respond to the crisis and lay the groundwork for the next phase.

by Simon Land, Sheldon Lyn, Ryan Murphy, Pieter Reynders, and Joel Saa-Seoane

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The coronavirus outbreak is first and foremost a humanitarian crisis. As the situation evolves, the number-one priority for all companies must be the health and safety of employees and customers. At the same time, consumer-packaged-goods (CPG) leaders are facing an increasingly unpredictable and dynamic economic future, which will require thoughtful action to guide their business through the crisis.

Broadly, companies are focusing on three phases of action. The first is to navigate the now by safeguarding and protecting their employees, their customers, and the viability of their business.[1] The second is to reorient the business so it can navigate the disruption and plan for the recovery. Finally, the most sophisticated companies are already positioning their business for the next normal after the crisis. Revenue growth management (RGM)—the discipline of driving sustainable, profitable growth through a range of strategies around assortment, promotions, trade management, and pricing—has an important role to play in phases two and three.

RGM strategies have traditionally allowed top performers to generate profits that they can reinvest in innovation and brand building. Sustaining this approach through the crisis will be a major challenge, as some categories have seen demand crater, and most consumers are bracing for a weak economic outlook. (Only 35 percent of US consumers were optimistic or very optimistic about economic conditions after COVID-19,[2] and only 10 to 15 percent in Italy, France, Spain, and the UK.[3])

Navigate the disruption

The crisis has affected consumer-goods companies in very different ways through changes in consumer behavior across several dimensions: category consumption, channel selection, shopper trip frequency, brand preference, and media consumption. (For an overview of these changes and their implications for demand, see *Rapidly forecasting demand and adapting commercial strategies in a pandemic*.)

These changes in consumer behavior require a new type of rapid planning, with a high level of uncertainty around the magnitude and duration of changes in consumer behavior. We recommend a "SPRINT" approach, which can be completed in four to six weeks (Exhibit 1).

[1] See "How Consumer Goods companies can prepare for the next normal," April 17, 2020, McKinsey.com.
[2] See "Survey: US Consumer sentiment during the coronavirus crisis," April 29, 2020, McKinsey.com.
[3] McKinsey & Company COVID-19 Consumer Pulse surveys, conducted globally between April 2 and April 19, 2020. All data relating to surveys are based on the McKinsey Global Consumer Pulse surveys conducted weekly since March 26 and expected to continue for the remainder of the COVID-19 pandemic. The most recent surveys for each country, usually including a comparison with the two previous weeks, are accessible at "Global surveys of consumer sentiment during the coronavirus crisis" on McKinsey.com. Not all dated surveys cited in this article are still available online, since older data are removed as surveys are updated. We will continue to provide in footnotes the relevant dates for which the data in this article were compiled, even if they are no longer available online.

Exhibit 1

Navigating the crisis calls for rapid and coordinated execution of a SPRINT-based plan.

Revenue response

Size and prioritize revenue exposure

Project demand

Revamp marketing plans

Integrate e-commerce

Navigate RGM adjustments

Team up with customers and execute

The essence of the SPRINT model is to develop a view of the expected revenue and margin evolution of the business based on each category-level demand archetype, and then to design appropriate actions across multiple commercial dimensions. The SPRINT model is comprehensively laid out in *Rapidly forecasting demand and adapting commercial strategies in a pandemic*. We focus here on the RGM component in step 5 ('N'):

Navigate RGM adjustments with caution. Coupled with supply realities, any demand spikes or drop-offs will create opportunities and challenges for CPGs. With respect to the four core aspects of RGM (pricing, promotions, assortment and portfolio, and trade), companies need to tread carefully. Any action on RGM should abide by the principle of building stronger relationships with customers and consumers (for example, by extending payment terms for more vulnerable customers or by delaying planned price increases on essentials). At the same time, there will be value-driving actions to take (Exhibit 2).

Plan for the next normal

Even as companies work nonstop to stabilize their business, we believe it is critical to allocate significant time to planning for the postcrisis phase. It can be as simple as executives spending a few hours every week thinking ahead, or as committed as assigning a specific team responsibility for creating RGM plans for 2021 and beyond. To succeed at RGM in the next normal, CPG companies need to focus on consumers, shoppers, and customers, and define scenarios for each.

Exhibit 2

RGM in a crisis requires strategic choices.

Core aspects of RGM	What to do	What to avoid
Pricing	Consider planned, moderate price adjustments on non-essentials	Increase price on essentials
Promotions	Shift promo spend to defend share in categories with surging demand and where there is a risk of switching as tolerance for trying new brands increases	Run "business as usual" promotions that are inefficient or where supply constraints limit the ability to support higher demand
Assortment and portfolio	Streamline the assortment to most productive SKUs to drive logistics/store operations efficiencies Reconsider timing of product launches to account for delayed consumer demand and supply-chain disruptions	Pushing higher-priced variants of products simply to improve profitability
Trade	Reinforce performance principles of trade terms (eg, customers with strongest performance orientation are prioritized for investments, including supply)	Take actions that could affect the viability of more vulnerable customers (eg, find ways to extend payment terms rather than making aggressive collection moves)

Consumers

Product and brand preferences—leading to assortment and pricing changes

Stockpiling and product unavailability are disrupting consumers' traditional preferences for specific brands or product attributes, especially in categories deemed essential. As a result, 30 to 40 percent of US consumers and 65 to 75 percent of those in India and Vietnam have already tried alternative brands or products during COVID-19.[4] The expected postcrisis recession is likely to exacerbate this trend as consumers look for and switch to more affordable options.

To respond, CPGs will need to make assortment and pricing changes:

— Re-evaluate portfolio positioning and pack-price architecture, and consider whether to change the pricing for certain SKUs or launch new packs that are more affordable or convenient. One coffee-subscription company saw growing consumer demand for its home-delivered coffee and made a five-pound pack, normally reserved for wholesale, available to end consumers online, which was an instant hit.[5]

— Consider whether they need new sub-brands with a differentiated proposition, specifically as an affordability play or to fulfill needs that matter more to consumers post-COVID-19.

— Consider whether to invest in a specific growth category through innovation or M&A. As an example, many manufacturers of beauty and personal-care products have started to produce alcohol gels to support health workers and their communities. Now, with increased demand for hygiene products, should these become part of their standard offering?

— Address health concerns, in particular hygiene-conscious packaging. Examples are beverage companies adding aluminum-foil tops on cans or fresh-food producers packing products. Notably, these changes will also need to align with consumers' rising standards on sustainability.

Consumption occasions—leading to assortment and promotions changes

The shift to at-home consumption may become structural as consumer habits around working from home or spending social time outside change. Since the impact would vary by category, consumer-goods companies need to have a clear understanding of this evolution by holding new consumer-usage panels more frequently or using new household-penetration data in more detail.

Early evidence from China also suggests that some of the consumption occasions most impacted by COVID-19 are not likely to return quickly to precrisis levels, and recovery is not uniform across the country. In Tier-1 cities, sales in restaurants and food service in early March (with reopening rates above 90 percent) were still 40 percent lower than in December 2019.[6]

CPG companies will need to leverage these insights to develop new occasion-led assortment and promotion strategy changes. If occasion insights are not yet a significant input to activation and innovation strategy, now may be the time to bring them forward. This can lead to developing products better suited to new or more important occasions, reallocating communication investment toward them, and improving the activation of products to match the occasions. Several wine companies, for example, have started to offer virtual educational wine tastings, with complimentary at-home delivery.

[4]Consumer Pulse surveys: US 3/19–20, 2020; India 4/10–13, 2020; Vietnam 4/18–21, 2020.
[5]Meggen Taylor, "Trade coffee launches a five-pound bag to satisfy consumer demand and to keep their roasting partners in business during the pandemic ," *Forbes*, April 7, 2020, www.forbes.com.
[6]MIYA payment engine data. Tier-1 cities are Beijing, Shanghai, Guangzhou, and Shenzhen.

Shoppers

Shopping occasions / missions—leading to promotions changes

Stock-up missions in grocery retail significantly increased during the initial crisis and may continue to be more functional, shorter, fewer in number, and higher in ticket value. In addition, the shopper may change: in China, male shoppers at brick-and-mortar stores increased more than 50 percent during the crisis.[7]

With consumers spending less time in stores, space for second placements is potentially restricted due to social distancing and a changing shopper profile. CPG companies need to redesign their promotional plans and reallocate budgets, including stimulating new-promotion volume uplifts, returns on investment, and reflecting changes in the assortment focus.

Channel and store preferences—leading to assortment and trade management changes

Shoppers are trying new ways of shopping and many may stick with them, leading to dramatic channel shifts:

— E-commerce is growing, albeit at vastly different speeds in different places. US grocery e-commerce household penetration increased from 13 percent before the pandemic to more than 31 percent in late March.[8] This acceleration is likely to remain to some extent after lockdowns are over, with consumers in Asia expecting to shop online significantly more after the crisis than they did before: +15 percent in China, +16 percent in Indonesia, +38 percent in India, and +47 percent in Vietnam.[9]

— Bricks-and-mortar retail is seeing a substantial change in store mix and shopper experience. For example, in Europe, 14 percent of shoppers switched to a discount store, and in the US, 17 percent of shoppers were already going to new stores during the COVID-19 situation. In China, 50 percent of shoppers who had changed stores reported they do not intend to shift back.[10]

Various data sources and analysis techniques can help CPGs monitor these shopping habits very closely. For example, shopper surveys and geospatial-location data can shed light on how shopping behaviors and missions are changing—and given how fast the crisis is evolving, weekly or monthly updates are desirable.

Companies should start positioning themselves now to succeed by:

— accelerating efforts to win in growing purchasing channels such as e-commerce and click & collect, including expanding e-category management capabilities and providing easy-to-handle, e-commerce-specific packaging. A consumer products brand, for example, refocused its promotional budget on its own website, offering over 50 percent discounts to match customers' changes in channel focus.

— ensuring sufficient product availability and distribution of a "must-have assortment" across all store types. Companies could also consider having a presence in the discount channel, provided they carefully assess the tradeoffs of such a move.

Customers—leading to trade-management changes

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[7] Consumer Pulse surveys: China survey 3/21–23, 2020.
[8] Brick Meets Click and ShopperKit Online Shopping surveys: August 21-23, 2019, and March 23-25, 2020.
[9] Consumer Pulse surveys: Vietnam 4/18–21/2020; China 4/8–13, 2020; Indonesia 4/10–12, 2020; India 4/10–13, 2020.
[10] Consumer Pulse surveys: Europe (including Italy, France, Germany, Spain, UK, and Portugal) 4/16–19, 2020; US 3/19–22, 2020; China 3/21–23, 2020.

In light of the changes to channel and store preferences described above, CPG companies will need to focus efforts with customers along four dimensions:

Strengthen operational relationships to ensure the basics are in place—for example, ensuring an effective supply chain to make sure there is always stock.

Support customers who may be under critical pressures—this can include extending payment terms or temporarily enabling consignment-based selling models. For example, an alcoholic-beverage company is encouraging outlet consumers to buy gift cards that can be redeemed later, helping to protect one of its core channels.

Reassess focus of investments across customers, given likely changes in the channel landscape, and who are going to be the "new winners." CPG companies will need to redefine their customer segmentation and purposefully tie investment amounts, components, and size to the new segmentation.

Redefine trade-terms agreements with retailers, as they are being disrupted by changes in shopper habits and preferences. This will include changes to:

— *promotion plans*—as noted above, promotional uplifts and returns are likely to fundamentally change, and CPG companies will need to reset promotional plans agreed with retailers, redefining terms, in particular fixed-sum payments.

— *growth bonus thresholds*—as shoppers spend more on essentials and less on discretionary items, growth thresholds may be arbitrarily hit or become completely out of reach.

— *timing of annual negotiations*—negotiations between CPGs and retailers typically start gearing up at the end of Q3 and accelerate in Q4. However, in light of the crisis, CPGs may want to delay negotiations until they have more clarity on what the next normal looks like, negotiate different components at different times, or agree to more flexible terms. At all times, companies should avoid being locked into a contract that has not been adjusted for the new reality.

There is no playbook for navigating a global pandemic, and there are shifts that will be hard to anticipate. But experience shows that companies that take a proactive approach, repositioning themselves to navigate the disruption and planning ahead for the postcrisis world as best they can, stand the best chance of not only surviving but coming out on the other side stronger. Companies that already have a dedicated RGM function should be putting that capability at the forefront of their effort. The actions they help direct should deliver for consumers and shoppers and strengthen relationships with key customers.

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Will innovation finally add up for consumer-goods companies?

In a changing landscape, companies can better meet consumers' needs by understanding the true value of innovation.

by Vinit Doshi, Stacey Haas, and Jon McClain

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In response to massive consumer-behavior changes due to COVID-19, multiple consumer companies have recently announced cutbacks in their innovation pipelines. These announcements may signal a new era for the consumer-packaged-goods (CPG) sector, one in which the innovation agenda can escape the endless line extensions of the past several years. The lower-value launches that pervaded pre-pandemic innovation portfolios have failed to drive meaningful growth or return on investment for many CPGs (Exhibit 1). The average first-year sales for new-product pacesetters declined by an astonishing 50 percent between 2012 and 2018.[1]

Innovation will be more important than ever as we move toward the next normal amid changing consumer needs and occasions. Companies can rethink their innovation agendas to more effectively address those needs and drive growth. However, many executives see barriers to boosting innovation performance, including the complexity of multi-functional organizational dynamics and the difficulty of predicting consumer preferences and behaviors. In addition, these innovations seem to be occuring faster than ever. Disruption due to the pandemic lends even greater urgency to ensuring that innovation strategies adapt well to changes in consumer needs and retail environments.

The industry has been weighed down by innovation that fails to deliver meaningful, incremental growth. While challenges exist, they can be overcome. CPG companies can significantly boost the performance of innovation by measuring it more effectively, managing it more strategically, identifying ideas worth pursuing, and supporting them with necessary resources. Understanding the true, incremental impact of innovation is fundamental to developing a pipeline that delivers on the strategic objectives of the company.

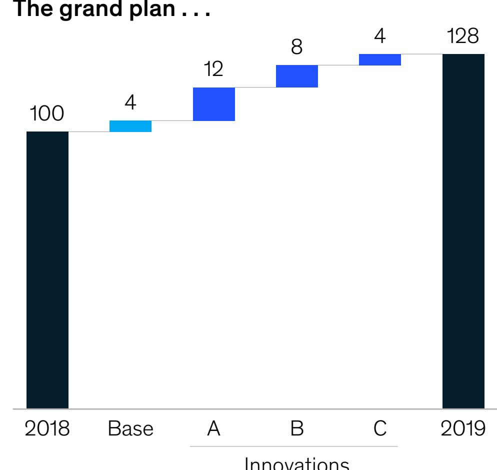
[1] Joan Driggs and Larry Levin, *New product pacesetters: Product innovation and the pace of change*, IRI, May 2019, iriworldwide.com.

Exhibit 1

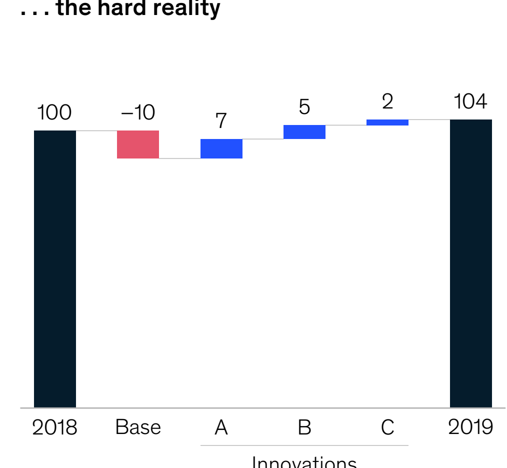
Consumer-goods companies face a different landscape than the one they imagined.

Portfolio sales, $ (2018 = 100)

The grand plan . . .



. . . the hard reality



Leading CPG innovators aim to be first to scale, rather than first to market.

Implement a better measure of innovation

In a previous article, we described successful innovators' strategies, agile processes, investment approaches, and organizations.[2] The first element of a winning model is to focus on targeted consumer needs. For example, instead of casting a broad net, they aim precisely at well-defined pockets of winnable opportunity that are linked to a broader platform. They launch more "speedboats"[3] by applying agile approaches to iterate their way to growth instead of risking everything on a few big bets. They also manage innovation as venture investment managers would, tracking progress against key performance indicators, adapting quickly to in-market performance, and appointing leaders to make decisions with autonomy. Leading CPG innovators also aim to be first to scale, rather than first to market. They identify high-potential ideas and trends and then leverage size to get to scale quickly.

Many companies also aim to have better insight into innovation impact that can inform the next set of innovations to launch. We previously described how companies can benchmark their overall innovation performance using measures of R&D-to-product conversion and new-products-to-margin conversion.[4] These metrics provide valuable insights on efficacy of R&D dollars and impact of new products on overall margin. We now have the rigorous data, systems, processes, and analytic knowhow to expand this to include additional metrics.

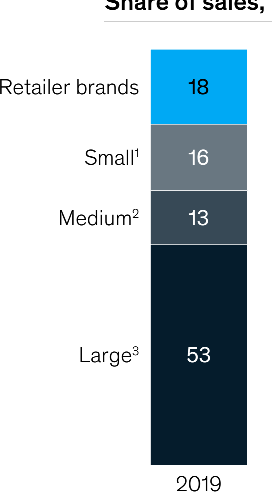
Currently, many companies track the share of sales coming from innovation, known as the vitality index. But with its simplistic focus on total revenue, this metric not only fails to differentiate profitable and unprofitable investments but also evaluates all innovation through the same lens, regardless of strategic intent. The vitality index is a kind of thermometer: it measures temperature but does not improve health. It can distract companies into shifting volume, effectively cannibalizing existing sales, rather than driving more valuable and disruptive innovation. Indeed, many companies with a strong vitality index—as much as 20 percent of sales from products launched in the past three years—are not growing their top lines. In a world of endless line extensions, the feel-good vitality index is becoming less and less meaningful. The decline in first-year sales of new products is evidence of the challenge facing large brands.

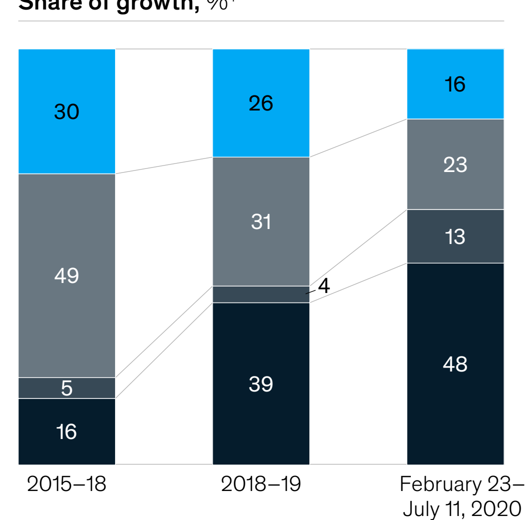
In a postpandemic world, this challenge of anticipating consumers' needs—and managing innovation to address those needs—is likely to get tougher as a result of massive, lasting behavioral disruption across consumers, categories, and channels. Consumers are placing greater priority on necessities. They're seeking larger sizes, shelf-stable and easy-to-prepare products, and products that deliver a higher value. They're shifting their shopping behavior to online and direct-to-consumer channels. Changes in disposable income and consumer attitudes increasingly favor brands that stand for trust, safety, health, and value. Established

[2] Mark Dziersk, Stacey Haas, Jon McClain, and Brian Quinn, "From lab to leader: How consumer companies can drive growth at scale with disruptive innovation," September 2018, McKinsey.com.
[3] Smaller launches to test and refine products in-market.
[4] Guttorm Aase, Erik Roth, and Sri Swaminathan, "Taking the measure of innovation," *McKinsey Quarterly*, April 2018, McKinsey.com.

Exhibit 2

Since March 2020, large companies have made significant gains in growth share.





[1]Companies with annual sales less than $500 million.
[2]Companies with annual sales $500 million to $2.5 billion.
[3]Companies with annual sales more than $2.5 billion.
[4]Figures may not sum to 100%, because of rounding.

brands, which had been suffering slow growth compared with smaller, more nimble brands, have now rebounded and account for nearly half of growth (Exhibit 2).

Leading companies are evaluating and adjusting their portfolio strategies in anticipation of the eventual recovery. Many are acting decisively to adjust assortment, fill product gaps, evolve price-pack architecture, adjust promotional activity, and increase omnichannel presence. Some companies are further exploring ways to align brand priorities with growth opportunities and accelerate the right innovation initiatives to compete effectively in an altered landscape. One leading food marketer sought to establish a more consistent and objective process for assigning limited resources to the right places earlier in the process. To achieve this, the company's innovation team is testing a data-driven approach to simulating innovation potential ahead of extensive product-development and -launch efforts.

The pandemic is also lowering barriers to brand switching. According to a recent survey, 75 percent of consumers have started a new shopping behavior—including 36 percent of consumers who have purchased new or alternative brands and products—often out of necessity due to product unavailability but also out of changing attitudes.[5]

This potential for easier trial may be good news for future innovation. But before that happens, marketers will need to know which past innovations have been successful and why (or why not); this knowledge is key for ensuring that innovation strategies can meet evolving consumer needs in a demanding retail environment.

It is critical to measure, simplify, and manage innovation performance differently and more effectively. To identify the true impact of innovation, marketers need a strategic and fact-based view. Better measures of innovation performance

[5]McKinsey & Company, COVID-19 US Consumer Pulse Survey, conducted between June 15 and June 21, 2020.

allow senior leaders to make superior decisions on the R&D, marketing, branding, and commercial levers used to support those innovations. A disciplined approach allows companies to institutionalize the process of learning and incorporate lessons back into strategic planning. Most important, it can shift organizational mindsets toward a relentless focus on ensuring that innovation works.

To accomplish this, we recommend three improvements to innovation: determining strategic roles, measuring net incrementality, and shifting evaluation from sales to profit and returns.

Determine strategic roles for each innovation
Not all innovations are equal. The most successful innovators understand the roles different kinds of innovation play in the overall growth algorithm—and the portfolio composition required to reach growth targets. Portfolio innovation can be grouped in four categories, each with a distinct role and a different path to achieve scale (Exhibit 3):

— *Line extension,* a low-risk, close variant of an existing brand that delivers the same essential benefit proposition—such as vanilla-flavored soy milk

— *Innovation expansion,* in which a new product in the same category delivers new or more benefits in ways that fundamentally expand total category potential—such as almond milk in the space of plant-based beverages

— *Disruptive innovation,* where marketers innovate to enter white space (new categories or business models) to serve new or unmet needs, reach new opportunities, and engage with consumers in pioneering ways—such as plant-based beverages as alternatives to dairy milks

— *Renovation* of an existing brand's positioning, product, or packaging to deliver improved benefits—such as cookies without trans fats;

Exhibit 3

Companies focused too heavily on line extensions can apply incrementality learnings to shift the balance toward expansion and disruption.

	Line extension	Expansion	Disruption	Renovation
Description	Extend existing product or positioning with similar benefits	Innovate with new product in current categories, consumers, or occasions	Disrupt to enter white space, such as a new category or business model	Improve existing brand's overall benefit delivery
Strategic objective	Renew the core value proposition through additional product choices	Create competitive advantage with meaningful product differentiation	Create new spaces for highly incremental and sustainable sources of growth	Improve the core value proposition of an existing brand; eg, "fix what we have"
Actions	Extend existing brand in category with new packs, format, flavor, or sizes	Launch new product under existing or new brand to serve consumers differently and more effectively	Launch into new categories, new consumers, occasions, unmet needs, or new business models	Improve existing brand's product, positioning, packaging, or benefit delivery
Investment[1]	Low	Moderate	Large, sustained	Low to moderate
Impact	Smallest	Moderate	Largest	Moderate
Typical timing	<12 months	1–2 years	2+ years	Immediate

[1]Represents typical scenarios; actual investment profiles vary widely across companies and categories.

this underused approach can benefit growth by delivering meaningful differentiation to the entire brand in a cost-efficient way

It is critical to measure each type of innovation against different standards of performance and over varying investment horizons. One critically insightful and necessary measure of performance is incrementality, or the portion of innovation volume that comes from new buyers and additional usage occasions. Incrementality can also be thought of as a new product's volume after netting out cannibalization from a brand's existing buyers.

A typical line extension's incrementality might not exceed 10 percent, but it should require less support and pay out more quickly. An expansion, which requires greater product differentiation and spending, can deliver incrementality of 20 to 50 percent. Disruptive innovation can deliver more than 50 percent in incrementality but typically requires more time and money to develop and scale. It is important to note that true breakthrough innovation (a step further than disruptive) requires different measurement approaches (both before and after launch).

Measuring innovation in the context of a portfolio helps senior leaders set the right performance bars for each initiative. It also provides strategic flexibility in innovation sequencing and mixes that can deliver both near-term results and sustained portfolio growth.

For example, a leading food manufacturer found that its rate of innovation was similar to those of its peers, but two-thirds of its launches were line extensions that yielded little incremental revenue. Many investments in innovation produced negative returns, diverting valuable resources from the more disruptive ideas required to build sustainable competitive advantages. With a clearer view of end-to-end profit and return on investment (ROI), including capital- and operational-expenditure costs, the senior team reprioritized innovation initiatives, favoring expansion and disruptions over line extensions. The shift significantly improved net sales, gross margins, and ROI.

Measure net incrementality to the portfolio
A critical step is measuring each innovation's true incremental impact to the brand and portfolio, net of cannibalization. Measuring the baseline can often prove a tricky affair. But recent advances in analytics using data-driven models of consumer behavior have made it possible to measure true incrementality while controlling for other factors. This shifts the conversation from what to sell toward which consumer behaviors innovation should strive to replace. The focus on incrementality is useful

Measuring innovation in the context of a portfolio helps senior leaders set the right performance bars for each initiative.

both in postlaunch evaluation and in identifying where to play when developing innovation strategy. Incrementality metrics can identify impact from new buyers to a brand and portfolio as well as incremental purchasing from existing buyers, net of cannibalization.

For example, a leading brand of household cleaners launched a close-in line extension touting superior cleaning benefits, but it resulted in less than 20 percent incrementality because it had entered a crowded space where headroom was limited. The challenge was even more difficult given the dynamics of a category with limited expandability, a high bar for consumer credibility, and consumer momentum moving from liquid cleaners to tools. Moreover, the overall brand declined by 4 percent as the new product cannibalized marketing support from the rest of the brand's products, resulting in negative ROI (Exhibit 4). These shortfalls persuaded senior leaders that they needed to innovate in growing spaces, create more differentiated benefits, and avoid cannibalizing the parent brand of its own marketing support.

A similar analysis in the milk and milk-alternatives market shows that plant-based beverages such as almond or soy milk were about 44 percent incremental to the overall category, meaning that 44 percent of growth in alternative-milk consumption came from other beverages, not dairy milk. The remaining 56 percent represented cannibalization from dairy milk, a number that may sound alarming but ultimately represented only a tenth of the

Exhibit 4

One brand entered a declining liquid segment with limited headroom and with consumer momentum going to tools.

Retail sales, year-over-year change

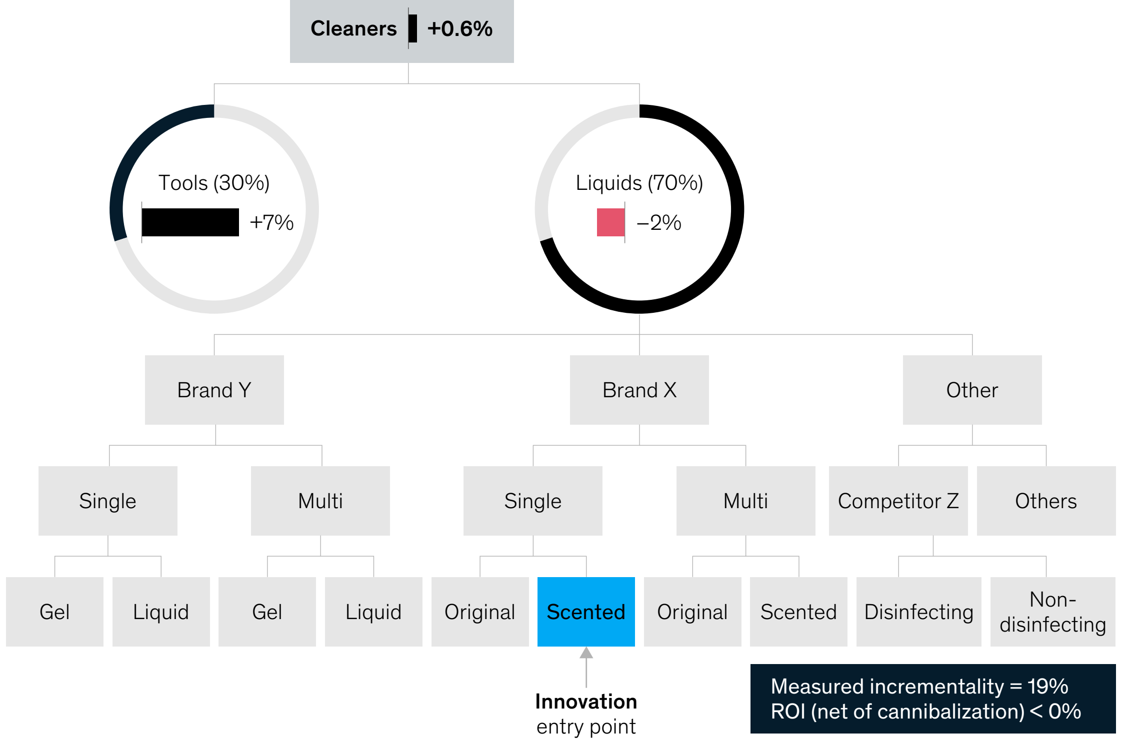
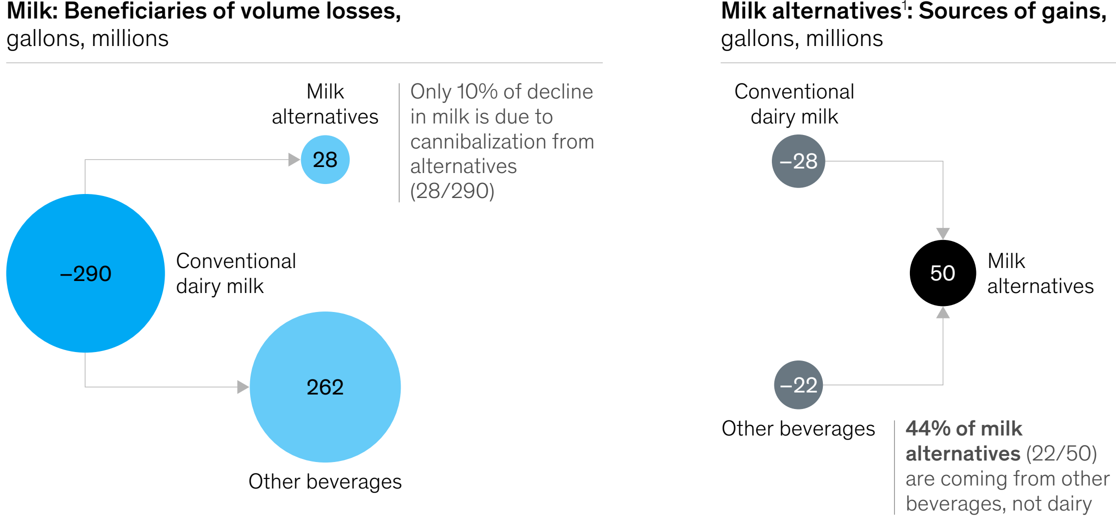


Exhibit 5

An analysis of incrementality shows that milk alternatives are not the main cause of declines in conventional dairy sales.



Most of the decline (–262 million) in conventional dairy milk is due to other factors not directly caused by plant-based alternatives: erosion of product appeal related to changing consumer tastes, loss of distribution, less effective marketing, price changes, etc

[1]Milk alternatives include almond, soy, coconut, oat, and rice. Conventional dairy milk includes cow's, lactose-free or -reduced, and other milks.
Source: Nielsen, 2015–19 sales; McKinsey Growth Mapping

total decline in conventional dairy milk. The quantification of true incrementality showed how the emergence of milk alternatives was more a symptom than the cause of decline in dairy (Exhibit 5).

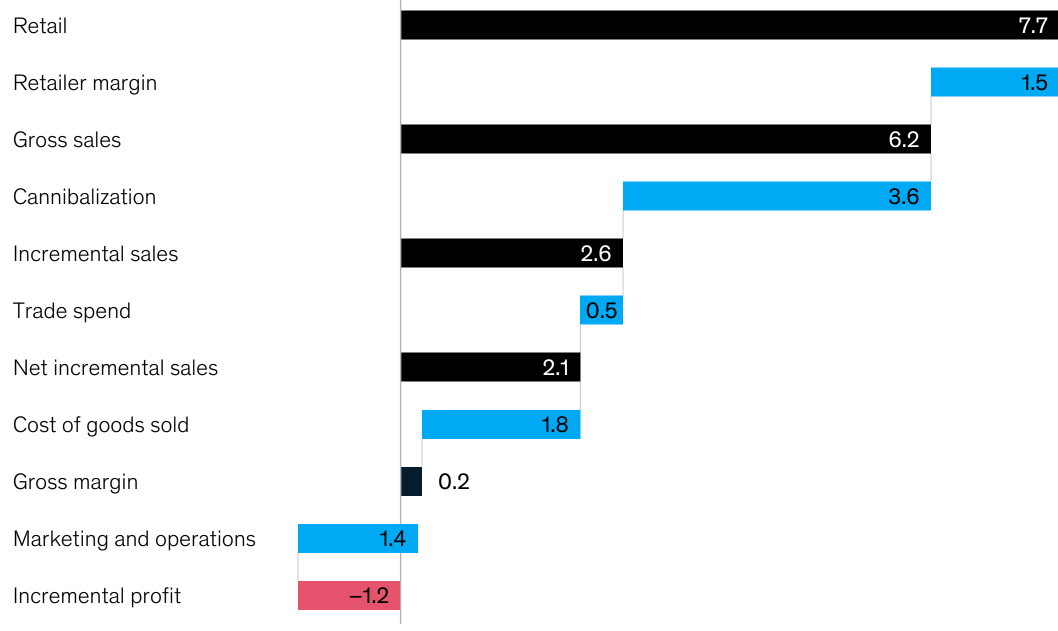
Shift innovation evaluation from sales to portfolio profit and return on investment

Marketers who manage innovation based on incremental profitability to the portfolio, instead of sales or share, stand to make better decisions to drive portfolio growth. They need to measure whether the innovation is profit accretive to the portfolio mix and quantify the ROI. With this fresh perspective, marketers can plan for accretive margins from the early stages—and give more disruptive innovation enough time and investment to become profitable.

For example, a leading snack-food manufacturer launched a fruit-flavored line extension of its brand in a fragmented category. The extension delivered the expected gross sales, based on the size of the parent brand. And by the standards of a line extension, its 42 percent incrementality appeared healthy. But after fully accounting for cannibalization and the costs of product development, marketing, and operations, the company discovered that the innovation yielded a negative ROI (Exhibit 6). Although a low ROI is not unusual for new products in the first year, the comprehensive measurement of incremental sales and profit led the company to revisit resource allocation behind line extensions.

Exhibit 6

For one company, an innovation netted negative returns after considering true incrementality.



Note: Figures may not sum, because of rounding.

Next steps

It may feel daunting to manage and measure innovation in the context of complex portfolio-growth strategies. But it doesn't need to be. We recommend starting with an unbiased assessment of the organization's capabilities and practices by asking nine questions:

1. Does innovation empower sustainable, profitable portfolio growth?

2. Do we use an analytical, data-driven framework to choose where to innovate?

3. Do we develop innovation systematically, based on consumer-led and analytical insights?

4. Are we able to accurately predict the size of innovation and sources of volume?

5. Do we pursue a balanced mix of innovations with distinct roles to meet specific strategic goals?

6. Do we set metrics and targets by type of innovation based on objectives and portfolio roles?

7. Are we able to accurately measure innovation incrementality?

8. Do we measure the impact of innovation to understand if it is margin accretive to the portfolio?

9. Does our organizational structure use a disciplined process to measure and manage innovation?

In our experience, nearly every CPG company could stand to make meaningful improvements in one or more of these areas. Leaders who commit to managing innovation performance in more purpose-ful and rigorous ways can expect to drive more profitable portfolio growth through innovation.

Advances in data and advanced analytics make it easier than ever to rapidly measure root causes and improve innovation performance. The real challenges lie in finding the discipline to establish a consistent and agile measurement process, glean the right insights from consumer and shopper data, and apply powerful advanced analytics based on machine learning to evaluate performance.

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Accelerating the recovery in consumer goods through digital and analytics

More than ever, scaling impact through digital and analytics is an imperative for consumer-goods companies. Here's our emerging recipe for navigating the recovery.

by Ford Halbardier, Brian Henstorf, Robert Levin, and Aldo Rosales

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The pursuit of large-scale impact through digital and analytics is not a new topic. Ask any consumer-goods executive if his or her company has invested in digital and analytics, and you'll almost certainly get an affirmative response. However, COVID-19 has severely accelerated disruption and highlighted the need for reinvention across four main areas:

1. *Seismic shift to digital engagement.* The longer the crisis persists, the more likely it is that the substantial channel shift to e-commerce, direct to consumer, and other digitally enabled purchase journeys will be transformative and lasting.

2. *Rapidly changing consumer behavior.* As consumers shift to online channels and dramatically change their habits, it has become increasingly important for companies to establish agile digital-marketing and consumer-insights capabilities to enable better decision making.

3. *Increased focus on supply-chain resiliency.* Unpredictable demand patterns, combined with the disruption of physical supply chains, have resulted in high volatility and uncertainty that require immediate and coordinated action across manufacturing plants, suppliers, and retailers.

4. *Growing need to rethink the product portfolio.* Consumers are looking for more-convenient, safer, and less-expensive alternatives. Suppliers have been struggling to fulfill those needs in this environment. Companies will have to innovate faster, reduce complexity, and simplify the product portfolio.

Scaling digital and analytics will be a key differentiator between resilient and nonresilient companies as they emerge from this crisis. In light of the recovery and reinvention challenge that the industry is up against, the call to action is loud and clear: either fully tap into the power of digital and analytics, or get left behind.

In this article, we describe the most common pitfalls that companies encounter in their journey toward digital and analytics scale-up, as well as the imperatives to consider in the context of COVID-19. We also explore an emerging recipe for success.

The most common failure modes

Drawing on our experience working with consumer-goods players around the world, we have identified the four most common failure modes—the mistakes that hinder organizations from capturing value at scale from digital and analytics:

1. *Neglecting to connect digital and analytics programs to the enterprise strategy.* Laggards tend to treat digital and analytics efforts as side projects rather than important enablers of enterprise-wide priorities.

2. *Making big investments prematurely.* Some companies, enamored of having the latest technology, invest in digital and analytics before they thoroughly understand what the business truly needs and what will deliver significant impact.

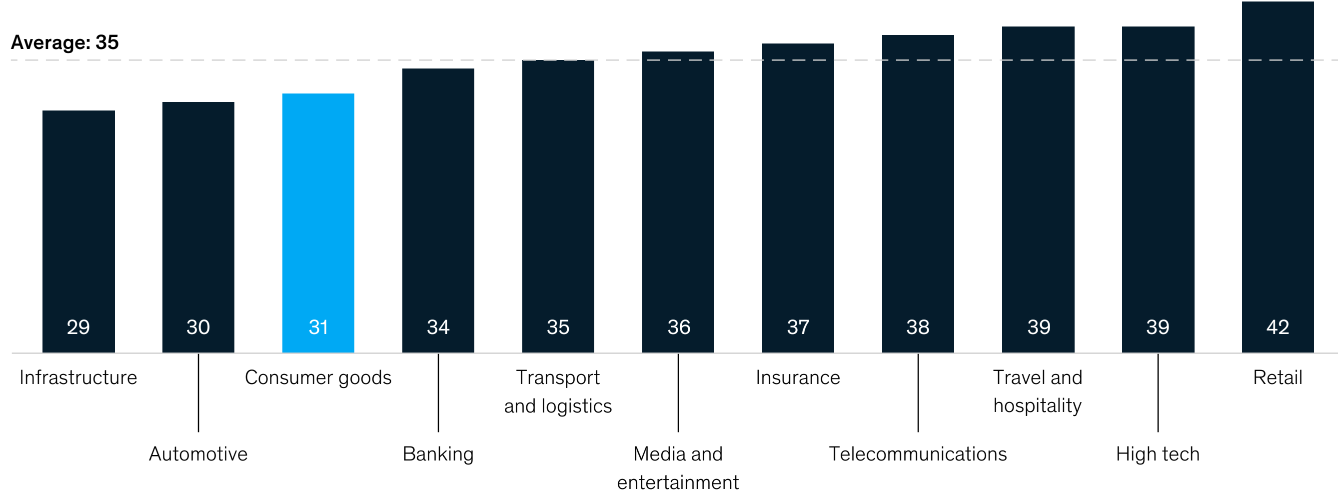
3. *Holding out for "perfect" hires.* Laggards spend as much as six months searching for two or three data scientists or wait until they feel they've found the "perfect" hire to lead the team.

4. *Underinvesting in change management.* Executives often tell us that they wish they'd spent as much or more on change management as they did on technology. As a rule of thumb, digital and analytics leaders should allocate their energy and investment as follows: 25 percent on data, 25 percent on technology, and 50 percent on change management.

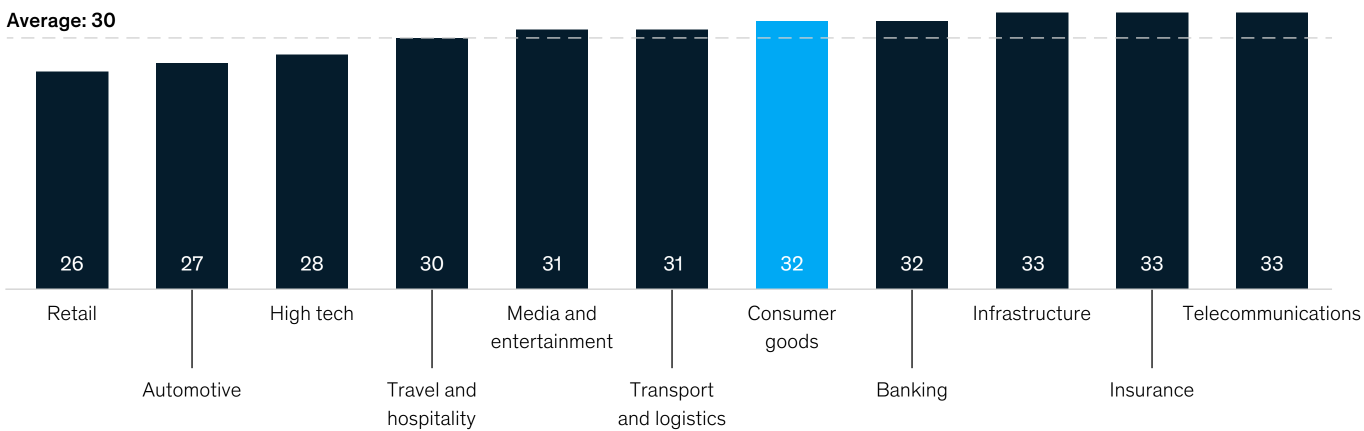
Exhibit 1

Consumer goods is among the least digitally mature industries.

Distribution of Digital Quotient score by industry, global, points (out of 100)[1]



Distribution of Analytics Quotient score by industry, global, points (out of 100)[1]



[1] As of June 2019.

Complexity in the context of COVID-19

The pandemic has created additional complexity that consumer-goods players must consider as they navigate the recovery phase.

First, speed is more important than ever. Companies have had to make decisions quickly. Remote working was adopted practically overnight, allowing companies to mobilize global talent instantly. Organizations have realized that this new way of working is enabling speed and flexibility. Coming out of the crisis, many will consider a permanent change to the traditional operating model, and companies that fail to adapt will most likely struggle to capitalize on this momentum.

Second, the cost and liquidity challenges will intensify as the economic downturn becomes more severe. Uncertainty about the duration of the COVID-19 crisis will make it challenging for companies to incur discretionary capital expenditures—such as digital and analytics investments—with confidence.

Third, COVID-19 will most likely increase the availability of technical talent. As start-ups struggle with short-term liquidity and companies across industries look for efficiencies, there could be an increased supply of skilled people pursuing new challenges. Consumer-goods players can become new hubs for digital and analytics talent.

An emerging recipe for success

Before the crisis, only a few consumer-goods players had delivered impact at scale from digital and analytics efforts; however, the recipe for success is becoming clear.[1] The following are four core elements of digital and analytics success that companies should put into practice as they navigate the recovery.

1. Set a bold long-term aspiration

Companies should avoid articulating only a vague, generic aspiration ("we will build excellent analytics capabilities"), which will inevitably fail to take hold. Instead, they must begin with a concrete digital and analytics vision clearly linked to the corporate strategy. One consumer-goods company, for instance, had the following vision for its transformation: to "create a best-in-class sales force using digital and analytics to enable the right actions, in the right outlets, at the right time, executed flawlessly every day."

Albeit long term in nature, the vision must address themes that the COVID-19 crisis has made more important than ever, such as e-commerce capabilities. Coming up with a balanced aspiration—one that is transformational but also targeted to short-term value areas—will help determine priority areas and investments.

Importantly, the aspiration must be informed by a candid, detailed assessment of the starting point, using a shared vocabulary and well-understood criteria and standards to ensure that people at all levels recognize the magnitude of the change required. One business unit's definition of "digital and analytics" might be vastly different from another's, so it's critical to establish a thorough understanding of the current state of affairs and a common definition of success.

2. Pursue 'domain transformations,' not unrelated use cases

At the heart of any digital and analytics program are use cases, which define specific business problems to be solved through new ways of working. Use cases can be found across the front, middle, and back of an enterprise. They can be grouped together in "domains"—subsets of use cases that share a common element, such as a deployment mechanism, data sources, or business users (Exhibit 2). We've found that to bring about transformational change, it's best to pursue use cases within the same domain.

In the early days of digital and analytics transformations, companies prioritized individual use cases, largely in the commercial functions, based on feasibility and impact. To support the highest-priority use cases, companies then established a set of broad-based enablers—for instance, a data lake, a technology stack, and a technical organization that housed all-new talent profiles, such as data scientists. In theory, these enablers would meet the needs of the entire enterprise.

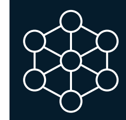
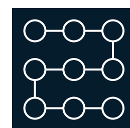
In practice, however, generic enablers rarely meet specific business requirements. Successfully scaling up digital and analytics efforts thus requires a different approach: one that prioritizes fully enabled domain transformations rather than unrelated use cases. Instead of pursuing the three highest-impact use cases in different domains, a company might pursue, say, the first, fourth, and

[1] For a cross-industry analysis, see Peter Bisson, Bryce Hall, Brian McCarthy, and Khaled Rifai, "Breaking away: The secrets to scaling analytics," May 2018, McKinsey.com.

Exhibit 2

Digital and analytics programs should support entire domains rather than unrelated use cases.

■ Domain ■ Use case

Front			Middle			Back
						
Sales analytics and merchandising	**Revenue and omnicategory management**	**Marketing analytics and personalization**	**Design and procurement**	**Operations and supply chain**	**Manufacturing and distribution**	**Human capital**
• Insights-based selling • In-store and outlet execution excellence • Sales-force coverage and support	• Pricing and trade-spend optimization • Dynamic pricing • Promotion optimization • Assortment optimization • Online merchandising	• Loyalty optimization • User experience and in-store optimization • Personalization and hyper-marketing • "Consumer back" innovation • Marketing mix modeling or attribution	• Product innovation • Procurement excellence • Integrated product-cost optimization	• Advanced inventory modeling and out-of-stock prevention • Digitized end-to-end supply-chain planning • Demand shaping • Point-of-sale-based demand forecasting	• Predictive maintenance • Network optimization and dynamic routing • Production optimization/ lean manufac-turing • Frontline and asset-performance management	• HR analytics for frontline performance • Back-office or robotic process automation • Diversity and inclusion • Organizational health

sixth highest-impact use cases, if these reside within the same domain. The company can then develop domain-specific enablers, such as data the domain needs, surgical changes to the tech stack, or capability building for business users. In this way, the company reaps higher returns on its investment because these enablers support all the use cases within that domain.

This approach also allows companies to tackle each domain's unique challenges. The sales analytics and merchandising domain, for instance—particularly for large, dispersed sales organizations—typically requires an intense focus on handheld tools linked to the core tech stack and deployed through broad-based capability building. On the other hand, the revenue-management and omnicategory-management domain is much more about sophisticated, granular analytics conducted by a relatively contained team, with limited implications for the tech stack. By transforming domains, companies can home in on these domain-specific challenges and more rapidly achieve impact at scale.

Domain transformations in the middle of the enterprise are often the most difficult: consumer-packaged-goods (CPG) companies typically have hundreds (or even thousands) of people in their supply-chain organizations, as well as multiple data sources scattered across planning teams, plants, and distribution centers. One CPG manufacturer had historically struggled to optimize the availability of its products while keeping the cost of goods sold (COGS) and inventory low. The executive team agreed to prioritize one domain—sales and

Data and architecture are among the toughest enablers for consumer-goods organizations to get right.

operations planning (S&OP)—and selected two use cases within that domain that would both deliver outsize impact and build the necessary foundations for future efforts. The first use case was digitized end-to-end supply-chain planning; the second was demand forecasting based on point-of-sale (POS) data.

The main enablers of the domain transformation included a data ecosystem that integrated inputs from more than 100 data sources and became the organization's "single source of truth"; a robust set of digital and analytics tools—jointly chosen and refined by the planning managers and use-case experts—to automate key portions of the planning process and free up the planning team's capacity; and an intensive capability-building effort that touched all 200-plus people spread out across multiple planning cells. This third enabler, overlooked in previous transformation efforts, was crucial to success, especially in light of the wide variability in technical expertise across the talent pool.

The impact was evident within the first year: higher revenues through lower out-of-stock levels and better customer service, reduced costs through a decrease in the number of obsolete products, and significantly reduced inventory through lower safety stocks. The company's demand-forecasting accuracy, already above average for the industry, improved by more than six percentage points. In hindsight, prioritizing this domain was critical to establishing a competitive advantage in a COVID-19 environment, where the capacity to react quickly has become a true differentiator.

3. Ensure the coherence of enablers across domains

Each domain must be fully enabled to succeed—but there must also be coherence in the enablers as they are built out across domains. Creating a bespoke digital and analytics organization for each domain, for example, isn't sensible. Instead, leading companies have only one digital and analytics organization—centralized, federated, or a mix of both—and then deploy specific skills and capabilities to each domain as needed.

Data and architecture are among the toughest enablers for consumer-goods organizations to get right (see sidebar, "Instilling a healthy data culture"). Many companies don't have as much consumer data and retailer point-of-sale data as they'd like. The relevant assets they do have—internal financial, product, and customer master data—typically reside in siloed legacy systems that are difficult to access and harmonize. And consumer-goods companies tend to lack the strong data-governance processes to use, secure, and share data across the organization in compliance with privacy regulations.

Some consumer-goods companies, recognizing these inadequacies, mistakenly believe that they need to change their entire data infrastructure at once. But in our experience, prioritizing the enablers that will yield the greatest value is much more effective and helps ensure the coherence of enablers across domains.

When a regional consumer-goods manufacturer embarked on a digital and analytics transformation,

Instilling a healthy data culture

by Alejandro Diaz and Mike Doheny

In scaling digital and analytics, the gap between leaders and laggards—both within and among industry sectors—is growing. For all consumer-goods companies, the emergence of digital and analytics as omnipresent realities of modern organizational life means that a healthy data culture is becoming increasingly important. A culture that brings together data talent, tools, and decision making can unleash competitive advantage.

Our experience suggests that instilling a data culture strengthens the nuts and bolts of a company's digital and analytics enterprise, helping it avoid the pitfalls that often trip up transformation efforts. Here are some of the practices that have helped companies build a culture that clarifies the purpose, enhances the effectiveness, and increases the speed of their digital and analytics efforts:

— *Don't amass data for data's sake.* Some companies approach data analysis as a cool "science experiment" or an interesting side project. The fundamental objective in collecting, analyzing, and deploying data should be to make better decisions. Data culture is decision culture.

— *Make sure the CEO and the board show commitment.* Leaders' commitment to a data culture must manifest in more than occasional high-level pronouncements. Instead, there must be an ongoing, informed conversation with top decision makers and those who lead data initiatives throughout the organization.

— *Get data in front of people.* Building cool digital experiments or imposing analytics tools top down doesn't cut it. To create a competitive advantage, stimulate a grassroots demand for data. When you put data in front of the people who can actually use that data, they get excited.

— *Marry talent and culture.* The competition for data talent is unrelenting. But there's another element that's sometimes overlooked: integrating the right talent for your data culture. That calls for striking the appropriate balance for your company between hiring new employees and upskilling current ones. Take a broader view in sourcing talent and a sharper look at the skills your data team requires.

Culture can be a compounding problem or a compounding solution. When an organization's data mission is detached from business strategy, it should come as no surprise that the results of digital and analytics initiatives fail to meet expectations. But when excitement about data analytics infuses the entire organization, it becomes a source of energy and momentum. The technology, after all, is amazing. Imagine how far it can go with a culture to match.

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for instance, it chose a decoupled technology stack that could expand as needed. Modernizing the core platform, typically a multiyear effort, was postponed until the return on investment could be clearly articulated. Instead, the company launched an effort to develop a set of application programming interfaces (APIs) that could effectively perform all required data exchanges. A cloud-based data layer would serve as the company's single data repository across all domains, with the APIs acting as the communicating vessels between the top layer and the rest of the core systems. Data were ingested incrementally, so the company could first tackle the most critical data elements required by the highest-priority domains and use cases.

The company also emphasized data governance from the start of the transformation effort by

appointing a chief data officer (CDO) within the IT organization. The CDO had “data ambassadors” embedded into each business unit. These ambassadors collaborated with business-line leaders in defining the end-state requirements and domain-specific initiatives.

4. Reconfigure your operating model for speed and flexibility

Consumer-goods companies aren’t typically structured to move fast or flexibly. Digital and analytics leaders have begun to organize their efforts around “squads” or “pods” that can move and react more nimbly, and such investments have proved effective under current working conditions.[2] One manufacturer revamped its operating model to incorporate the following elements:

— *Business-led squads with dedicated IT support.* Squad leaders are responsible for defining the specific business problems that the squads tackle and for ensuring value capture. Squad leaders (or product owners) aren’t IT or other technical staff but rather experts from the business lines, with deep knowledge of each domain and the relevant use cases. All squads also have IT and data-science experts as needed and can thus achieve rapid progress, from a minimum viable product to impact at scale, using a sprint-based working model. Even when working remotely, squads can hold agile ceremonies effectively.

— *A technical center of excellence.* The company built a team of data scientists and engineers, sourced both internally and externally, for a new center of excellence (COE). The COE is distinct from other technology teams, such as those for infrastructure and security. It oversees data science within each squad, as well as best practice and knowledge sharing across squads.

— *An empowered transformation office.* To help ensure the transformation’s success, the company formed a transformation office comprising top-team executives. During regularly scheduled reviews, sponsors and squad leaders update the transformation office on the progress of initiatives; sponsors can also pitch new ideas. This structure and cadence allow the company’s senior leaders to track milestones and dynamically reallocate resources to priority areas.

— *An emphasis on leadership training.* Executives and managers completed a mandatory capability-building curriculum that taught them not only how the digital and analytics program would help the business outperform, but also how to adjust their management styles to the new ways of working. One way, for example, was to steer clear of a “command and control” style and to empower teams to make decisions in agile sprints. The investment in leadership development sent a strong signal to all levels of the organization, generating excitement and enabling more credible change management.

Digital and analytics programs are no longer optional. COVID-19, while a near-term headwind, also provides an opportunity for reinvention. The time to act is now: companies that take bold actions will reshape the industry, whereas companies that merely react will be left behind.

[2] For more on squads and other aspects of agile organizations, see Daniel Brosseau, Sherina Ebrahim, Christopher Handscomb, and Shail Thaker, “The journey to an agile organization,” May 2019, McKinsey.com.

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Retail industry

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The next normal in retail: Charting a path forward

To succeed in the next normal, retailers must assess their revenue management practices, operating models, digital capabilities, capital investments and M&A strategies – then make bold moves to transform themselves.

by Steven Begley, Becca Coggins, Matthew Maloney, and Steve Noble

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This article first appeared on McKinsey.com in July 2020.

So now what? That's the eminent question US retailers face in the wake of the COVID-19 pandemic. After months of quarantines and phased recovery, it's clear that standard operating procedures in retail have changed and will continue to change as health and economic implications of the novel coronavirus evolve.

Retailers must act now, not only to keep pace but also to thrive in new market conditions. Most will need to significantly rethink their strategies and business models in the next normal—for example, what kinds of goods and services do consumers want and need in this changed environment? What macroeconomic factors will inform their purchasing decisions? Which new consumer habits will stick, and for how long?

Retailers' ability to answer these questions and find success in the next normal will depend, in part, on the subsectors they operate in and their overall liquidity. It will also hinge upon the degree to which they can adopt new capabilities and draw on new expertise—some of which they may need to leverage through mergers, acquisitions, and partnerships.

To begin this transformation process, retailers will need to systematically assess their capabilities in five areas that are critical for any retail operation to succeed: revenue management, operating models, digital, capital investments, and M&A and partnerships. Through this exercise, retailers can identify gaps and requirements and make bold moves to position themselves differently in the next normal.

In this article, we consider how the landscape has changed for three retail subsectors—grocery; apparel, fashion, and luxury (AF&L); and restaurants—as well as the moves companies in these sectors can make to adapt and thrive postpandemic.

What's changed

According to our "consumer of the future" research, the pandemic has already altered consumer purchasing patterns and behaviors in deep and perhaps lasting ways. Given high unemployment and widespread quarantines, for instance, consumers are at home more often than not. They are shopping less, spending less when they do shop, and focusing more on health and well-being products and concerns.

Significant macroeconomic, commercial, and cost shifts over the past six months or so are changing the landscape for retailers as well (Exhibit 1). Most are anticipating limited containment of the novel coronavirus. Those operating in discretionary categories, in particular, are expecting a slow recovery over the next 18 months or so. And they expect a resurgence of the virus in late 2020 or early 2021, which could mute long-term growth and global recovery.

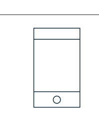
Exhibit 1

Key shifts in the retail landscape will inform companies' pathways to success in the next normal.

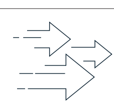
Macro

Spending
Reduction in discretionary income

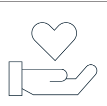
Commercial



E-commerce
Growth of e-commerce and omnichannel platforms



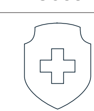
Shifts in purchasing
Focus on "essentials" and value; home as the center of life



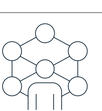
Loyalty and switching
Shock to loyalty and brands (more switching)

Cost

Footprint
Right-sizing brick-and-mortar stores and supply chain



Safety
Increased costs related to hygiene—eg, more frequent and in-depth cleaning cycles



Labor dynamics
Increased need for on-demand workforce that can scale with demand

It’s clear that standard operating procedures in retail have changed and will continue to change.

Shifts in spending. Macroeconomic factors during the pandemic period have altered the playing field for retailers. Demand for discretionary products has been significantly different than that for nondiscretionary products. For example, demand in the AF&L sector has dropped significantly, along with demand in the air travel, hospitality, commercial aerospace, and oil and gas sectors. The drop in demand for AF&L products has hovered between 20 percent and 45 percent at various points over the past few months. Overall numbers in the food and restaurant industries are down, although some segments—such as grocery stores and some takeout restaurants—have done well. The demand for groceries, which skyrocketed to between 7 percent and 17 percent as consumers stocked their pantries ahead of and during the pandemic, will likely revert to precrisis levels (between 1 percent and 3 percent) by the first half of 2021. According to our research, sit-down restaurants will likely take much longer to get back to previous norms—perhaps not until 2022 or 2023, depending on which economic scenarios emerge.

Shifts in purchasing, loyalty, and switching. Commercial changes as a result of the pandemic also loom large for retailers. There’s been a significant (if predictable) increase in online sales and pickup and delivery services, as consumers have been unable or unwilling to enter brick-and-mortar stores for fear of infection. Over the past several months, online shopping has increased about 20 percent in the grocery category. As a result, consumer loyalty has been disrupted, and switching has become more common. This is partly because consumers have learned to replace favored brands with more available or more affordable ones in the face of product shortages. More recently, consumers have also shown little compunction when switching to brands they can purchase through contactless or other “safe” methods.

Shifts in footprint, safety, and labor costs. Retailer cost considerations have also changed—among them, greater investments in interventions required to bolster or maintain supply chains, safeguard employees’ and customers’ health, and maintain staffing levels. For instance, as they have started to reopen, restaurants have seen a marked increase in costs because of new cleaning and social-distancing requirements as well as greater attention being paid to employee safety.

Of the three subsectors we examined, grocery is the most likely to expand both revenues and margins, given its starting point. By contrast, our research shows that AF&L is likely to experience significant revenue decline and margin contraction because of consumers’ reduced discretionary spending and increased use of e-commerce, which tends to be a higher-cost channel for many retailers. And the restaurant sector is likely to see profit-margin pressure—primarily because of higher delivery costs—as well as decreased revenue.

How to transform

Many of the disruptive trends in retail were already in flight before COVID-19 emerged. But in many ways, the pandemic has accelerated these trends from decades to just days. Most retailers likely have not fully planned or addressed all of these trends; thus the capabilities required to transform the business in the next normal will not be first nature to most of them. Most have begun to expand their use of e-commerce, social media marketing, or analytics-based supply-chain management, but hardly any have developed these capabilities to the degree needed to meet current demand.

True transformation and reinvention will come only when senior retail executives take a step back from the turmoil and systematically evaluate their current products, capabilities, and strategies; identify any gaps; and devise a transformation plan (or roadmap) for addressing those gaps. Specifically, retailers should consider their capabilities along the following five dimensions:

Revenue management. Retailers should assess the full suite of revenue levers at their disposal and then double-down on them to sustain and accelerate sales and gross margin. For instance, senior finance and business unit leaders can undertake a clean-sheet evaluation of product assortment, price, and promotion levers to optimize sales and customer loyalty. They can also pursue innovations required to address consumers' changed needs and behaviors as a result of the pandemic. For example, a grocer might consider adding local, organic foods to its product mix—goods that postpandemic consumers may now be willing to pay a premium for.

Operating models. Successful retailers should use this unprecedented period to rethink their operating models—examining store footprints, labor, and supply chains to optimize cost structures and meet changing consumer preferences. Through this analysis, they may identify new sales models or new ways of working that could help alleviate margin pressures. Something as simple as building more flexibility into pickup and delivery operations could help a retailer reallocate resources more effectively and better balance demand loads.

Digital capabilities. Continued social distancing—mandatory or voluntary—will require that retailers develop or purchase reliable e-commerce or digital capabilities to serve consumers who remain concerned about health and safety in the wake of the pandemic. Retailers may want to establish (or accelerate) expansion into new channels, a curbside pickup option, online-ordering applications, home-delivery options, and other digitally driven services.

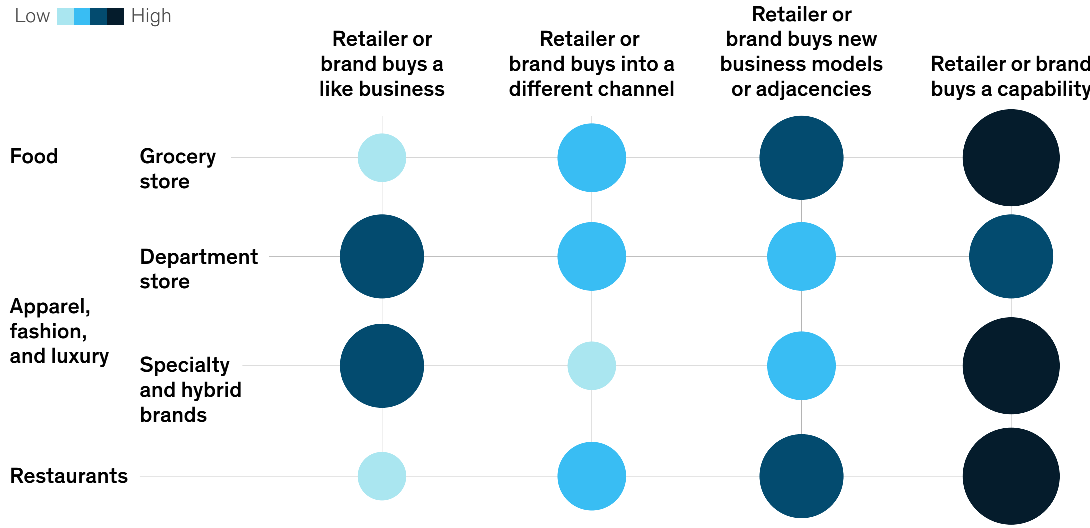
Capital investments. Most retailers understand the critical need to take a closer look at capital investments postpandemic—not only to address consumers' changing preferences, but also to position their organizations for growth in the next normal. With increased investments in technology, for instance, companies may be able to automate and streamline central work processes or otherwise accelerate digital transformation. And companies that are experiencing increased e-commerce demand will likely need to invest in updating their omnichannel networks.

M&A and partnerships. For many retailers, organic moves may be intuitive while inorganic ones, such as M&A and partnerships, may require even more deliberate consideration, especially in this time of great uncertainty. A number of leading indicators suggest that M&A and partnerships hold a lot of promise for retailers in the next normal, as the industry undergoes consolidation and retailers seek new capabilities, technologies, and expertise to address changing customer demands—and do so quickly (Exhibit 2).

Exhibit 2

M&A and partnerships hold promise for retailers in the next normal.

Anticipated relative level of M&A and partnership activity



It's important for retailers to acknowledge that not all deals are created equal; the potential deal must be aligned with the company's overarching strategy. Continued concern over the coronavirus means most grocers will need e-commerce and alternative delivery options, including scan-to-go and contactless payment and pickup services. Thus they may want to seek out deals and partnerships that can provide the necessary technical capabilities (speech-recognition software, for instance) and skill sets (data scientists, for instance); for many, it may simply take too long to acquire the expertise and build the required new systems from scratch. By contrast, retailers with high liquidity may be on the lookout for bargain acquisitions that can help them maintain or even grow revenues—such as seeking out distressed assets or adjacent brands that can help elevate their existing customer-loyalty tactics and programs.

Plan-ahead team. Through a systematic self-assessment, retail executives can pinpoint the organic and inorganic moves to execute that can help them survive and thrive in the next normal. At that point, a plan-ahead team should be convened to prioritize and execute the transformation. These teams identify the actions that can offset long-term headwinds—such as developing new marketing plans to counteract disruptions in brand loyalty or determining what optimal store footprints and shopping experiences should look like in the next normal. The plan-ahead team collaborates with the executive-leadership team to align on the transformation roadmap and to monitor and report back on the results. The plan-ahead team also works closely with the company's finance team to stress-test and update budgets, as initiatives are rolled out, and to assess acquisition targets. Similarly, this team should engage with operations leaders to manage the daily initiatives necessary to drive transformation.

The outlook in three subsectors

Using the self-assessment framework, we can see potential pathways to success in the next normal for companies in the grocery, AF&L, and restaurant subsectors.

The pathway for grocery

Grocery is the subsector of retail most likely to experience revenue growth, as consumers have changed their buying patterns and are cooking more at home. As mentioned earlier, our analysis indicates that topline growth in grocery will continue but eventually stabilize. However, this sector is also likely to face meaningful margin compression because of the limits being placed in the short term by states and municipalities on the number of shoppers allowed in stores, as well as higher costs for cleaning and delivery. McKinsey analyses show that, without transformation, grocers' margins could drop from between 2 percent and 5 percent, on average, before the onset of the pandemic, to between 1 percent and 4 percent going forward.

Continued economic pressure could force grocers to compete on price as they battle for customer loyalty. For this reason, we believe market share could partly shift from supermarkets to lower-cost, more convenient channels, such as mass, clubs, and discounters. The latter are favorably positioned based on footprint, format, and digital strength. Many mass players, for instance, hold sufficient cash as a percentage of sales, indicating that they can make the investments necessary to remain relevant to customers. Clubs are essentially one-stop-shops for consumers and track well against projected reductions in store visits as a result of the pandemic. Retailers that have natural depth and breadth of assortment on their shelves (including unique pack sizes) and in their warehouses are well-positioned in the case of unforeseen supply shocks.

Because of continuing concerns about COVID-19, grocers will need to move even more aggressively into e-commerce and alternative delivery options—including scan-to-go and contactless payment and pickup services. Moreover, consumers' shifting preferences for food items, including those pantry items necessary for routine daily cooking, means that grocery stores will need to continually re-evaluate their full product mix—in many cases shifting to fresh, local, and healthy options in line with consumer trends.

In this environment, grocers may look to reduce costs (between 10 and 15 percent) by accelerating digital and automation transformation across stores and home-office activities; they may be able to achieve this more quickly by seeking out M&A and partnerships that can provide the necessary technical capabilities and skill sets. Partnerships with manufacturers, for instance, may allow grocers to offer private-label and exclusive products at more competitive prices. And tech acquisitions may allow grocers to leverage analytics (and data scientists) that can help them understand and react to shifts in consumer demand and optimize price and promotional investments.

Making bold moves can help retailers build and maintain resiliency.

The pathway for AF&L

The AF&L sector is likely to face a sharp decline in revenue and margins, with a much longer expected time for recovery than other sectors. Extended store closures, lagging consumer sentiment, and financial insecurity are likely to affect the industry significantly over the next few quarters. Gross margins will likely be affected by slower-moving inventory and the need to offer more discounts and promotions to bring consumers back into the fold. Cost of goods sold and selling, general, and administrative expenses may be affected by supply-side constraints, investments in omnichannel sales, and the need to build health and safety infrastructures in physical stores. McKinsey research projects overall revenue losses in this subsector to be from 20 percent to 45 percent in 2020, with the potential for a 30 percent to 55 percent rebound in 2021 (with the possibility of returning to near 2019 levels).

Similar to the grocery subsector, there has been a marked shift in the AF&L sector toward online or omnichannel sales, with a projected postpandemic increase in e-commerce penetration of 10 to 15 percent. Discretionary spending in this category, however, is expected to drop 50 to 60 percent in the next normal. To bolster revenues, AF&L companies may lean even more heavily into omnichannel services—for instance, improving the customer purchasing experience online, enhancing delivery capabilities, or introducing curbside pickup options. They may introduce personalized content—in which consumers can customize colors or designs of certain products—or subscription-based services to try to regain customer loyalty and establish reliable revenue flows. When it comes to inventory forecasting and replenishment, or renegotiating sourcing agreements, AF&L companies may need to rethink their existing strategies—perhaps doubling down on the use of advanced analytics to ensure agility and flexibility as demand rises and falls in the next normal.

To bolster margins, AF&L retailers can renegotiate rents, reduce sourcing and supply expenses, and economize labor forces and store footprints. They can use store and labor data to make strategic decisions about which stores to reopen, the optimal number of in-store versus back-end employees, and the investments required to build out shields, walls, sanitizing stations, and other elements of safety infrastructure.

Those AF&L retailers in a stronger liquidity position may be more aggressive with their M&A programs—for instance, picking up distressed assets, investing in new business models, seeking out possibilities in adjacent markets and channels, or enhancing their brand capabilities through deals. Retailers in this category should focus on elevating customer-loyalty tactics and programs to keep existing customers in the fold and planning new marketing and promotional initiatives to attract new customers during the recovery phase. They may offer special promotions on certain product categories, or apply shopper loyalty points toward services from attractive new partners.

The pathway for restaurants

The frequency of visits to bars and restaurants dropped by 50 percent over the past six months, and our research suggests that restaurants will continue to experience significant headwinds, as consumers choose to stay and eat at home. Continued restrictions will change the way consumers want to be served. There has been and will continue to be a shift to e-commerce, delivery (19 percent increase in consumer adoption of delivery), ordering through online apps, and contactless pickup (21 percent increase in curbside pickup).

Because restaurants have limited real-time labor flexibility, their labor costs will increase as a percentage of revenue as revenues decline. Our research also indicates that margins will decrease by 50 to 100 basis points, given fixed occupancy costs—although relief may be possible if real estate prices go down. Increased costs from new forms of delivery, contactless payment, and a potential shift toward lower-margin products will put added pressure on this segment. Additionally, there will be a continued increase in expenses related to supplies and cleaning.

The restaurants that thrived during quarantines (pizza category), or that were not significantly affected relative to others (burger and chicken categories), are obviously best positioned to rebound. Many have mature technology capabilities and the liquidity to further invest in new capabilities that can improve their operations. Others, however, can accelerate their recovery in the next normal by using a mix of new channels, offerings, and price points. Those with primarily eat-in service, for instance, could expand upon the order-ahead and delivery models they launched during the pandemic. They may use partnerships or M&A to quickly build some of the capabilities required to operate in new ways—such as advanced analytics to increase their forecasting, order-taking, and real-time delivery times.

In the next normal, retailers will need to transform operations and capabilities along several dimensions—bolstering digital and other capabilities, revamping key commercial and revenue growth management levers (price, promotion, assortment), rethinking operating models, and exploring M&A and partnerships. Systematically assessing the company's objectives against the changed landscape and making bold moves can help retailers build and maintain resiliency in the next normal and during other crises that may emerge.

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Redefining value and affordability in retail's next normal

Most US consumers are worried about the economy. Grocers, mass retailers, convenience stores, and drugstore chains will need to carefully refine their value strategies.

by Rich Fox, Maura Goldrick, Carson Green, and Aaron Rettaliata

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This article first appeared on McKinsey.com in June 2020.

COVID-19 has exacted a heavy toll on the United States, claiming lives as well as livelihoods. In some parts of the country, the public-health crisis is showing signs of abating—but economic issues are now starting to take center stage. Consumers are anxious, and with good reason: extreme macroeconomic shifts, including a historic rise in unemployment and a steep decline in GDP, portend prolonged financial insecurity and economic pain.

These developments will fundamentally reshape how consumers perceive value and seek affordability in a post–COVID-19 world. Value perception—the combination of price, quality, and service by which consumers judge whether they're getting a good deal—has long been a major factor in consumers' decisions about where to shop; it will become even more critical as we emerge from the current crisis.

Analyzing how consumer behavior changed during previous downturns can give retailers insights into how to prepare for what comes next. But the COVID-19 crisis, though similar in some ways to past economic shocks, has particular nuances that make it more complex for retailers to navigate. For one, during neither the Great Depression nor the 2008 recession were consumers homebound for months, fearing infection simply from being near other people. Also, COVID-19's impact to date has varied greatly across cities and states because of different rates of virus spread and different levels of local-government intervention.

Against this backdrop, retailers will need to be deliberate about influencing consumers' value perception. After all, for many US consumers, affordability will be the single most important factor informing purchase decisions. In this article, we share our perspectives on how retailers can develop a value strategy that will position them for success in the next normal.[1]

US consumers' top concern: The economy

Since mid-March, more than 40 million people across the country have lost their jobs. The unemployment rate—which hit 14.7 percent in April before easing to 13.3 percent in May—has soared to its highest level since the Great Depression and eclipsed the 10 percent we saw at the peak of the 2008 recession. And the economic uncertainty affects more than just the jobless: in a McKinsey survey conducted May 18–24, nearly half of US consumers reported cutting back on their spending. Just under two-thirds said they are "very" or "extremely" concerned about the national economy—making it the number-one concern of survey respondents.[2] Americans are now more worried about the economy than about their health and safety (Exhibit 1).

When asked why they started buying more private-label goods, 44 percent of consumers cited affordability and better value.

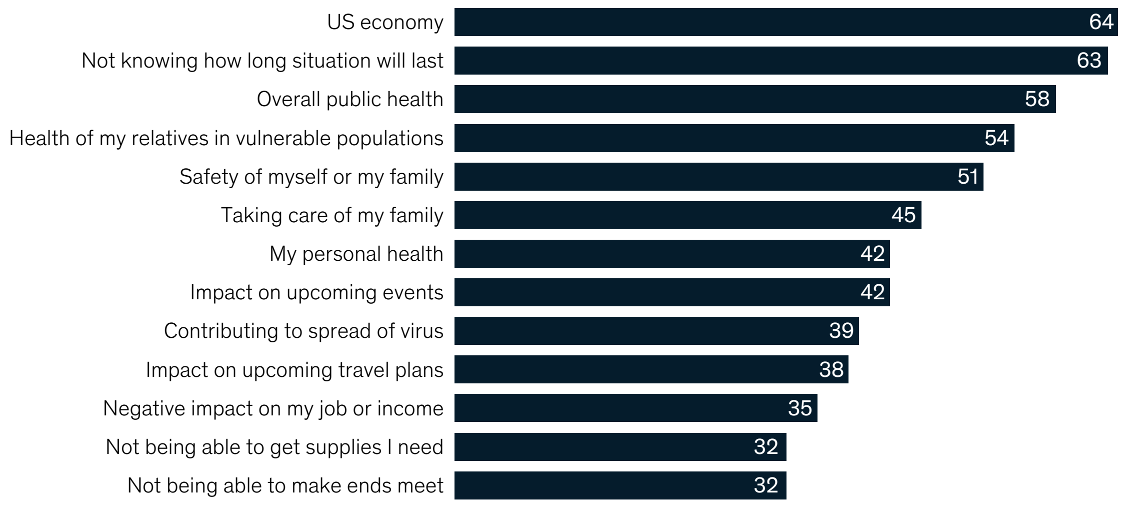
[1] Shubham Singhal and Kevin Sneader, "From thinking about the next normal to making it work: What to stop, start, and accelerate," May 15, 2020, McKinsey.com.

[2] Shruti Bhargava, Courtney Buzzell, Tamara Charm , Resil Das, Anne Grimmelt, Cayley Heller, Ahbay Jain, Janine Mandel, Sebastian Pflumm, Kelsey Robinson, Christina Sexauer, "Survey: US consumer sentiment during the coronavirus crisis," May 29, 2020, McKinsey.com.

Exhibit 1

The economy, uncertainty about the duration of the COVID-19 situation, and public health are the top three concerns for Americans.

Largest concerns of the US population related to COVID-19,[1] % of respondents who are "very concerned" or "extremely concerned"



[1]Question: What concerns you most about the COVID-19 situation?
Source: McKinsey COVID-19 US Consumer Pulse Survey, May 18–24, 2020 (n = 1,975), sampled and weighted to match US general population aged ≥18 years

Several states have eased restrictions, in an effort to jump-start their economies, but it will take time before consumer confidence and spending return to precrisis levels. More than two-thirds of survey respondents believe the pandemic will have an impact on their financial situation for at least another two months; 30 percent foresee the impact lasting until early 2021 or beyond. (For the latest US consumer-sentiment survey findings, visit McKinsey.com/coronavirus.)

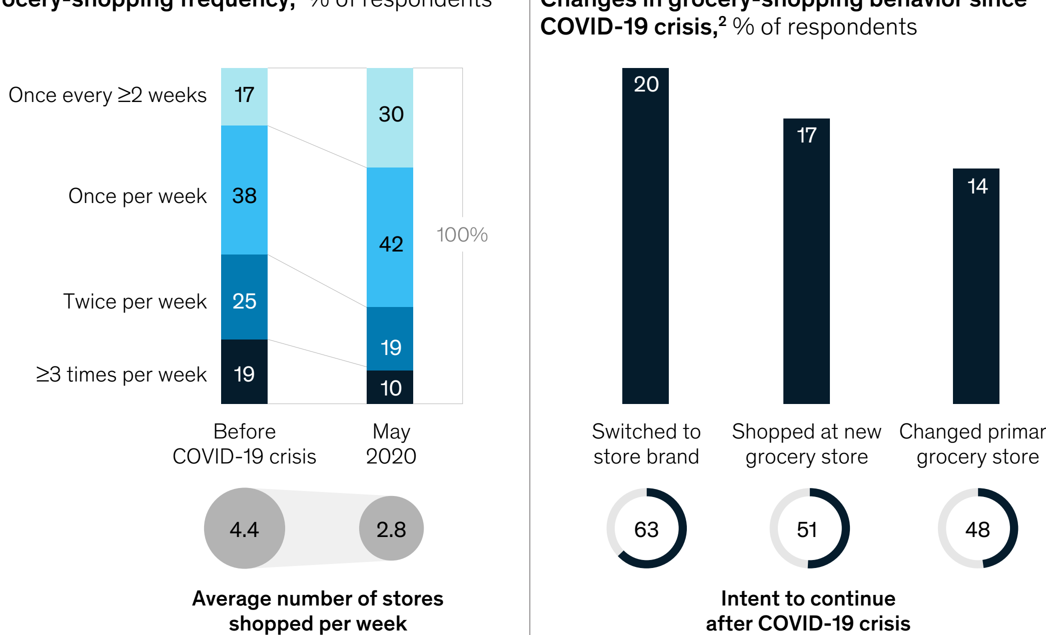
A classic economic crisis ... with a twist

Early indications suggest that the changes in consumer behavior during the COVID-19 crisis will largely mirror the changes that manifested themselves during the 2008 recession—but with some unique nuances. We've observed, for instance, the familiar flight to value: our recent research shows that 34 percent of consumers have increased their spending on private-label products during the pandemic and that most of those consumers plan to continue doing so even after the crisis has passed. When asked why they started buying more private-label goods, 44 percent cited affordability and better value.

The current crisis, similar to the 2008 recession, has thrown off many consumers' traditional shopping cadence. Take grocery shopping: in the early days of the pandemic, consumers loaded their pantries, made fewer shopping trips, visited fewer stores each week, and targeted their spending on essentials. Consumers have also tried new retailers and new brands during the crisis, possibly shifting the loyalty dynamics within the retail sector (Exhibit 2).

Exhibit 2

US consumers are consolidating shopping trips and shifting their retailer and brand loyalties during the COVID-19 crisis.



Note: Figures may not sum to 100%, because of rounding. Consumer sentiment and behavior may be because of current public uncertainty and official restrictions.
[1]Question: How frequently did you purchase groceries (in store or online) before the novel coronavirus outbreak? How frequently are you purchasing groceries (in store or online) currently during the novel coronavirus outbreak? Indicate how many stores you visited for your grocery needs, both before and during the current novel coronavirus outbreak.
[2]Question: Have you used or done any of the following since the coronavirus (COVID-19) situation started? Compared with now, will you do or use the following more, less, or not at all once the coronavirus situation has subsided?
Source: McKinsey COVID-19 US Consumer Pulse Survey, April 20–26, 2020 (n = 1,052) and May 18–24, 2020 (n = 1,975), sampled and weighted to match US general population ≥18 years

But the COVID-19 crisis, unlike past economic disruptions, brings a new layer of complexity: the severe threat to consumers' health and safety. Consequently, the pandemic has amplified and accelerated the consumer behavior we've seen in times of crisis. For example, during the 2008 recession, financially strapped consumers drastically reduced their spending on out-of-home dining. But during this pandemic, restaurant dining has come to a standstill as physical distancing and stay-at-home orders in many regions forced consumers to eat practically all their meals at home.

In addition, some retail trends that we expected to unfold over several years have now taken hold in a matter of weeks. Digital and alternative fulfillment models (such as curbside pickup), which some retailers previously viewed as experimental, suddenly became must-haves. In US grocery, e-commerce penetration was a mere 3 percent before the crisis and is expected to reach 8 to 10 percent this year. Because online grocery typically comes with steep price markups, as well as delivery fees and tips, we expect demand to soften as consumers' financial considerations begin to outweigh their health concerns. Already, consumers

are predicting that after the crisis they'll prioritize affordability when deciding where to shop (Exhibit 3). E-commerce penetration in grocery will likely dip back down to between 5 and 6 percent postcrisis.

Furthermore, the impact of COVID-19 hasn't been uniform across the country, because of differences in both virus spread and government regulation. Geographic variability in consumer sentiment is therefore likely to persist and potentially even widen—which means that retailers will need to vary their value strategies by region.

How to shape value perception in the next normal

Since consumers will increasingly look for value and affordability, retailers must offer a convincing value message to succeed in the next normal. They will, of course, still have the classic value communications, pricing, and promotional tools at their disposal, but they must deploy these tools in new ways. Every retailer will also need to reassess its entire value strategy—reevaluating both products and services—to ensure alignment with consumers' new need states.

For food, mass, convenience, and drug retailers in particular, we recommend the following six actions.

1. Develop a value strategy for each consumer segment.

In light of economic uncertainty, the general consensus is that value will matter—but there is unlikely to be a one-size-fits-all approach to maintaining or improving consumer value perception. There are, of course, no-regret moves: look to "recession-proof" your assortment by doubling down on private label and ensure that you have a robust set of opening price points in each category.

With the significant shift away from off-premise food consumption, you need a multipronged strategy to address what affordability means to your most important customers. For example, consumers under intense financial pressure will seek out grocers that offer compelling price points on the approximately 1,000 essential SKUs that consumers purchase most often (which are typically SKUs that both traditional grocers and small-box discounters carry). Conversely, more-affluent consumers might be less price sensitive but may look to grocers to provide substitutes for needs typically fulfilled elsewhere, such as eating out or entertainment. To appeal to these consumers, consider highlighting premium items (such as gourmet chocolates, fine wines, and international cheeses) or enhanced services (such as ready-to-eat meals and home delivery), especially since these tend to be less expensive alternatives to restaurant dining and can therefore help drive value perception while also pushing up average price points.

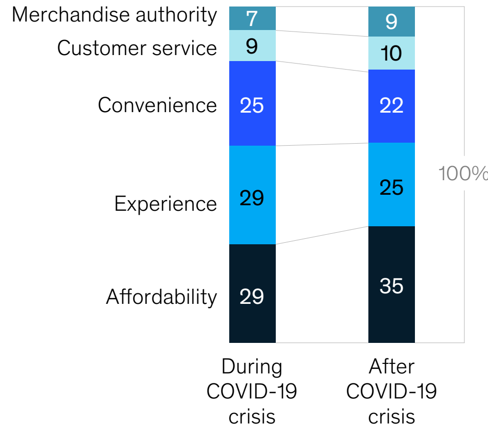
2. Localize your value levers.

Given the variability in COVID-19's impact across the country, adjust your pricing, promotions, and assortments to best serve local communities. Consumers in areas that are still under heavy

Exhibit 3

Affordability will become the most important factor for US consumers when choosing where to shop after the COVID-19 crisis.

Most important factor when choosing where to shop for groceries,[1] % of respondents



Note: Figures may not sum to 100%, because of rounding. Consumer sentiment and behavior may be because of current public uncertainty and official restrictions.
[1]Question: Which factors are most important as you choose where to shop for groceries during the novel coronavirus outbreak (ie, during past 2 weeks), and which ones do you expect will be the most important after the outbreak is over and the situation is back to normal?
Source: McKinsey Marketing and Sales COVID-19 US Pulse Survey, May 1–3, 2020 (n = 2,300)

Boldly exploring innovative tactics in promotions, pricing, and assortment will be paramount for responding to the changing needs of your consumer base.

restrictions, for example, may respond better to value messaging around pantry loading and at-home eating. In states that have already eased restrictions, you might instead capitalize on the pent-up demand for out-of-home dining by introducing new products and services that compete with restaurants.

Account for new market dynamics and determine who your true competitors are in the post–COVID-19 world. We expect a wide range of competitive responses, including stronger opening price points and new services (such as free delivery) to meet local needs—all of which will require close attention at a regional level. A broad approach to value and affordability will be less effective than a targeted, localized one.

3. Build agility into your commercial activities.
While the pandemic's peak may be behind us, the shape of the recovery is still difficult to predict. Agility—the ability to respond rapidly to changes in consumer sentiment and value perception—will be crucial. As part of building agility, you will need to monitor carefully chosen metrics that are reliable indicators of how consumers are thinking about price and value, such as e-commerce penetration, basket size, and private-label penetration. Consider supplementing commercial levers that have long lead times (for instance, print circulars and TV advertising) with levers that allow for immediate adjustments (such as digital circulars, in-store product pricing, and store displays and promotions).

Also, maintain connectivity to broader trends in the business. By accessing real-time data on the inventory availability of "spiky" items such as toilet paper and cleaning supplies, for example, you'll be able to adjust the timing of promotions based on availability, instead of disappointing your customers. Boldly exploring innovative tactics in promotions, pricing, and assortment will be paramount for responding to the changing needs of your consumer base.

4. Update your value communication for the postcrisis context.
Given the shifts in consumer behavior—more cooking at home, larger baskets, less cross-shopping across retailers—each shopping occasion, for loyal and new customers alike, takes on greater importance for retailers. Find new ways to communicate and deliver value. First, use your unique value proposition as a base for value communications, expanding beyond purely communicating price points. Highlight the areas in which you are best positioned relative to your competitors, whether that's the broadest private-label offering, the freshest produce, or the best shopping experience.

Additionally, consider launching new product offerings to serve COVID-19–related occasions. For example, advertising a single, attention-getting price for the ingredients for a family meal ("Feed the family for $15"), instead of promoting individual items, may resonate with parents who have been cooking multiple times a day for the past two months. Presenting indulgent purchases as replacements for products and services from nontraditional competitors (for instance, billing a popcorn-and-candy deal for an at-home movie night as a substitute for going to a movie theater) could be attractive to shoppers seeking affordable entertainment. Relevant and empathetic messaging

that avoids tone-deaf references—such as references to fancy dinner parties or large social events—will help consumers continue to view your stores as a trusted resource in a time of need.

As your consumer value proposition evolves, your relationships with vendors and your trade-investment decisions should evolve as well. With many annual promotional plans disrupted, choices about how to allocate funding and what new avenues to invest in (digital channels, for instance) will become more important.

5. Define value-perception triggers to help guide rapid decision making.
Identifying specific customer and competitor triggers up front can equip you to make decisions quickly and to execute more effectively. To illustrate: many retailers are currently debating whether or not to expand shelf space for private-label products. Instead of trying to predict customer demand, agreeing on a specific trigger—for example, the growth of private-label share by more than five percentage points in a given category—can provide clarity and help the business respond rapidly to consumer trends.

Define similar triggers with regard to the supply chain (for example, resuming promotional activity when out of stocks return to normal levels), competitor dynamics (repricing the top 20 key value items when competitors reduce prices on them by a certain percentage), and customer loyalty (sending "best customer" coupons to customers when the number of their shopping trips per month falls below a certain level). Attempts to define value-perception triggers in real time often devolve into chaos and can lead to ill-advised tactics, such as running promotions on items that are already out of stock. Set up these triggers now to be ready for a variety of scenarios.

This will be particularly important if you rely on a high level of promotional intensity to drive value perception and, ultimately, customer choice. In the next normal, you may find such an approach to be incompatible with consumer needs and opt for a different approach instead (such as everyday low pricing on select items and categories).

6. Upgrade your tools and organization.
Analytics, consumer insights, and systems play a central role in delivering impact through commercial levers. In the wake of this crisis, you will almost certainly need to enhance current tools and build new capabilities, such as automated reporting to track consumer responses, and systems that can deploy localized store-level promotions.

With many retailers forced to close stores and furlough employees, consider hiring new talent for your most critical functions (such as e-commerce and digital). New work-from-home norms could also open up talent pools across the country and beyond. Reevaluate build-versus-buy decisions regarding tool deployment in the context of COVID-19, since the pandemic may have changed the factors that influence those decisions.

Identifying specific customer and competitor triggers up front can equip you to make decisions quickly and to execute more effectively.

While no one can say for sure how the next normal will play out, it's becoming clear that economic uncertainty and shifts in consumer behavior—both mandated and voluntary—will reshape the retail landscape. By reexamining core merchandising strategies and tools, tailoring them appropriately to the new environment, and deploying them in innovative ways, retailers can offer the value and affordability that consumers will seek in the post–COVID-19 world.

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The next normal: Retail M&A and partnerships after COVID-19

Now is the time to think about retail M&A after the coronavirus crisis. Five trends could unlock opportunities for retailers, brands, and investors to shape the next normal.

by Harris Atmar, Steven Begley, Jane Fuerst, Stefan Rickert, Rodrigo Slelatt, and Madeleine Tjon Pian Gi

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As a global pandemic, COVID-19 poses mind-boggling health and humanitarian challenges, and the economic impact on lives and livelihoods of the efforts to contain the virus is the strongest in a century.

Retail is one of the sectors most affected by COVID-19, in both positive and negative ways. Grocers, pharmacies, and e-commerce market-places are sustaining consumer access to essentials—food, medication, toiletries, and selected "at home" categories—while striving to protect customers, employees, and suppliers.

At the same time, store closures and sharp declines in discretionary consumer spending have crippled nonessential retail (other non-food, apparel, fashion, and luxury products). Many retailers have already had to make tough choices, including temporarily or permanently closing doors, furloughing employees, and more.

Despite this challenging environment, analyses of past crises have shown that there is still potential for value creation through M&A across industries; for further detail, please see the recent cross-industry article, "The power of through-cycle M&A."

This article examines trends that are likely to create M&A and partnership opportunities that may enable retailers, brands, and investors to shape the next normal postcrisis.

Impact of COVID-19 on the retail sector

Across the globe, consumers plan to reduce short-term and mid-term spending, especially in nonessential categories. Consumer intent, of course, varies by individual economic situation and outlook. For more detail analysis of consumer sentiment, please see McKinsey's global survey of consumer sentiment during the coronavirus crisis.

Shift to online and digital purchasing. As shelter-in-place orders proliferate and potentially extend, and consumer anxiety about infection persists, consumers across age groups have already shifted spend to online channels. The longer the crisis lasts, the greater the likelihood that online and omnichannel purchasing will become the next normal. While this shift is pronounced in grocery and other essential categories, the channel shift within apparel, fashion, and luxury (AF&L) brands and retailers has not come close to making up for the lost brick-and-mortar sales as our recent article on the impact of COVID-19 on the sector demonstrates.

Across both AF&L and food, drug, and mass-merchandise (FD&M) players, the shift in consumer spending to online will pose a question about the future—and purpose—of their brick-and-mortar locations. Driving unique in-store experiences will become even more critical than it has been to drive traffic, facilitate the omni-experience, and improve profitability.

Healthy, safe, and local. One of the biggest challenges facing retailers is the need to protect customers and employees from contracting or spreading COVID-19. Concerns about health and safety have never loomed larger for stakeholders across the value chain. The retailers with the highest degree of touchless automation, both in stores and in warehouses, may enjoy a clear competitive advantage, as they face lower risk to consumers, employees, and their overall operations. Increasing focus on improving health, paired with increased demand for fresh food could drive longer-term habits focused on healthy lifestyle and nutrition.

Shift to value for money. As in any economic downturn, a postcrisis downturn will probably lead consumers to demand value for money across retail sectors. This is already happening in essential categories, as private-label sales at grocers and pharmacies are increasing, and pricing and promotion strategies are emphasizing value. In the AF&L sector, recent analysis indicates bifurcation of the market with respect to price positioning.

Flexibility of labor. The COVID-19 crisis underscores the need for more flexible resource allocation that deploys labor across a broader range of activities. This could accelerate the move toward more agile and dynamic resourcing from stores to distribution centers to corporate offices. It could

Despite this challenging environment, analyses of past crises have shown that there is still potential for value creation through M&A across industries

drive new models of collaboration between retailers and their stakeholders to address scarce capabilities and enable the labor pool to move more fluidly in order to meet demand across priority activities.

Loyalty shock. Scarcity of products has spurred trial of new brands, as customers trade up and down. In Asia and the United States, but less so in Europe, we have seen store and brand switching due to proximity, availability, ease of use, and safety considerations, creating opportunities for new habit creation. In the United States in particular, many consumers stated they have tried store or generic brands for the first time, with many saying they were satisfied with the product and would purchase again.

Retail M&A during and after the COVID-19 crisis

Before COVID-19, we observed four primary deal archetypes, though this sector did not see as much deal activity as other sectors. Analysis of more than 900 global retail M&A deals over the last ten years suggested the following archetypes (Exhibit 1):

1. **like-for-like acquisitions**, that is, the purchase of direct competitor, who plays in the same categories and/or channels and serving similar consumers, with the goal of gaining scale and unlocking cost synergies

2. **category or channel expansion**, that is, buying into a new category or channel with the goal of improving growth exposure and/or broadening the product offering to the consumer

3. **new business models and/or adjacencies**, typically deployed in a bid to vertically integrate up or down the value chain with the purpose to increase scale and/or control in the supply chain to strengthen the specific value proposition of the retailer

4. **capabilities**, that is, targets that offer new platforms, tools or know-how and talent (typically back end, not consumer facing) to enhance value proposition and service to the end consumer

Historically, archetype 1 (in which the retailer or brand buys a like business, usually to gain scale or share) drove most of the deal value. However, since the 2008 recession, we have seen “new business model” acquisitions (archetype 3) gradually increase over time. Deals to acquire new channels or categories (archetype 2) and capabilities (archetype 4) have also increased, but not as aggressively. Analysis of the impact of total shareholder returns (TSR) across deal archetypes finds shareholders responding most positively to archetypes 1 and 4. Across the more than 600 (non-AF&L) deals we surveyed, TSR for archetype 1 deals increased 2 percent, and TSR for archetype 4 deals increased 6 percent post-announcement. The other archetypes saw lower value creation, potentially reflecting questions about the wide variance in P&L economics of the e-commerce channel and new business models.

Given changes in consumer spending across channels as well as persistent concerns about

Exhibit 1

Analysis of +10 years of retail deals indicates four key M&A and partnership archetypes.

	Retailer or brand buys a like business	Retailer or brand buys into a different channel or extends up or down its value chain	Retailer or brand buys new business models or adjacencies	Retailer or brand buys a capability
Description	Acquirer and target have a similar business model, channel and category presence, offering and similar value proposition	Acquirer and target have different (and/or complementary) routes to market	Acquirer and target have different business models (eg, subscription) and/or occupy different parts of the value chain; area with the most growth in volume of deals	Acquirer buys a target that offers a new capability, typically not consumer-facing (eg, tech, software, artificial intelligence and/or advanced analytics)
Objective	Food, drug, and mass: Typically a scale, geographic expansion or regional roll-up, where synergies are captured Apparel, fashion, and luxury: Gain further share in a category/customer segment or extending into a new price point or geography	Largely a network play to become omnichannel and capture growth in other channels; includes buying up or down-stream to secure its supply chain or distribution network	Transform or diversify the business, likely to get ahead of growth in adjacent segments or related businesses	Typically a “learning” play, or to improve profitability by impacting commercial levers (eg, loyalty, payment) or supply chain (eg,“Last mile” or micro-fulfillment)
Example	Global grocer acquires global grocer to create one of the largest food retailers worldwide	Global multi-category eCommerce retailer acquires brick-and-mortar food retailer, expanding into fresh produce and brick-and-mortar for the first time	Regional drug store/pharmacy chain acquires health insurance payor	Regional grocer acquires retail analytics company
% of total 2008–19 deal spend	65–75	10–15	10–15	5–10

Note: Archetypes are not mutually exclusive, i.e. companies may acquire a single target who delivers across more than one archetype.

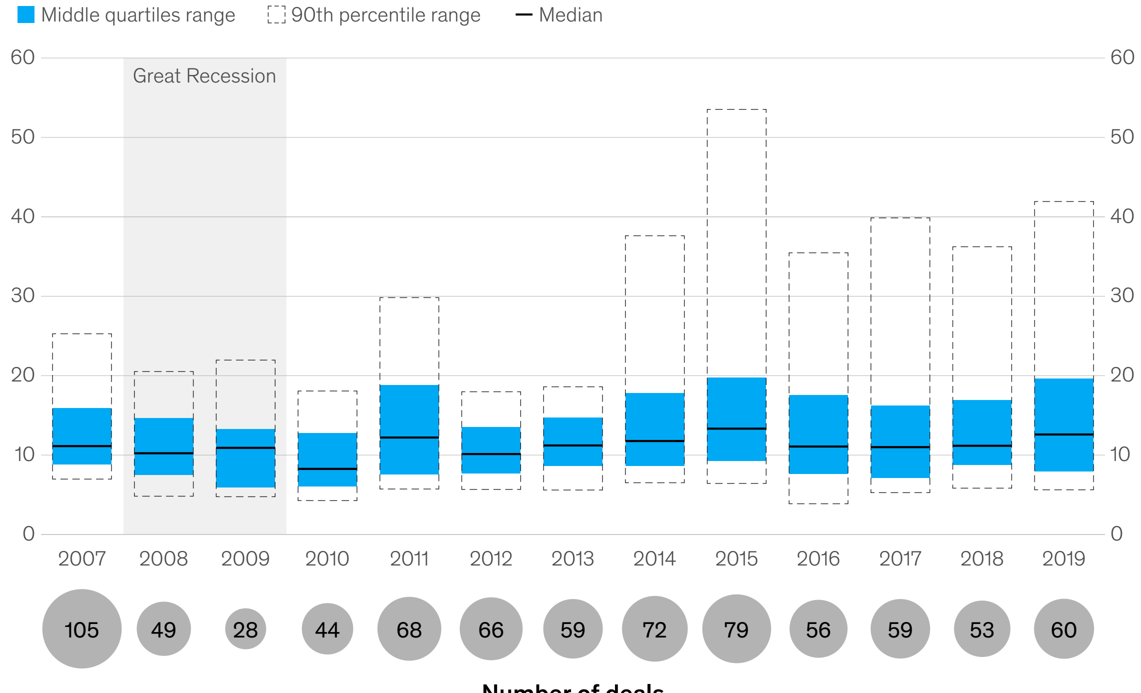
health and safety, and despite the weaker economic outlook, we expect retail M&A activity to accelerate as the crisis stabilizes. Consolidation of smaller players, acquisition of new business models, and capability tuck-ins (such as archetypes 1, 3, and 4) are likely to increase as financially sound retailers and industry stakeholders uncover opportunities. Within this context, players have new license to rethink their M&A strategy.

Taking learnings from the last recession, retailers that can continue to make organic and inorganic investments through a down cycle typically outperform competitors over the long term. Companies that outperformed during the last recession participated in 10 percent more deals and in larger deals (approximately 1.8 times higher median) than companies that did not outperform. Analysis of the financial crisis in 2008 also indicates

Exhibit 2

Analysis of transaction multiples indicates deal volume and valuation falls and remains depressed following an economic crisis.

Enterprise-value-to-EBITDA[1] ratio for retail and apparel, fashion, and luxury M&A transactions[2]



[1]Earnings before interest, taxes, depreciation, and amortization. [2]Transactions announced as of April 9, 2020. Included industries: Apparel retail; Apparel, fashion, and luxury goods; Automotive retail; Computer and electronics retail; Department stores; Distributors; Drug retail; Food retail; Footwear; General merchandise Stores; Home improvement retail; Home furnishing retail; Hypermarkets and super centers; Internet and direct marketing Retail; Specialty stores; Textiles. n = 798.
Source: Capital IQ

that companies that take M&A action early may also benefit from more favorable valuations at first (Exhibit 2).

In the new COVID-19 context not all retailers will be equipped to pursue M&A. The most likely are the leading ecosystems and larger FD&M companies with strong e-commerce positions that focus on essentials or well-performing brands, play in subsectors less affected by the crisis, and enjoy some combination of relatively low financial leverage, access to investment-grade debt, and a cash-heavy balance sheet.

Smaller, more specialty players are less likely to flourish, as they are more often weakly capitalized and may lack the breadth and depth of e-commerce capabilities—or the financial muscle to build them—required to profit in the short to medium term from shifts in consumer spending. These players may become targets for more resilient competitors.

Private equity (PE) may also play a key role in accelerating M&A activity postcrisis. At the beginning of 2020, the global private-equity industry had an estimated $1.5 trillion in dry powder,[1] and it likely will be key player in the overall retail M&A landscape.

[1]Anne Sraders, “Private equity firms are sitting on $1.5 trillion in unspent cash, and looking to raise more,” Fortune, January 25, 2020, fortune.com.

Implications for food, drug, and mass-merchandise players
Because FD&M retailers are deemed essential in most markets, they have both obligations and often advantages during the COVID-19 crisis. They have a social imperative to improve their productivity to meet broad humanitarian needs, and they are currently some of the few retailers taking in cash, while also seeing firsthand the shifts in consumer behavior, spending patterns, and channel preferences.

We expect FD&M deal or collaboration activity to increase across all archetypes, but especially new business models and adjacencies (archetype 3) and capabilities (archetype 4).

Roll-ups of smaller regional or independent FD&M players (archetype 1) may accelerate in 2021, as these retailers face sustained sales declines driven by consumers shifting to alternative channels or players with stronger omnichannel offerings. This may create opportunities for the largest retailers to expand their geographic reach and generate back-end synergies. It is less likely this will occur in the short term as nearly all grocers have seen a spike in sales that is expected to persist through the end of 2020; potential sales declines driven by pantry unloading may not occur until 2021 depending on how long COVID-19 crisis lasts. In the short term, this roll-up may manifest as purchase of assets, particularly well-priced prime retail locations.

Acquisitions to expand into new categories or channels (archetype 2) may be smart plays for FD&M retailers, especially as they prepare for the next normal postcrisis and face lower in-store traffic. Broadening category footprint, that is, moving into complementary categories, could enhance players' value propositions and increase in-store traffic. Other opportunities in food service may also materialize, as some food service players (for example, quick-service-restaurant players) face financial difficulties. However, this expansion will be tempered by a need to simplify and strengthen supply chains; perhaps only where acquisitions are natural extensions of existing assortment and does not inhibit the agility of the supply chain.

Traditional FD&M and pure-play e-commerce players may move opportunistically into adjacencies (archetype 3) to integrate vertically and strengthen their route to market. Attractive options may include delivery services to capitalize on the anticipated stickiness of e-commerce and omnichannel buying and vertical integration of suppliers to guarantee availability and control over strategic categories. Other downstream opportunities in food service may materialize as some players face financial pressures.

FD&M players may double down on the acquisition of digital capabilities, platforms, and other value-adding bolt-ons (archetype 4) to enhance and transform existing operations quickly, given the relatively strong performance and persistent demonstration of touchless use cases. These deals will capitalize on evolving technology, secure scarce capabilities, and meet postcrisis service needs. For example, we expect that FD&M retailers will increasingly look to invest in automation technology (for both in store and back end), analytical tools and capabilities, e-commerce platform-management opportunities, and last-mile technology tools to pull forward digital transformation. This could also manifest via collaborations with logistics providers.

Implications for AF&L players
The past five years have favored a few AF&L success stories and left a long tail of lower-performing companies. Most AF&L companies (62 percent) saw negative TSR (versus 21 percent of the S&P 500), and only 15 percent of AF&L companies achieved TSR greater than 10 percent (versus 46 percent of the S&P 500).

Today, several AF&L categories (for example, footwear, apparel, and jewelry) are some of the retail categories hardest hit by the crisis. We expect AF&L M&A and partnerships could evolve in three ways postcrisis, accelerating some of the trends described in our latest State of Fashion outlook beyond COVID-19.

Purchases of brands or retailers (archetype 1). Strategic acquirers and PE investors may look to revitalize or own and license longstanding brands that become distressed but are believed to retain strong brand value. Strong brands that acquirers can leverage to build out unique business models may be especially attractive targets. As with FD&M, in the short term, some of this could manifest as asset sales, particularly as challenged brands and retailers look for injections of cash.

Further consolidation into existing or new "brand houses" (archetype 1). Relatively cash-safe AF&L players and PE or other private investors may look to combine multiple brands in a portfolio and give them creative autonomy, while realizing cost benefits from jointly negotiated rents, wholesaler terms, and back-office cost synergies.

Partnership with small players (archetypes 2–4) **and platform and marketplace consolidation.** The combination of an expected downturn and below-expectation performance in recent deals to exit direct-to-consumer (DTC) brands (for example, Casper IPO) could lead to more cautious funding of AF&L-focused DTC players, at least in the short term. This may open the door for strategic purchases of high-growth-oriented brands and retailers that have the digitally focused operations and consumer bases required for growth. Brands and multibrand players could also look to take smaller platforms in house to enhance consumer reach and digital capability. Overall, we expect the crisis to lead to further consolidation of marketplaces and platforms.

Next steps for retailers

COVID-19 and the onset of an economic slowdown may well reshape the landscape of retail deals and partnerships. We encourage retailers to take four steps now as they contemplate M&A and partnerships going forward, grounded in the three C's of excellent M&A strategists (competitive advantage, capacity, and conviction).

Define the next normal—and your competitive advantage. The first step to redefining M&A and partnership strategy is to understand what the next normal means for each brand and retailer. The new reality will depend largely on how core consumer segments, including behaviors and spending habits, have been impacted by COVID-19. Where are the growth spaces today and where will they be in the future? Where are consumers spending money—which categories and/or channels? How have their tastes, preferences, or concerns changed, driving new opportunities for differentiation or shaping new habits? In this context, how have previous competitive advantages changed and what new advantages have emerged? Identifying the opportunities for growth in the next normal—and which areas can be accelerated via partnerships and M&A—will be the first step to reshaping M&A strategy.

Assess capacity to execute acquisitions and partnerships. A realistic assessment of balance-sheet strength and ability to make acquisitions independently (that is, while debt markets are slowed or frozen), as well as ability to secure financing in the postcrisis environment, will be a key input to evolving M&A strategy. Understanding what targets (and what size targets) are feasible to acquire now versus later should inform how areas of exploration are prioritized. For players with limited cash availability or challenging financial health, partnerships with other players to pool financial resources while addressing strategic priorities could be considered (for example, sourcing collaborations).

Build conviction through identification of key areas of exploration within the M&A and partnership market and think through value creation up front. Retailers should generate data-backed perspectives about market trajectory, new-normal scenarios postcrisis, and the risks of further disruption. Shortlisting top-priority areas and securing executive and board commitment to

M&A will accelerate decision making as markets thaw and potential targets are discovered. In the post-COVID-19 tight credit market, we expect that synergy capture expectations, and track record, will matter to investors, which makes it even more important to think through synergy ambitions and value-capture plans up front. We also envision that a potential economic crisis will make it more important to carefully think through how a deal can help to sharpen and/or reposition the joint entity's value proposition(s) to better service customers' needs.

Explore opportunities to strike new deals and partner with healthier players. Players without the cash and financial health to pursue acquisitions should identify potential assets to liquidate or potential partnerships to shore up the balance sheet until the crisis passes. The implications of COVID-19 are just as high for potential sellers as they are for potential acquirers.

The retail sector cannot escape the economic impact of COVID-19. But, despite the difficult economic outlook, we expect retail M&A activity to accelerate as the crisis stabilizes, creating opportunities for financially sound players to acquire or partner with less advantaged players. Now is the time for retailers to think about M&A postcrisis. This calls for defining their role in the next normal, reevaluating financial health, segmenting the M&A market, and contemplating new deals and partnerships.

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Adapting to the next normal in retail: The customer experience imperative

The COVID-19 crisis has led to dramatic shifts in consumer behavior. Retailers will have to work hard to meet ever-evolving customer experience requirements in order to win and remain relevant.

by Holly Briedis, Anne Kronschnabl, Alex Rodriguez, and Kelly Ungerman

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This article first appeared on McKinsey.com in May 2020.

The COVID-19 pandemic has upended the retail industry, forcing the closure of physical stores and causing uncertainty for the future of the in-store experience. These abrupt shifts have left many retailers scrambling to effectively serve customers through other channels. Digital-first and omnichannel retailers have pivoted more easily, but retailers that prioritized physical stores and face-to-face engagement over omnichannel strategies have struggled to respond.

For retailers, the starting point matters in a crisis. Organizations that can quickly reimagine their omnichannel approach to create a distinctive customer experience will recover faster from the pandemic. Analysis of the financial crisis of 2008 shows that customer experience leaders saw a shallower downturn, rebounded more rapidly, and achieved three times the total shareholder returns in the long run compared with the market average (Exhibit 1).

The pandemic has changed consumer behaviors, some permanently.[1] We have seen a consolidation of shopping trips: in China, for example, the number of transactions in grocery declined by 30 percent during the pandemic, while the average value per transaction increased by 69 percent. In the United States, e-commerce availability and hygiene considerations are increasing store switching behavior, with 17 percent of consumers shifting away from their primary store. Many customers have also tried new omnichannel models: buy online, pick up in store (BOPIS) grew 28 percent year-over-year in February compared with 18 percent in January, and grocery delivery is up by 57 percent.[2] More important, many of these new engagement models are here to stay. Consumers report high intention to continue using models such as BOPIS (56 percent) and grocery delivery (45 percent) after the pandemic.

To remain relevant in this changed environment, retailers should set a North Star to guide their aspirations for customer experience, with specific goals across five actions: double down on digital, inject innovation into omnichannel, transform store operations and win on "SafeX,"

[1] McKinsey COVID-19 US Consumer Pulse Survey, April 20–26, 2020, n = 1,052, sampled and weighted to match US general population aged 18 years and over.
[2] Delivery and BOPIS benefit, shopping centers not yet heavily impacted," Retail Touchpoints, March 11, 2020, retailtouchpoints.com.

Exhibit 1

Customer experience (CX) leaders are more resilient during recessionary periods, experiencing shallower troughs and quicker recovery.

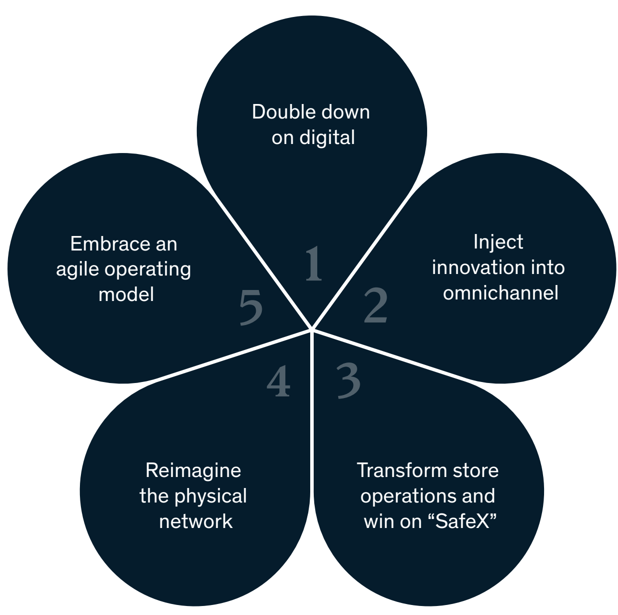
Financial performance (total shareholder returns) of CX leaders vs laggards[1]

[1] Comparison of total shareholder returns for publicly traded companies ranking in the top ten of Forrester's CX Performance Index from 2007–09.

Source: Forrester Customer Experience Performance Index (2007–09)

Exhibit 2

Omnichannel leaders are adapting to the next normal in customer experience by taking initiative across five key actions.



reimagine the physical network, and embrace an agile operating model (Exhibit 2).

How retailers can meet new customer expectations

The savviest retailers have spent years creating omnichannel strategies that blend physical and online channels to engage consumers in the channel of their choosing. COVID-19's impact on customer behavior has reshuffled the deck. In-person interaction has dramatically changed or been supplanted by digital engagement, and early indications suggest that much of this shift may endure in the long term. E-commerce sales in apparel, department stores, and beauty products have increased by nearly ten percentage points, on average, since the onset of the pandemic. In grocery, e-commerce penetration, which has risen from 2 to 3 percent before the crisis to 8 to 10 percent during its peak, is expected to settle at twice the previous "normal" level, 5 to 7 percent, by year's end.

Looking forward, we believe retailers should focus on five actions to build more resilience in their customer experience and to emerge even stronger in the recovery.

1. Double down on digital

COVID-19 has dramatically and suddenly shifted more customer traffic to digital channels. Consider that online sales, which increased at a 14 percent compound annual growth rate (CAGR) over the past four years, grew by 25 percent in a two-week period in March 2020—led by grocery purchases.[3] The profound impact of the pandemic on consumer shopping habits has increased the urgency for retailers to expand their digital presence quickly.

[3] Giselle Abramovich, "Adobe Digital Economy Index: Tracking the state of ecommerce during COVID-19 and beyond," Adobe, March 31, 2020, adobe.com.

Dial up the acquisition engine and drive traffic to digital assets. Retailers can partially offset diminished foot traffic in physical stores by boosting investments in online acquisition. This effort will require them to reallocate funds from offline media to digital channels. With more investment in online marketing, winners are adapting their strategies to account for shifts in consumer behavior. These adaptations include paying closer attention to paid search (for example, looking at not just keyword performance but also consumer intent) and improving the "shoppability" of social channels (for example, through featured products and clickable content on Instagram).

Extend digital-channel presence and engagement. Shelter-in-place orders have led companies to test new methods of customer engagement. App downloads increased 11 percent from January to April 2020 compared with the same period last year. Many retailers with established mobile apps have cited record downloads, while others sought to make up ground quickly. Around 45 to 50 percent of retailers had plans to prioritize a mobile app or point-of-sale experience this year, and several companies have accelerated their efforts in response to the pandemic.

In addition, while building and nurturing online communities are not new ideas, they have gained momentum. Retailers are augmenting direct customer interactions with engagement in apps and other relevant channels. Nike China, for example, activated its digital community by offering virtual workouts and saw an 80 percent increase in weekly active users of its app.

Ensure that the digital experience is truly "zero friction." Customer expectations are rising for digital channels along measures such as site speed, stability, and delivery times. To keep pace, retailers should start by designing web pages that are optimized for digital shopping. For example, making the highest-selling (and ideally highest-margin) products easy to find helps to make the customer journey more seamless. The first page of Amazon listings receives nearly two-thirds of all product clicks.[4] Increasing load speed to best-in-class levels is also paramount: the ideal load time for peak conversions is no more than 2.7 seconds (and every 100-millisecond delay above that can reduce conversion by up to 7 percent[5]). Additional priorities include high-functioning landing pages and consistent marketing messages. With more customers now engaging through mobile devices, retailers must ensure that all digital channels are integrated and offer consistent services (such as payment options) and experiences (such as shopping carts updated in real time across devices).

2. Inject innovation into omnichannel

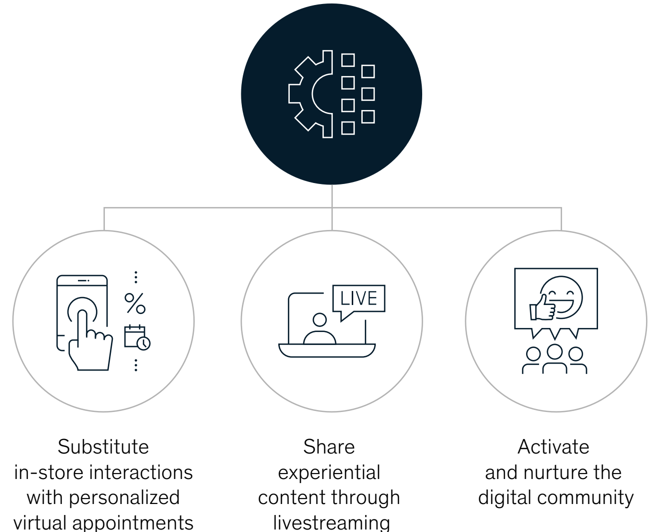
To adapt to new customer behaviors and preferences, retailers will need to evaluate their current omnichannel offerings and find opportunities to innovate and fill gaps. Any additions should be clearly aligned with emerging customer needs and integrated with existing channels to support a consistent experience.

Bring an in-store feel to the digital experience. The inability to engage customers in a physical environment has pushed some retailers to bring more of the in-store experience online (Exhibit 3). First, leading retailers have substituted in-store personalized interaction with offerings such as virtual appointments, where sales associates use videoconferencing platforms to offer personalized attention to customers. Sales agents help individuals find products that meet their needs while learning ways to better serve customers online. Similarly, retailers are using livestreaming to engage with customers and increase revenue and loyalty by sharing experiential content. In China, for example, Taobao Live made it easier for brick-and-mortar retailers to join its livestreaming channel platform, leading to a 719 percent increase in participating merchants

[4] Dan Alaimo, "Amazon now dominates Google in product search," Retail Dive, September 7, 2018, retaildive.com.
[5] *The state of online retail performance*, Akamai, April 2017, akamai.com.

Exhibit 3

Facing limitations on physical customer interactions, retailers are innovating to bring the in-store experience online.



Substitute in-store interactions with personalized virtual appointments

Share experiential content through livestreaming

Activate and nurture the digital community

in February 2020 compared with the prior month.[6] Trained staff can create content that addresses customer challenges in an entertaining way while promoting current products and new launches.

Second, retailers have been developing alternative engagement models to de-risk digital-purchasing decisions. In apparel and fashion, for example, one of the main impediments to online purchasing has historically been the inability for customers to see how items would look on them. Jewelry brand Kendra Scott is tackling that problem by launching a new platform, Virtual Try-On, which uses augmented-reality (AR), machine-learning, and computer-vision techniques. Launched in April in response to COVID-19, the platform allows shoppers to preview styles as they move, enjoying the experience of a retail setting in the comfort of their home. Shopify, which allows its merchants to add 3-D models to their product pages, found that conversion rates increased by 250 percent when consumers viewed 3-D products in AR.[7]

Launch or diversify delivery mechanisms. COVID-19 has heightened the importance of safe delivery modes, including curbside pickup and aggregator delivery: around 22 percent of US consumers are using delivery services more than they were before the crisis. Retailers have scrambled to launch services to meet this demand. One retailer that aligned speed and consumer expectations was Panera. In just two weeks, the company conceived, developed, and launched a grocery-delivery service that enables customers to order entrees from the core business and add groceries to a unified online cart. And when the company's cafes began to close in response to stay-at-home orders, Panera moved quickly to launch curbside ordering and pickup within two weeks.

Retailers are also reassessing store formats to support third-party delivery services. One grocer is creating "speed zones" near the front of the store and stocking them with the most popular items to enable delivery companies to accelerate pick, pack, and delivery of orders.

[6] "Taobao live accelerating digitization of China's retail sector," Alibaba Group, March 30, 2020, alibabageoup.com.
[7] Jon Wade, "Bring product pages to life with built-in support for 3D models and video," Shopify, Mar 14, 2020, shopify.com.

Partner across retail to enhance convenience. Many retailers have explored strategic partnerships to enhance convenience for customers and boost sales. These ecosystems can be quite powerful, allowing retailers to gain access to new capabilities and extend their brand reach to new customers in new places. Footwear retailer DSW, for example, has partnered with grocery chain Hy-Vee to offer products through the grocer's extensive network of physical locations. Such arrangements give retailers access to new shopping occasions and new customers, and can extend one retailer's brand halo to its partners.

3. Transform store operations and win on 'SafeX'

The pandemic has hobbled traditional store operations, with physical distancing and a new preference for self-service altering the formula for customer experience. The priority for many customers today is to get in and out of a store as quickly and safely as possible—if they choose to go in at all (Exhibit 4). Providing safe(r) experiences, SafeX, will be critical to alleviating customers' anxieties and enabling a return to in-person interactions. In China, for example, 65 percent of consumers indicated that they expect to care more about product safety after COVID-19 than prior to COVID-19.[8] Retailers must implement policies and processes to enable safe distances, sanitize surfaces and products, and communicate proactively, clearly, and empathetically.

Beyond managing the SafeX considerations that are currently top of mind, retailers need to dramatically reduce costs and improve operational efficiency in their stores to offset revenues that are increasingly shifting to online channels.[9] Done properly, this effort will help companies enhance customer experience and safety while trimming operating expenses.

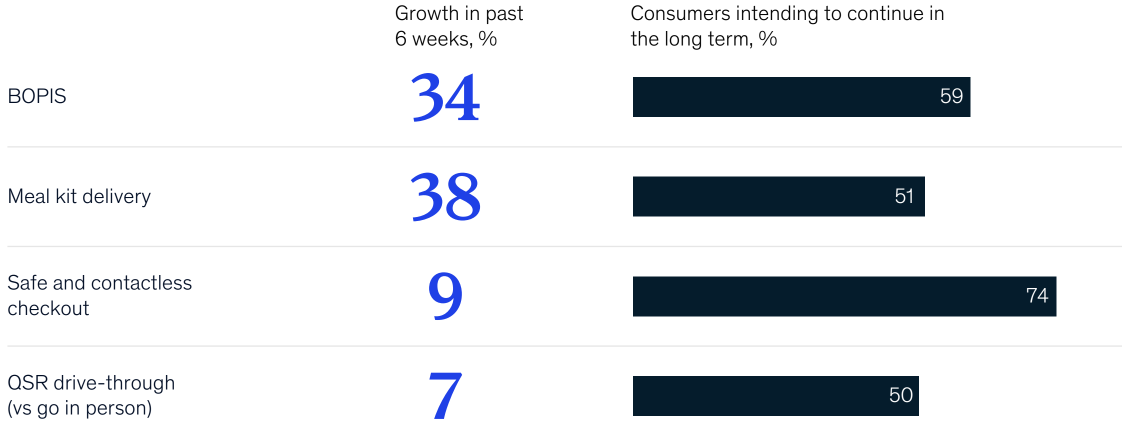
Retailers can start by establishing a set of service and experience elements that are nonnegotiable. New safety requirements for both customers and associates will be a core part of these nonnegotiables and could include no-contact payment methods or cleaning and employee-hygiene processes. The workforce will need to be redirected from less-relevant activities to priority areas. Many of the opportunities can

[8] McKinsey COVID-19 Mobile Survey, April 21–25, 2020, n = 5,013, sampled and balanced to match general population (except India, which has a higher focus on consuming class).

[9] Praveen Adhi, Andrew Davis, Jai Jayakumar, and Sarah Touse, "Reimagining stores for retail's next normal," April 2020, McKinsey.com.

Exhibit 4

Safe delivery modes are increasingly important to consumers—winning on 'SafeX' matters in digital and omnichannel.



Source: McKinsey COVID-19 US Consumer Pulse Survey, April 20–26, 2020, n = 1,052, sampled and weighted to match US general population aged 18 years and over.

be captured quickly by changing store hours, improving scheduling, and altering the mix of full- and part-time employees. Some retailers have started to move certain elements of the experience outside of the store (for example, returns in the parking lot), given limits on customers per square foot in stores. A structured effort focused on addressing new operational needs and implementing leaner practices can yield labor efficiencies of 5 to 15 percent.

For retailers that have closed stores during the pandemic, the reopening process offers an opportunity to establish new models. First and foremost, physical-distancing requirements will likely constrain the number of employees who can be in stores at the same time. These limitations could force retailers to prioritize activities such as opening and closing processes, checkout, restocking, and e-commerce fulfillment. Store reopenings will also offer retailers an opportunity to fundamentally change how core processes are carried out and implement best practices.

4. Reimagine the physical network

Over the past three years, consumers have shifted an increasing share of their purchases to e-commerce, which has led to ever-growing declines in physical store traffic. COVID-19 has accelerated this trend with apparel retailers and department stores, which are projected to see a 10 to 13 percent increase in online penetration after COVID-19. The rising volume of e-commerce transactions will force retailers to reevaluate their network of brick-and-mortar stores and how physical locations can best support the customer experience.

While physical stores are critical to the customer experience, our analysis suggests that the United States has more retail shopping capacity than other countries with sizable retail markets. Retailers should be thoughtful about which stores they choose to reopen and in which sequence.

Optimize the footprint. Sophisticated retailers are evolving how they evaluate stores and optimize their network. For example, cutting-edge data sources can be used to get a detailed view of micro traffic patterns. Retailers should also adjust their analysis for the impact of COVID-19 and determine if store performance is the result of underlying intrinsics or just the physical store location. Last, four-wall profitability should be a comprehensive and holistic measure that takes into account the cross-channel sales contribution of the store (see sidebar, “Taking

Taking a comprehensive, data-driven approach to store closures

One North American retailer undertook a comprehensive assessment of sales volumes and customer activity across its own stores (which included several formats), wholesale stores, and e-commerce channels to achieve a cross-channel ecosystem view. The project entailed defining the role of channels, determining which are mutually supporting and which cannibalize others, and identifying where these effects are the strongest. By simulating store closures, the retailer was able to calculate the total economic value of each store, which provided insight into the portion of e-commerce sales that stores contributed as well as the volume of sales redistributed to other physical stores.

The assessment enabled the retailer to identify the optimal location and channel mix for each market. For every store slated to be closed, the retailer was able to calculate the halo effect and recapture rate of that store in sales volume. By taking a holistic view of physical stores and their contribution to omnichannel sales, the retailer boosted sales growth by 10 to 20 percent and improved EBITDA[1] margins through smart closures.

[1] Earnings before interest, taxes, depreciation, and amortization.

Exhibit 5

Retailers are taking a hard look at their footprint and deciding the role of each store moving forward.

a comprehensive, data-driven approach to store closures”). If a retailer exits a market, will there be a loss in online sales? If a store is added, what is the halo effect on online penetration? Retailers can use four-wall profitability and cross-channel strategic importance to cluster stores by the potential actions: transform and grow, reopen as usual, reassess their role, and renegotiate leases or consider closure (Exhibit 5).

Redefine the role of physical stores. The pandemic has pushed retailers to move beyond the traditional view that physical locations are primarily for in-store customer engagement. Promising new models have begun to take hold and will continue to evolve in particular for stores that have high strategic importance for the retailer’s network. We will likely see a continuation of the pre-crisis trend toward retail stores that create immersive experiences to drive foot traffic. Retailers are also experimenting with more gray or dark stores for fulfillment, a long-running trend in the restaurant industry. In this model, which has been deployed by many retailers, physical locations are turned into temporary or permanent fulfillment nodes to enable faster delivery.

Create the store of the future. The evolution of the physical store’s role as a core component of the omnichannel journey has also affected store layouts. Many retailers had been using their stores to educate consumers on product offerings, reinforce their brand’s positioning, and support e-commerce sales. Indeed, research before the pandemic found that opening a new location increases traffic to the retailer’s website by 37 percent the following quarter.[10] New technology solutions are also changing store formats: tech-enabled stores, such as Amazon Go locations, feature new models that support customer journeys. Sales associates remain

[10] International Council of Shopping Centers, “Physical stores key to retail success, study finds,” October 15, 2018, icsc.com.

Retailers need to raise their metabolic rate—that is, the speed at which they process information and develop new offerings.

critical to the experience at these stores but play more of an advocate role for customers. Retailers will have to rebalance these elements to reflect the postcrisis constraints.

5. Embrace an agile operating model

The pace of change in the post-pandemic environment will force retailers to continually reassess their strategies. This approach requires more real-time insights on customers as well as a new agile operating model to harness these insights and put them into action.

Before the pandemic, digital leaders were using data to optimize customer experience, gauge satisfaction, identify foot traffic trends, and generate purchase recommendations. Winning retailers are moving beyond surveys as a mechanism for customer input and toward near-real-time tracking of consumer trends and behavior shifts. With the rise of digital in recent months, companies will have even more dynamic data at their fingertips, and they can use these data to extract immediate insights. For example, many retailers have seen an influx of new customers to physical stores (for essential retail) or digital channels. Winners will generate insights from these new customers and construct targeted retention plans, messages, and offers to maintain the customer relationship in this era of brand switching and cost consciousness. Social media is another channel that offers insights on rapidly changing consumer behaviors. For example, one Chinese rental-car company created a team to monitor social media and identify real-time trends. The company then created new offers based on insights from the social media analysis.

In addition, as retailers reformulate their customer experience, they should bring customers *into* the design process to share feedback as ideas develop, ensure new offerings are meeting actual needs, and de-risk initiatives along the way. Qualitative feedback can be gathered through online tools or in-person concept sprints so ideas can be assessed and iteratively improved.

By adopting agile practices alongside the generation of real-time consumer insights, retailers can more quickly recalibrate their business model and offerings to meet consumer expectations.[11] Retailers need to raise their metabolic rate—that is, the speed at which they process information and develop new offerings. The speed at which some retailers have been able to stand up new omnichannel models (for example, launching a new delivery business in three weeks) shows what

[11] Wouter Aghina, Karin Ahlback, Aaron De Smet, Gerald Lackey, Michael Lurie, Monica Murarka, and Christopher Handscomb, *The five trademarks of agile organizations*, January 2018, McKinsey.com.

a truly agile operating model can unleash. A rapid approach to tests and trials can enable retailers to launch offerings at scale more quickly and avoid losing share in the face of shifting consumer behavior. Senior leaders must empower junior colleagues to make decisions rapidly.

The next normal is still taking shape, and customer expectations will continue to shift in response. Retailers that focus on customer experience and respond with agility and innovation in their omnichannel experience will fare better and strengthen their ties to customers.

Retailers have much ground to cover, and time is of the essence. They should start by establishing a North Star to guide their aspirations for customer experience, with clear objectives across each of the five actions described above. A cross-functional team should take the lead in assessing the starting point, quickly developing the path forward, and driving implementation.

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Automation in retail: An executive overview for getting ready

The winners in the sector will be those who understand the implications of automation and act quickly to respond to them.

by Steven Begley, Bryan Hancock, Tom Kilroy, and Sajal Kohli

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Retail is under pressure. Margins are stressed from all sides: higher costs to manage e-commerce supply chains, growing demands from suppliers to pass on raw-material cost inflation, higher investments to match new competition, and steadily rising labor costs. At the same time, the customer's expectations continue to surge as digital natives and disruptors alike raise the bar for personalized service—on the back of what, at times, is an advantaged cost structure. As retailers struggle to adapt, and even to survive, they increasingly pursue automation to address margin strain and more demanding customer expectations. Automation, however, is a new capability for all but digital natives, and the sophistication in approach varies accordingly.

Over the past three years, the McKinsey Global Institute has conducted a broad-based research initiative on automation across sectors. This research has shown that about half of the activities in retail can be automated using current, at-scale technology. While this number is alarming, the change will be less about job loss and more about the evolution of jobs, the creation of new ones, and reskilling. Only about 5 percent of all jobs can be fully automated with current technology, and automation will lead to the creation of jobs as companies invest in growth.

The thinking behind this report was done before the outbreak of the COVID-19 pandemic. We have considered whether the observations and recommendations remain valid in this turbulent time and have concluded that the direction outlined still fits with the 'next normal' we expect retailers to navigate, and is now even more pertinent with the acceleration of shopping trends. We have seen a fundamental step change in the shift towards online shopping and home delivery during the COVID-19 lockdown period across the world, which we expect will be sustained post COVID-19 and accelerate channel shifts the midterm. Shoppers are trialing new ways to shop—for example 40 percent tried grocery delivery. We expect a level of long-term "stickiness" from these changes—with lessons from China suggesting retailers should still be expecting 10 to 20 percent year-on-year growth online in most categories as the market moves towards the 'next normal.' The situation has given businesses a stronger sense of what they need in order to deliver, to be more productive, and to have the flexibility to operate in downtimes or when demand surges beyond usual capacity. The expected ongoing impact on the economy and consumer confidence puts further pressure on retailers to find new ways to combat inflationary headwinds. Customers have rising expectations around digital and automation, such as touchless payments. If anything, COVID-19 is a reminder that retail may need to reboot faster than anticipated.

New realities

In our work in the retail sector, we see automation reshaping business models and the broader value chain. Let's start with four new realities we observe among retailers.

1. Margin pressure has made automation a requirement, not a choice

Retail-margin pressure is mounting, driven by more intense competition, investment in e-commerce, and pressure to increase wages. While these cost pressures are not new, many retailers have already exhausted traditional cost-reduction levers. Unable to pass on costs to their customers in this hypercompetitive environment, retailers are using automation to support and bolster margins.

These pressures are consistent across retail subsectors. Our analysis suggests that typical grocery and hypermarket retailers face 100 to 150 basis points of margin pressure, and typical specialty apparel or department stores 350 to 500 basis points. A comprehensive automation program can significantly offset these headwinds. Automation initiatives across store, supply-chain, and headquarter functions can generate 300 to 500 basis points of incremental margin, which retailers can reinvest in their growth opportunities.

2. The bottleneck to automation is internal, not external

An assessment of available automation technologies shows that they can already operate a typical retail grocery store with up to 55 to 65 percent fewer hours. The critical components include electronic shelf-edge labels, self-checkout terminals, shelf-scanning robots, and partially automated backroom unloading. These technologies have been proved at scale and offer internal rates of return higher than historical retail hurdle rates—yet few retailers are moving quickly to implementation.

In some cases, the bottleneck is a lack of skills and capabilities. But one of the biggest challenges is the inertia of the business. Retailers struggle to break free from the soft tyranny of budget cycles and the replication of last year's capital spending. Our corporate-finance research suggests that two-thirds of companies fall into this trap. For these players, more than 90 percent of a given year's capital expenditures simply reprise those of the

preceding year. Only one-third of companies are dynamic reallocators, consistently shifting 30 to 40 percent to different business units or new uses over five to six years—that is, a reallocation rate of 5 to 6 percent a year. Dynamic reallocators enjoy disproportionate rewards: growth in total shareholder returns nearly three percentage points higher than those of other companies over an extended time period.

3. If you aren't already implementing automation, you are falling behind Amazon

Amazon, which has made headlines with its Amazon Go retail concept, has been the most prominent disruptor. Through the implementation of automation technology, we believe that Amazon Go has the potential to deliver top-line benefits due to additional transacting traffic from reduced wait times and the use of customer insights to optimize assortments and personalize promotions. Further potential could come from the opportunity of commercializing customer data and insights. The company now operates ten Amazon Go stores, in three US cities, and the tech giant has ambitious expansion plans: 3,000 stores by 2021.

Amazon is not alone. Faced with disruption and the opportunity to expand margins, select incumbent retailers are also investing in automation and artificial-intelligence (AI) technologies at scale to enhance both the customer and employee experience. Take, for example, Kroger Edge: digital shelves (which the retailer rolled out across 200 stores in 2018) that display prices, nutrition facts, coupons, and video advertisements—all dynamically updatable from a central source. Eventually, Kroger plans to link the shelves to shoppers' smartphones, allowing an increased level of personalization.

Ahold Delhaize and Albertsons have announced partnerships with Takeoff Technologies, a company that builds automated miniwarehouses for the robotic in-store fulfillment of digital orders. Other retailers are exploring technology use cases for employee activities. Target and Walmart have invested in autonomous cleaning robots that save hours of its associates' time. Walmart has also rolled out virtual-reality headsets to train associates, as well as the FAST Unloader technology to automate the backrooms of stores. If recent headlines are any indication, the adoption of these technologies by retailers will accelerate.

4. The automation opportunity is bigger than operations

Much of the discussion about the future of work in retail has focused on the use cases for automation and AI in stores. However, supply-chain and head-quarter functions (such as merchandising) will also be affected massively.

Consider merchandising. Today, automatable activities account for approximately 30 to 40 percent of the time of merchants, who, for example, spend about 20 percent of their time on merchandise-planning activities. Advanced planning systems can automate historical analytics and generate predictive scenarios, significantly reducing the time needed to plan merchandise and empowering merchants to make faster decisions. Similarly, dynamic systems with web-scraping and predictive impact analytics could automate pricing and promotions. Automating these and other time-intensive processes will enable merchants to increase the time they spend on more strategic activities, creating value for the enterprise (Exhibit 1).

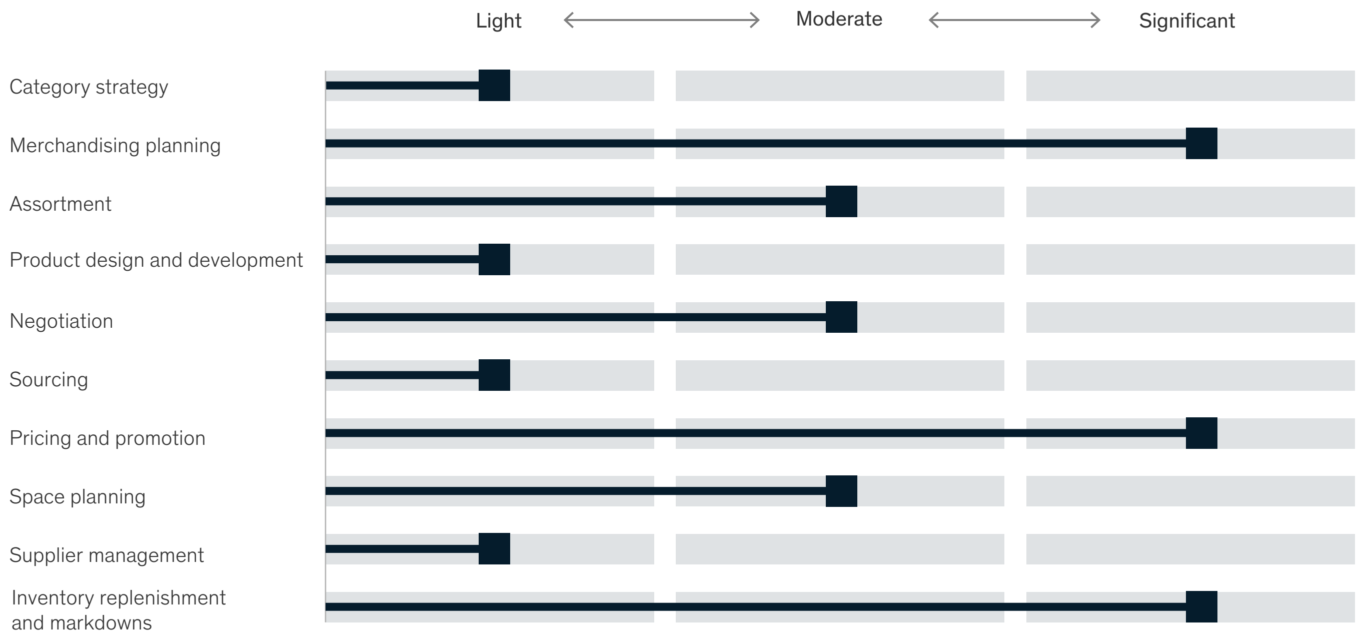
Automation can also make HR processes more efficient and provide leaders with new insights for a successful people strategy. One retailer we know, for example, designed an app-based hiring tool to streamline the recruitment of store associates. At the start of the project, the recruiting process was difficult. Each candidate would provide almost 50 documents and visit the company's offices up to five times; end-to-end, the whole thing took an average of 45 days. To make matters worse, about 40 percent of the associates hired left within six months.

To solve these problems, the company established an agile, cross-functional working team, which created minimum viable products in just ten weeks: for candidates, a mobile-app tool to help browse jobs and apply for them; for HR managers, a web-based tool to screen and identify potential hires. Now implemented in more than 1,000 stores, the solution has not only reduced hiring time by more than 80 percent and store administrative hours by

Exhibit 1

Automation will have an impact on most elements of the merchant role.

Projected impact of automation by core merchandising activity



20 percent but also improved the quality of new hires through the application of advanced analytics to applications.

Supply chains offer several more automation use cases, and retailers are at the forefront of implementation. Target and Walmart have partnered with Swisslog to build warehouses with automated case picking. Ocado sells its Smart Platform, a proprietary e-commerce warehousing solution, to other retailers. More broadly, automated smart robots can store, retrieve, depalletize, and transport products—all while calculating optimal routes through a warehouse. Drones and robots can also be used for security and safety surveillance and for quality checks.

Battlegrounds to survive and thrive

In this section, we explore the critical imperatives for retailers as they build the workforce of the future (see sidebar, “Is your management team actively preparing for the future of work?”).

1. Organizational structures and ways of working must be transformed

Adding technology, by itself, is not enough. Retailers must also rethink their operating models across stores, distribution centers, and headquarters. Automation creates organizations with far fewer layers—each employee is responsible for a more diverse set of responsibilities. Real-time data and analytics will empower faster decision making.

Is your management team actively preparing for the future of work?

Questions to consider:

— What is the size and scope of the workforce that would be affected by your technology road map?

— What business changes or adjacencies could generate significant new jobs?

— Do you have a plan to train people for the skills of the future? Who will be your partners?

— Given the workforce implications across the economy, would you prefer to address them proactively or reactively?

— Do you have a plan to source new talent at all levels of the company?

— How do wages need to evolve so that you retain workers and attract good talent?

Consider a store that employs shelf-scanning robots, effectively automating a large part of a traditional store-department-manager's role. The instructions of a robot rather than a department manager guide stockers, who now work more efficiently and can therefore be cross-trained to perform additional in-store activities, such as providing service to customers or picking online orders. Meanwhile, retailers must reconsider the organizational structure, since they no longer provide a career path from stocker to department manager to store manager. Stockers must now move laterally through multiple teams while building leadership skills through outside training and executive exposure before moving on to leadership roles in stores.

To fully unlock the benefits of this technological transformation, extensive adopters of automation and AI are exploring more agile ways of working. Structurally, this means shifting from strict hierarchies and siloed functions; instead, "teams of teams" are built around end-to-end accountability, with flexible resources that improve work flow. These teams are empowered with real-time data, and decisions are purposefully decentralized to cultivate a bias to action.

2. The redeployment of labor is a strategic opportunity missed by most

Efficiency is often perceived as the primary motivator for adopting automation technologies, but among retailers, innovation is the ultimate way to survive. As they implement automation technology, they create a large bank of hours with a trained and trusted workforce. The opportunity to redeploy a portion of these hours to more valuable activities provides an opening for a differentiating kind of innovation.

Several grocers, for example, are creating new roles for in-store pickers and e-commerce distribution centers. One example of near-in redeployment is Ahold Delhaize's e-commerce investments, which will add 150 new jobs to the local economy in Lancaster, Pennsylvania. Meanwhile, McDonald's has not only introduced table service in restaurants but also rolled out self-service ordering kiosks. Best Buy has pushed further into adjacent services, creating new customer-service roles in its In-Home Advisor and Total Tech Support programs and retraining employees for them. In the years to come, we will see additional retailers explore shifting labor into other, further-out uses, such as home health care or installation services.

3. Retailers must prepare for skilling and reskilling at scale
As the demand for physical and manual skills declines, the need for technological skills, as well as social and emotional ones, will rise quickly in every sector, including retail (Exhibit 2). Faced with the skill gap created by the future of work, retailers have three options to acquire talent: hire new employees, outsource to gig workers and external partners, or reskill current workers.

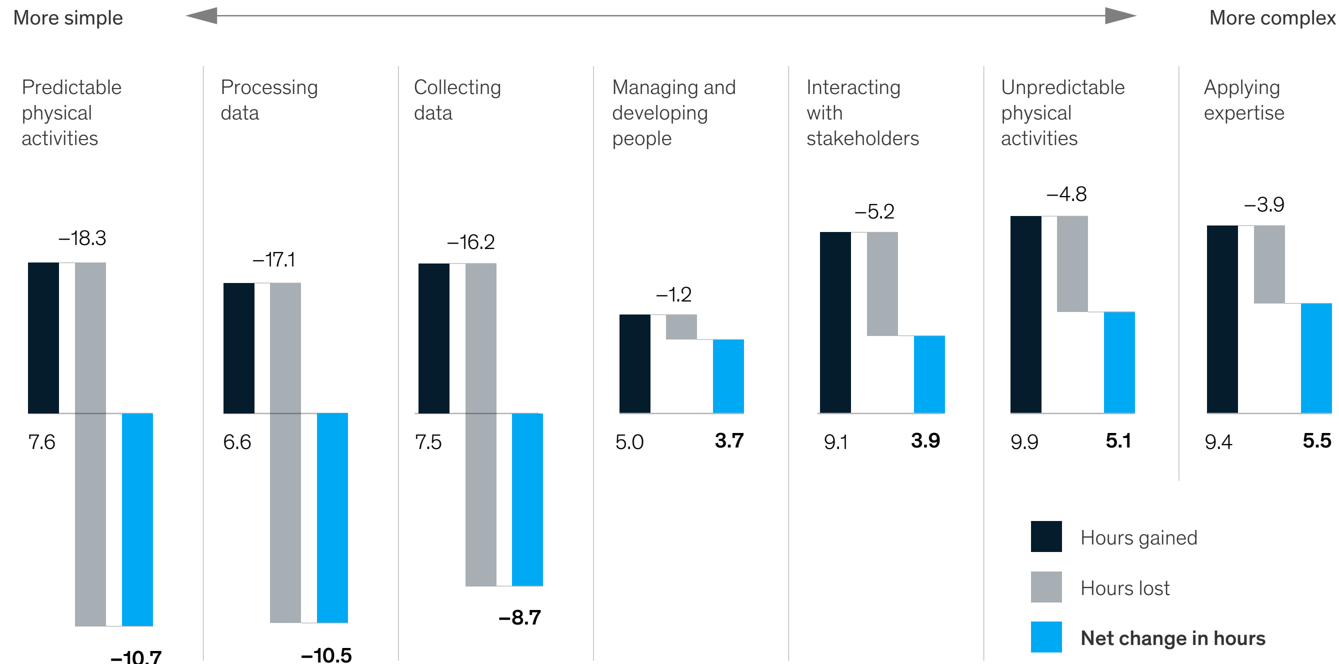
While hiring may appear to be an ideal solution, the rapid growth of technology companies and the digitization of incumbents have diminished the available skill pool. Companies report that an inability to source talent is the main reason for delaying digital transformations, and this is hardly surprising; we estimate that digital skills are available in only half the needed quantity and agile skills in only a quarter. Retailers therefore cannot assume that hiring and outsourcing will bridge the skill gap, and this leaves a mandate to reskill employees.

Although reskilling takes a good deal of effort, it often offers a higher return on investment, in the longer term, than hiring; in fact, the business case for reskilling can be 1.5 to three times better. On average, replacing an employee can cost 20 to 30 percent of an annual salary, reskilling less than 10 percent. Reskilling existing employees also allows a retailer to retain institutional knowledge and saves the ramp-up time needed to onboard new hires. Furthermore, reskilling is more likely to earn goodwill from employees, customers, and governments alike. This goodwill can have tangible benefits; approximately 40 percent of transformations fail because of employee resistance, so a reskilling campaign can mitigate that risk. For these reasons, we believe that reskilling will be a large part of the answer for

Exhibit 2

Automation and artificial intelligence will fundamentally reshape activities and skills.

Total change in US work hours, by activity type by 2030, trillion



Note: Some occupational data projected into 2016 baseline from latest available 2014 data.
Source: ONET skill classification, US Bureau of Labor Statistics; McKinsey Global Institute analysis

Employers increasingly view talent—not real-estate costs—as the primary driver of decisions regarding office locations.

retailers. Across industries, global executives agree: 75 percent of those surveyed say reskilling will provide at least half of the solution for the skill gap.

Employers will play a leading role in helping workers to reskill, but collaboration with external partners will also be required. For instance, educational institutions and industry associations can create specialized curriculums and certifications for future skills. Not-for-profit organizations can develop innovative approaches to make reskilling efforts more affordable and effective. Such partnerships are even more important for smaller retailers (such as regional grocery chains) that may have fewer resources for a substantive reskilling effort.

Companies at the forefront of employee-reskilling efforts recognize the importance of collaboration. Walmart's Dollar a Day college-tuition program, for example, has won support from other key organizations since it started. To ensure the initiative's success, Walmart has partnered with Guild Education, which provides coaches to help the company's employees select the appropriate degree and navigate the college-application process. Walmart also picked its university partners thoughtfully, choosing three—Bellevue University, Brandman University, and the University of Florida—known for their high graduation rates and focus on adult learners. AT&T launched Future Ready, a $1 billion web-based, multiyear reskilling effort, with the support of universities (such as Georgia Tech) and online platforms (for instance, Coursera and Udacity).

4. Talent-acquisition strategies require an upgrade

As previously mentioned, the future of work is heightening the competition for skilled employees. Given the relative scarcity, retailers must approach talent strategy more broadly—looking, for example, at the implications for site decisions and the role of outsourcing to external partners and gig workers.

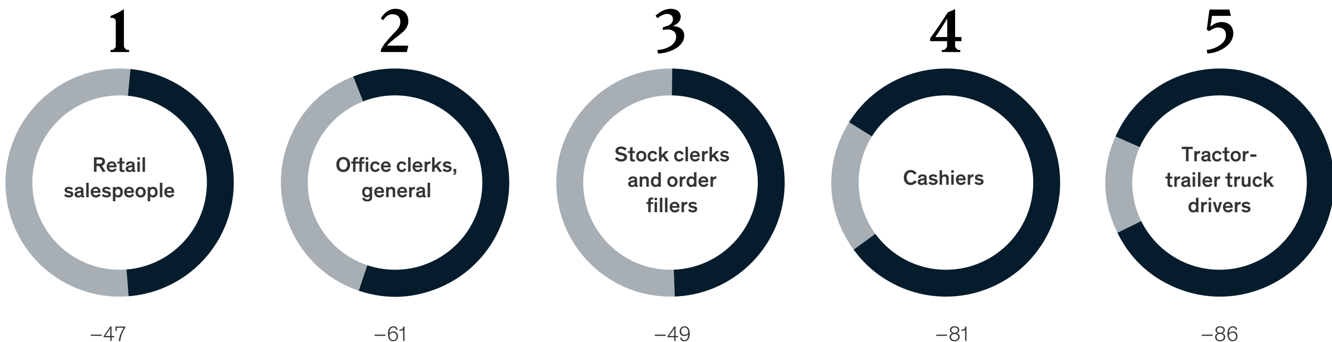
Employers increasingly view talent—not real-estate costs—as the primary driver of decisions regarding office locations, and many are moving their headquarters to optimize for talent. Ahold Delhaize's Peapod and McDonald's have both moved their headquarters from the outskirts of Chicago to the heart of downtown. The Canadian grocery chain Loblaws runs its Loblaws Digital organization in a trendy Toronto neighborhood rather than the main headquarters, in the suburbs. Executives from each of these companies have cited the need to attract talent as the key motivation for their site decisions.

By engaging gig workers and outsourcing tasks to partners (rather than hiring), retailers can also expand the way they define the acquisition of talent. Today, roughly one-third of US workers are freelancers; if current trends continue, independent workers could become the majority of the US workforce by 2027. Tapping into this gig economy helps employers to fill specific skill gaps quickly and more flexibly, and the opportunity to pay for outcomes can help minimize costs. Understanding these benefits, several leading companies across the full consumer ecosystem—both manufacturers and retailers—are exploring the potential of independent workers. Coca-Cola, for instance, invested early in the gig-economy platform Wonolo, which connects gig workers with potential employers. It remains a customer of the platform today, along with the North Face and Uniqlo. P&G piloted an on-demand talent initiative for project-based work, such as translations and content creation. The result was faster resourcing, improved quality, and lower costs.

Exhibit 3

Some retail jobs will be affected disproportionately across the United States.

Maximum potential automation impact from existing technologies, % of time with the potential to be automated



Source: McKinsey Global Institute analysis (US and Western Europe)

5. Wage reinvestments are a missed opportunity—few invest strategically
As retailers introduce additional automation into their retail models, they will end up with fewer but more highly skilled jobs. To get the right talent, retailers must invest in higher wages and benefits. Many retailers are managing this shift reactively, investing only when they find that they can't attract and retain the right talent profiles. That's a missed opportunity to take a more strategic investment approach, which can yield a higher ROI. To prepare for wage reinvestment, retailers should now develop the ability to differentiate performance and rewards for key contributors. This is also the moment to develop a clear skill-and-certification ladder that can reward employees with higher pay.

6. Every retailer needs a social-impact plan
Automation will disproportionately disrupt retail, since three out of the five most automated jobs in any sector in the United States are in retail (Exhibit 3). By the numbers, automation will have a disproportionate impact on the entry-level roles with the lowest levels of skill—and the highest turnover. As a result, retail's role in where "America learns to work" may shift.

The remaining retail jobs will probably be better paid, with higher skills and lower turnover. As even frontline retail jobs become more advanced, society will face a broader question: how to create better pathways so that people with entry-level skills can acquire new ones and thrive. Retailers can take a lead in answering this question—and in tailoring the solutions by types of people and communities.

The future of work has arrived in retail. Executives should prepare for the impact of automation and AI technologies across all core functions and proactively address the workforce implications. The longer companies wait to respond, the higher the risk they will not be able to catch up. Addressing automation and workforce transitions should be at the top of every retail management team's agenda.

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The end of IT in retail?

Retailers who want to stay ahead of the pack and drive business results through technology innovation are rethinking the setup of their IT departments.

by Marcus Keutel, Gautam Lunawat, and Markus Schmid

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This article first appeared on McKinsey.com in February 2020.

"The IT is the problem—as usual!" This complaint is a constant refrain whenever retailers with brick-and-mortar origins realize that desired process improvements or technology-reliant product innovations will be delayed, must take a different form than planned, or won't happen at all. Usually this statement is true and false in equal measure. It's true because today nearly every change a retailer might make depends on technological solutions, which often fall below expectations. But it's false as well because, often, the root cause of the problem is the business side, not IT. In fact, a joint study by Oxford University and McKinsey of more than 5,000 IT projects identified three reasons behind most failures: inadequate management of the many people involved, investment that is not aligned to business needs, and a lack of transparency regarding the project portfolio. As retailers across the globe are dealing with implications of COVID-19, and preparing for the 'Next Normal', technology-enablement of the retail value chain has become more critical than ever. Traditional business-IT operating models will not deliver the results.

The biggest stumbling block: Silo structures

Invisible trenches between the IT department and the rest of the company constitute one of the main reasons why brick-and-mortar retailers often struggle far more with technology than their digitally native counterparts. Many decision makers in traditional companies still see IT as an administrative function positioned somewhere below the CFO, far away from the operative business owners. Typically, in such IT departments, big teams toil away on large monolithic projects, and resources are allocated based on political criteria rather than business factors. Business-side practitioners and developers seldom share ideas directly with each other. As a result, this type of IT function is generally unattractive to digital talent, and commercially successful retailers struggle to build the internal technology competence that they need.

The technological shortcomings that result from this siloed structure can threaten a retailer's very existence—especially as the demands it faces multiply dramatically in the age of digitization, and as digital disruptors like Amazon continue to invest and innovate aggressively. Over the past few years, leading retailers such as Kroger, John Lewis, Tesco, and Walmart have significantly boosted their technology investments. However, many retailers still devote less than 1.5 percent of revenue to developing their technology assets.

While more investment is essential, an incumbent retailer cannot close the gap to the industry's technology leaders by simply throwing more money at the problem. Choosing the right digital model and continuously developing it using a test-and-learn process are far more important. The company must build a modern technology organization to support the delivery of the best business results. In the end, transforming mind-sets, capabilities, and ways of working is critical not only in classical IT areas such as application development and infrastructure but also in core commercial divisions like sales, merchandising, and marketing.

Paths to a modern technology organization

When it comes to organizing IT, traditional retailers might look to digital pioneers such as Amazon or Zalando. Although some digital natives have their own struggles when it comes to their IT setup—for example, the scalability of their technology—they are nevertheless good role models based on one organizational commitment in particular: for them, joint responsibility for commercial processes and technology development has always been the rule.

Retailers can consider this basic idea and optimize their technological performance in six steps:

1. **Entrust responsibility to small, cross-functional product teams**
   The modern technology organization is no longer a large IT department organized according to IT systems. Instead, small teams of developers provide technical support for specific business processes, known as products. For example, individual teams could be built around assortment planning (in sales or purchasing),

pricing and promotions (marketing), or inventory management (supply chain). The products are defined at a granular-enough level that a small team of developers can support the process from beginning to end. This approach enables "tearing down the walls" between business and IT. The granular structure also creates an opportunity to connect each of the products and development teams with a counterpart from the business side—a connection that typically increases the teams' effectiveness. Because of their cross-functional staff, such teams can drive further development independently and be measured against the concrete business results of their work. One retailer, which has been moving toward such a structure with approximately 90 product teams, shows just how differentiated the new structure can be (Exhibit 1).

2. **Set up 'tech chapters' as new structures within IT**

The establishment of product teams usually requires a change of the classical IT structures with leaders at the division, department, and team level. One option that is currently used by many companies is to replace the classical structure with "tech chapters" that manage the professional development of employees in the product teams and recruit new tech specialists. Typically, chapter leaders do not influence the content of product development (the "what"), focusing instead on the methodology and technology (the "how"). In large IT organizations

Exhibit 1

Small, cross-functional product teams handle technological development in each business unit.

Allocation of product teams to a retailer's commercial units

1st level	2nd level	Allocated IT product teams (selected)	
Customer	Acquisition		
	Product search and advising	Product presentation Recommendation engine Product search	Electronic price display Web landing pages Product configurator
	Checkout		
	Service		
	Loyalty		
Products and services	Assortment management		
	Pricing		
	Supplier management		
	Inventory management	Sales forecasts Demand planning Replenishment	Order management Availability management Stocktaking
Supply chain	Warehousing		
	Transport		
	Service fulfillment		
Support	Finance		
	HR		
	IT platform	IT security Data warehousing and reporting	Identity management User support Development support
	Analytics		

(1,000 employees or more), retailers typically break up the tech chapters, as otherwise the resulting organizational units would become too big and the responsibilities would become unclear. One option is to break the tech chapters into domains. For example, the "customer" domain would be in charge of all customer-facing products. This can be an effective way to create groups of employees who would benefit the most from sharing knowledge with each other.

3. **Assign product ownership to the business**
   Instead of the business side throwing requirements "over the wall" to the IT department, in this new model each product team has a product owner from one of the business divisions. He or she leads the content of the team's work and, in contrast to most of today's models, is not limited to defining requirements. They determine what their teams work on and initiate the development of further technological solutions that can improve the company's performance in their respective business area. This means that the head of sales, for example, is responsible for the checkout product team; the head of purchasing has responsibility for the demand-planning product team. Product owners work with their product teams using agile methods; product teams and tech chapters work together as needed. Product owners directly drive development with a business mind- set, while the chapter leaders contribute technological know-how (Exhibit 2). In many cases, this model will require a retailer to hire experienced product-owner profiles into the business—individuals who are not only deeply knowledgeable about the business but are also tech-savvy, with nuanced insights about how to get the most out of the business/technology interface.

4. **Specify KPIs as standards of success for each team**
   Binding key performance indicators (KPIs) let product owners and their teams know how their performance is measured and where it needs to improve. Digital retailers have long used team-specific KPIs where instead of a single target for everyone based on an indicator, like overall sales development, each team has its own set of KPIs linked to business performance. This ensures that developers have incentive in the same way as their colleagues in the corresponding business area. For the marketing team, for example, a KPI could be transaction cost per website visitor; for the search team, the share of search results that lead to a purchase; and for the recommendation team, sales generated through recommendations. By setting targets for indicators like these, retailers ensure that the team's objectives are in line with those of the company as a whole. The KPIs themselves may not be new, but using them to explicitly evaluate the content of technology development inspires a much stronger commitment to them—they essentially become the currency that product teams use to both prioritize their activities and demonstrate their usefulness.

5. **Add sponsors at the top-management level**
   Ideally, each business division will have a sponsor on the executive board whose involvement includes setting priorities for his or her area. This close connection to top management helps resolve cross-divisional conflicts regarding development priorities early on and reduce the need for coordination at the expert level. Another welcome side effect: technological questions and their prioritization become consequential not only for product owners but also for nearly every manager in the company.

6. **Modernize the tech stack**
   To realize the maximum benefit from such a transformation, it is crucial to enable the product teams by reviewing and updating the tech stack. Typically, the result is a rather intensive modernization with a higher degree of modularization. To ensure scalability and allow for rapid change, a shift to cloud platforms and SaaS solutions is inevitable. Further, most companies are working on breaking up their monolithic architecture and moving to microservices with a clear API-first strategy.

Exhibit 2

In a modern technology-driven organization, product owners determine 'what' development will entail while tech chapters determine 'how' it will be done.

Target structure of a technology-based retail company, illustrative example

● Role included on team

Tech chapter	Product teams: Product owner	Product teams: Product owner	Product teams: Product owner
Agile coach	●		●
UX[1] designer		●	●
Architect	●	●	
Developer	●	●	●
Other roles, as needed	●	●	●

[1] User experience.

This will simultaneously decrease the need for manual operations and pave the way to migrate to a DevOps setup, where most product teams are responsible not only for developing their products but also for running them. Retailers on this journey typically take a stepwise approach—starting from where they expect to capture the highest business value. In general, we see two approaches that companies have used to implement a modern technology organization:

— *"Big bang."* Changing the full setup all at once has the advantage of a short implementation timeline. However, it also requires a tremendous amount of preparation and bears a high risk of disrupting daily operations.

— *Step by step.* This approach, which starts with selected domains followed by a sequential rollout, enables a test-and-learn environment and provides enough time for affected employees from the business functions to understand and adapt to the required changes. In most cases, the step-by-step approach will be the preferred choice.

New organization, new challenges

Tearing down the walls between business and IT by implementing the transformation steps described here can unleash vast potential. Experience shows that the resulting setup enables companies to develop and use new technologies much more efficiently (see sidebar, "Suddenly fast and reliable: How two retailers benefit from restructuring their IT setup"). At the same time, it frees the classical IT function to focus exclusively on cross-cutting technology topics. Central expert teams work alongside the tech-chapter leaders to make decisions on system architecture, ensure

Suddenly fast and reliable: How two retailers benefit from restructuring their IT setup

The experiences of two European retailers show the value that reorganizing technology structures can unlock:

— After making the organizational changes, a housewares retailer was able to complete an order-management module, which had fallen months behind schedule, within budget and in less than two months.

— A food retailer using the new structure managed to develop an entire technical solution for food deliveries—from the online shop to the management of merchandise, inventories, and the delivery fleet—within ten months. The solution went live on schedule.

In both cases, the key to success was entrusting operational decision makers from the business side to take on the role of a product owner. It quickly became clear that they could be far more targeted in identifying and prioritizing requirements when their responsibility expanded from simply operating solutions to shaping them as well. At the same time, having product owners working with product teams put the responsibility of deciding on potential benefits and costs in one place—an important prerequisite for making technology decisions from a business perspective.

data security, and manage relationships with major technology partners. Responsibility for infrastructure, such as cloud computing and data pipes, is another overarching concern that is an important enabler function.

Demands on the chief technology officer (CTO) as the organization's ultimate technology authority increase as well. The new model requires the CTO to have greater business foresight, since he or she must provide the right impetus for potential digitization initiatives in the organization. Therefore, the CTO should not only possess outstanding capabilities but also be positioned at eye level with the other business-unit leaders and top managers. That's why retailers that move toward this structure often decide to make the CTO a board-level role.

The changes laid out here are immense: decades-old structures disappear, hundreds of employees must learn new ways of working, and in many cases, the business becomes directly responsible for technology development.

Implementing a modern technology organization takes time. Companies may be able to set up business-led product teams in a matter of months, but fully learning the corresponding new behaviors and ways of working can take years. The transformation will be successful only if the top-management team wholeheartedly stands behind the journey.

Transforming from a classical IT department to a modern technology organization is a radical step, but taking it can mean the difference between a retailer struggling to survive and one that translates digitization into genuine business success.

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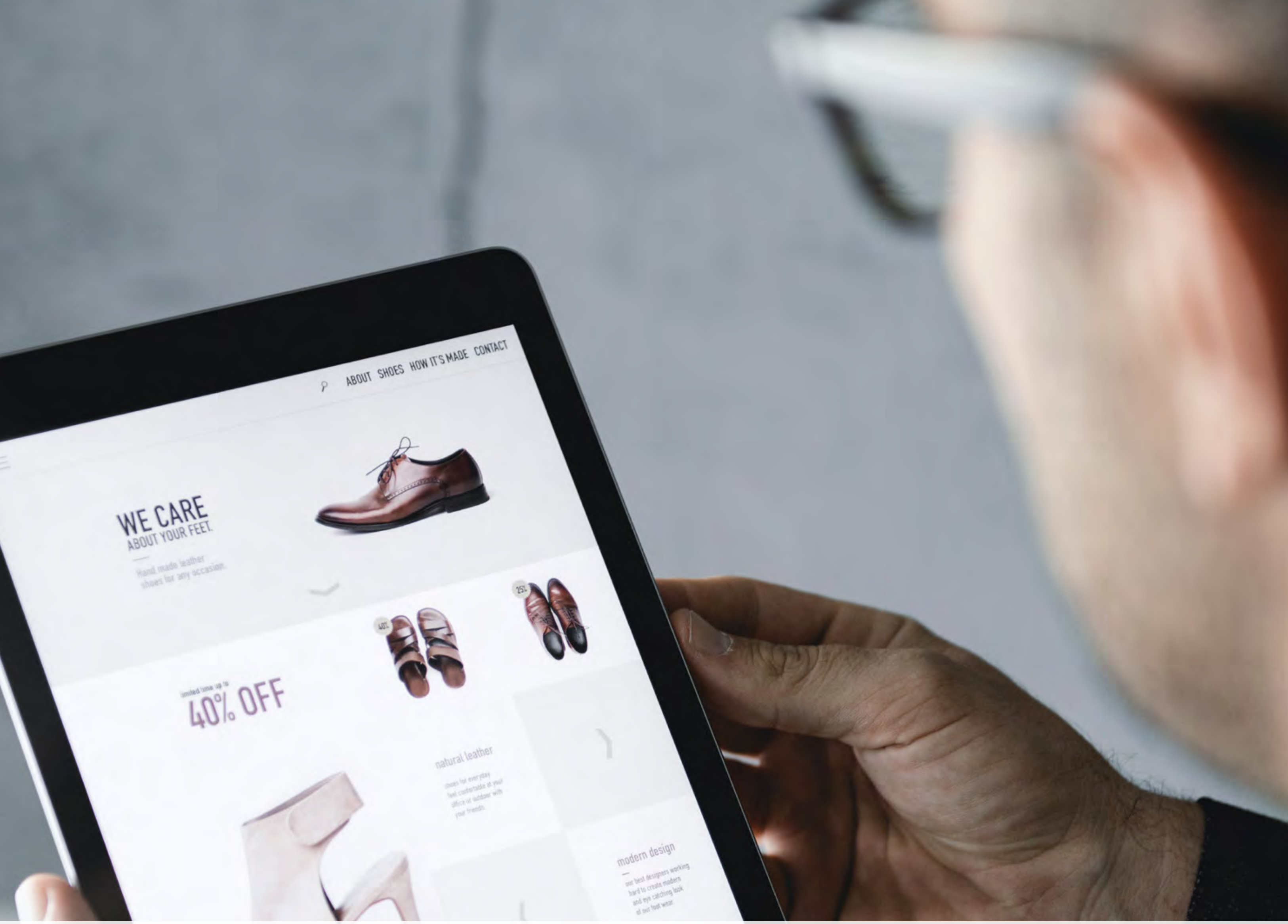

Fashion's digital transformation: Now or never

Some apparel, fashion, and luxury companies won't survive the current crisis; others will emerge better positioned for the future. Much will depend on their digital and analytics capabilities.

by Antonio Gonzalo, Holger Harreis, Carlos Sanchez Altable, and Cyrielle Villepelet

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The COVID-19 pandemic is both an unprecedented health crisis and a global economic shock. The effect on the fashion industry has been severe: according to current estimates, year-on-year industry revenues will contract by 27 to 30 percent in 2020, although the industry could regain positive growth of 2 to 4 percent by the end of 2021. We expect a large number of global fashion companies to go bankrupt in the next 12 to 18 months. Some of this is a function of the challenging position that many fashion players were already in before the pandemic: profitability in the sector has deteriorated consistently over the past eight years. Only 44 percent of global fashion companies generated economic profit in 2018.

Although no one in the industry foresaw the intensity of this crisis, some fashion companies are finding that they are better equipped than others—largely because of their digital know-how. In this article, we touch on COVID-19's impact on the fashion industry to date. We then propose a set of actions that fashion companies can take to build their digital and analytics capabilities—not just to ensure business continuity and minimize the downside of COVID-19, but also to emerge from the crisis in a position of strength.

A deepening digital divide

Our consumer-sentiment surveys, conducted in mid-May, show 40 to 50 percent declines in purchase intent for fashion categories among European consumers.[1] E-commerce is clearly not offsetting the sales declines in stores. Nevertheless, it has been a lifeline for fashion brands as many stores have been (or remain) shuttered—and it will continue to be critical during and after the recovery period. In China, the return of offline traffic and revenue has been gradual: in early May, two months after stores reopened, revenue was down 40 percent in fashion outlets and 30 percent in department stores from pre-COVID-19 levels, while online sales continued to grow. This suggests that some percentage of offline sales could permanently migrate to e-commerce.

A number of trends in the post-COVID-19 world—the "next normal"—will make digital and analytics play an even more important role.[2] Physical distancing appears likely to continue, making consumers less likely to visit brick-and-mortar stores, and a contact-free economy is already starting to emerge—raising e-commerce and automation to a new level.

The implications of these trends will differ for each company, depending on its digital starting point and strategic orientation. Digital and analytics leaders (companies in which online sales account for 30 to 40 percent of total sales, parts of the value chain are significantly digitized, and online and offline channels are integrated to some degree) have an advantage today but could quickly lose it if other players accelerate their transformation. On the other hand, laggards (companies with less than 20 percent of total sales coming from the online channel, low digitization levels across the value chain, and siloed online and offline operating models) have an opportunity to make an "all in" bet on digital and analytics—and perhaps gain market share with smaller capital-expenditure investments, which used to be a limiting factor for many brands.

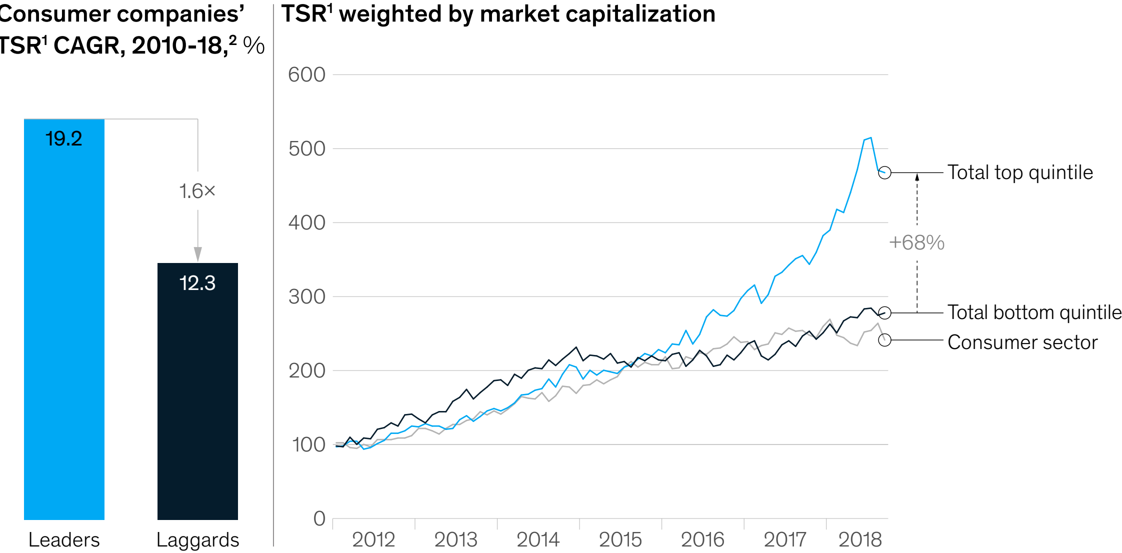
Digital is not only an increasingly important sales channel; it can also help companies adapt cost structures and make each step of the value chain better, faster, and cheaper. For example, digitization can enable new logistics and sales-fulfillment options (such as click-and-collect and drive-through), fuel innovative ways of customer acquisition, and help predict and manage inventory to create a more resilient supply chain. The fundamental enabler to all this will be data—the transparency, governance, and accuracy of which have never been more important.

This all portends a deepening digital divide. Even before the crisis, companies that were digitally and analytically mature outperformed competitors that hadn't invested in robust digital and analytics capabilities (Exhibit 1). The COVID-19 crisis has only widened the gap between industry leaders and

[1] For survey findings by country, see "Global surveys of consumer sentiment during the coronavirus crisis," April 2020, McKinsey.com.
[2] Shubham Singhal and Kevin Sneader, "The future is not what it used to be: Thoughts on the shape of the next normal," April 2020, McKinsey.com.

Exhibit 1

Digital and analytics leaders outperform their competitors in total returns to shareholders.



[1] Total shareholder returns.
[2] S&P 500 index, consumer sector.

Source: Capital IQ, McKinsey analysis

laggards. For leaders with the ability and willingness to invest, the pandemic has clearly been an accelerator in the shift to digital. As a top executive of a leading apparel player recently declared, "We've accomplished two years of digital transformation in two months."

That said, digitization won't be a panacea. Companies should direct investments to areas in which the highest business value lies—which might not be in sales but rather elsewhere in the value chain. Equally important, companies should avoid "gold plating," aiming instead for the fastest minimum viable digital solution that will achieve the business goal. Finally, the sequencing of initiatives will play a big role in making a company's digital transformation as self-funding as possible. The fundamental enabler to all this will be data—the transparency, governance, and accuracy of which have never been more important.

For executives in the fashion sector and all related subsectors (such as beauty and sporting goods), the imperative is clear: make digital and analytics a core element of your company's strategy.

Navigate the now: Short-term priorities

The health and safety of employees and customers, of course, has been—and remains—the absolute priority. As fashion companies start to reopen their networks, health and safety precautions have led to a reimagining of operations, from how employees collaborate to how associates interact with consumers in stores. Digitization and automation are at the heart of these transformations.

Although the situation remains uncertain and is evolving daily, there are clear actions involving digital and analytics that fashion players should implement now.

Engage with your customers in an authentic way
Email, social media, and other digital channels have seen significant spikes in usage during the crisis (Exhibit 2). Fashion brands must therefore continue to communicate frequently with consumers. Use digital channels to launch genuine, purpose-driven communications regarding health, safety, business continuity, and community building. If you decide to send consumers relevant content, be sure to do so in an appropriate and empathetic tone (for example, a global sports-apparel player now offers yoga lessons on Instagram). We also now see companies taking clear political and social stands. True leaders emerge in times of crisis. How you communicate with customers—and what you communicate—could shape long-term loyalties, particularly in a moment when many consumers are switching their primary brands and retailers (75 percent of consumers say that trust in a brand has become a relevant factor in their purchasing decisions) and finding their routines disrupted.

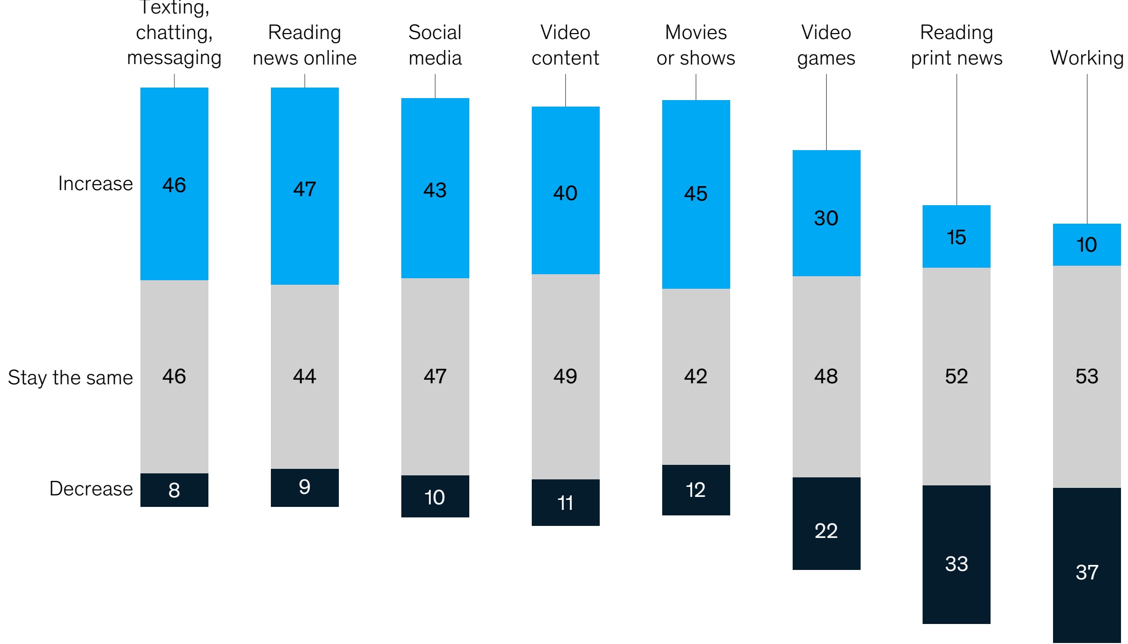
Refine and scale up your online operation
We expect the online share of fashion and apparel in Europe and North America to increase by 20 to 40 percent during the next 6 to 12 months. In April, traffic to the top 100 fashion brands' owned websites rose by 45 percent in Europe.[3] Some of the

[3] Similarweb, April 19, 2020, similarweb.com.

Exhibit 2

Consumers are spending more time online during the crisis.

Change in time spent on select activities,[1] % of respondents



35% of consumers browse for fashion inspiration in online shops at least once per week

22% of consumers state they will browse for inspiration online more often in the next 4 weeks

10% of consumers think brands should not promote their own interests at this time of crisis

[1] Question: Over the next 2 weeks, how much time do you expect to spend on these activities compared to how much time you normally spend on them?

Source: McKinsey COVID-19 Consumer Pulse Survey, Apr 1–Apr 6, 2020, n = 5,000+; McKinsey COVID-19 Apparel & Fashion Survey, Mar 27–Mar 29, 2020, n = >6,000

larger players have even reduced their promotion intensity to be able to handle the volume of orders.

Delivering an excellent customer experience online is crucial, so reallocate your resources and shift management attention from offline to online. Also, scale up capabilities in both demand generation and fulfillment (Exhibit 3). Seek to eliminate points of friction in every part of the online customer journey—for example, by improving your website's search function and expanding your online assortment. Some retailers have redeployed store personnel from closed stores to support online fulfillment or to assist consumers via digital call centers.

While most fashion players already have an e-commerce presence, some still don't. Companies without one can launch a basic online platform in 10 to 15 weeks. A private-equity-backed retailer did it in 13 weeks (Exhibit 4).

Prioritize digital-marketing levers as demand rebounds

In anticipation of a shift toward online sales, allocate more of your marketing budget to digital channels. Establish or improve your digital-marketing "war room" and increase its visibility in the organization—for instance, by establishing a C-level digital-performance dashboard that provides a cross-channel view of e-commerce, customer relationship management, and social media, thus enabling rapid identification of opportunities for efficiency optimization or growth.

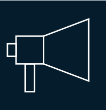
Retrain your look-alike models to capture value from the new consumer segments and behaviors

Exhibit 3

Companies must accelerate their online capabilities in both demand generation and operations management.

Example levers

Accelerate demand



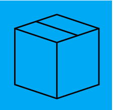
Relevance, awareness, and traffic

- Simplify range, prioritize essentials to meet immediate demands of new customer traffic
- Launch contextual and personalized campaigns across marketing channels
- Allocate budget to highest-impact targeted paid channels (eg, Facebook, Instagram, search-engine advertising)
- Adjust search-engine optimization and other nonpaid channels to situation (eg, refine keywords)
- Shift focus from brand building to performance marketing (including budget reallocation)

On-site and conversion

- Tailor on-site messaging to address current situation (eg, contextual landing page with special content for COVID-19 situation)
- Launch and optimize targeted markdowns and promotions to wind down forecasted stock excess
- Optimize on-site product assortment and display (eg, focus on top SKUs)
- Introduce bundles (eg, family boxes), special offers (eg, free shipping, 3-for-2), and innovative discounts

Manage operations



Stock and fulfillment

- Strengthen supplier relationships, especially for priority SKUs (eg, CEO meeting)
- Prioritize SKUs and ensure sufficient stock allocation (eg, longer inventory days for high-demand SKUs)
- Ensure omnichannel management of stock, fulfilling online orders from best online or offline location to optimize overall stock positioning
- Prepare fulfillment and customer-support capacity for increased demand
- Staff temporary resources as needed
- Identify scenarios and plan for worst case; work with government authorities to understand guidelines

Loyalty

- Focus on user interface and user experience (more important than ever as customers are more willing to switch brands at this time)
- Leverage customer relationship marketing and maximize frequency of email and app push campaigns
- Investigate opportunity to create special offers for loyal customers
- Focus on contactless delivery (delivery staff training, communication) to match customer expectations
- Communicate proactively with customers (eg, email from CEO to address situation)

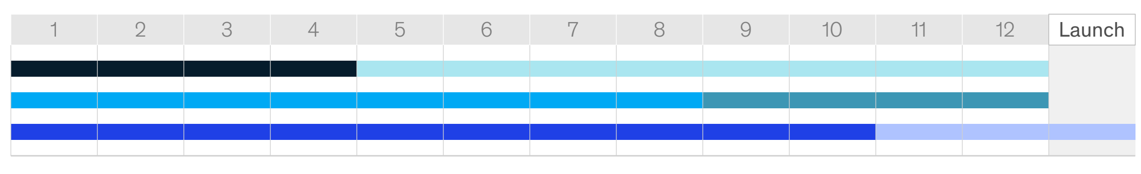
Exhibit 4

A retailer built and launched an e-commerce platform in 13 weeks.

Launch timeline, weeks

Company Private-equity-owned retailer with 1,000 physical stores but no online presence

Impact More than 400% week-on-week growth rates in online sales within the first month



Assortment/ merchandising Decide on online assortment and prepare product pages (eg, photos, details, measurements)

Design Design online store, prepare minimum viable product, integrate digital marketing tools, test prototypes, and make new design iterations

Technology Development Build tech foundation; integrate online store with warehouse-management system

Operations Set up warehouse processes to handle online orders; onboard new warehousing staff and set up customer-service team

Marketing Develop and execute marketing plan, including search-engine optimization, in-store advertising, and launch strategy

Getting ready for launch Track objectives, key results, and key performance indicators; maintain budgeting; set up tracking tools

that have emerged during the crisis. Upgrade your digital-marketing activity to be best-in-class—for example, by adding sophisticated imagery to your social-media posts and conducting “social listening” to inform the development of new services and offers.

Use granular data and advanced analytical tools to manage stock

The value of excess inventory from spring/summer 2020 collections is estimated at €140 billion to €160 billion worldwide (between €45 billion and €60 billion in Europe alone)—more than double the normal levels for the sector. Clearing this excess stock, both to ensure liquidity and to make room for new collections, will become a top priority.

At the best-performing companies, an “inventory war room” uses big data and advanced analytics to first simulate dynamic demand scenarios specific to locations (channel, country, store) and SKUs, then to synthesize the resulting inventory risk—thus enhancing decision making. The war room decides, for example, whether to redistribute SKUs, transfer inventory to future seasons, or accelerate markdowns (Exhibit 5). A company’s investments in developing advanced analytical tools to steer markdowns during the crisis will pay off almost immediately.

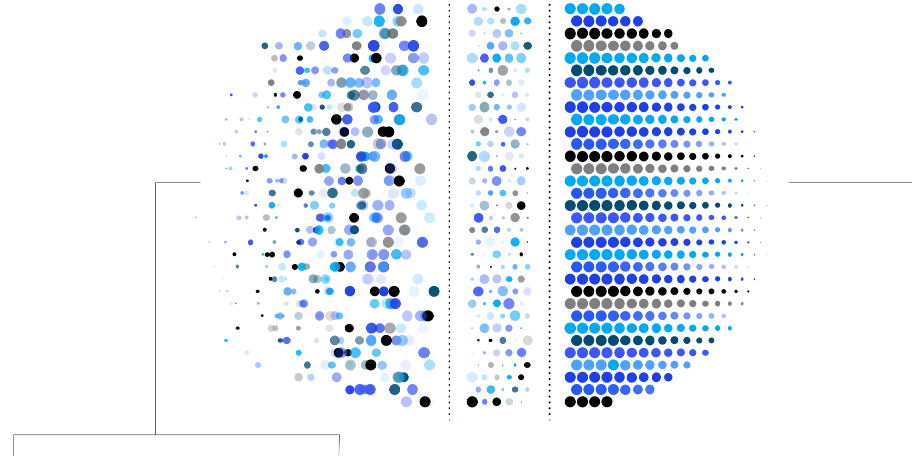
Optimize costs using a zero-based approach

In light of crisis-related sales decreases, cutting costs is an obvious imperative for most companies. However, reducing all budget lines across the board is risky. We recommend a zero-based budgeting approach instead.

Identify two categories of projects: critical projects linked to core digital and analytics priorities that must proceed as planned or at a slightly lower speed (for example, building a new data lake to enable personalized marketing) and core projects that can be delayed (such as those that don’t enable emergency response). Continue only the projects that fall into those two categories; stop all others. A range of savings levers—such as vendor renegotiations and tactical moves to the cloud—can help dramatically reduce your operating costs. Reset your digital and analytics priorities and budget and adapt them to a post-coronavirus world.

Exhibit 5

Using analytics, a company can quickly build sell-through scenarios and synthesize resulting inventory risk.



Required data

- Sales, units, cost, and price by item, by store, and by week
- Inventory at a granular level by item by week
- Possibility of selling in-store inventory online
- Existing product hierarchy
- Existing store master file
- Season-indicator data

Optional data

- Sell-through plans at best available level of detail
- Product-attribute data (standard or custom)
- Product-level e-commerce data (eg, clicks per day)
- Category-level sales breakdown

Analytics

- Ingest, blend, and interpret up to 20 terabytes of data, then combine data with projections from leading global health organizations, business decisions (such as when to open doors by state), and economic-recovery scenarios

Output

- Granular understanding of the "baseline" scenario across styles, channels, and locations
- Forecast networkwide performance during the crisis, variations across the footprint
- More granular understanding of cash required by scenario

Shape the next normal: Longer-term strategic actions

Although time frames remain uncertain for now, fashion players should start planning how they'll compete in—and perhaps even influence—the industry's next normal. Consumer habits, companies' interactions with consumers, and the number and types of touchpoints will all change. The requirements for supply-chain speed and flexibility will continue to increase. Digital and analytics will play a critical role in helping companies emerge stronger from the crisis.

Set an ambitious aspiration and define a clear road map

A digital and analytics transformation is typically an 18- to 24-month journey, requiring an ambitious aspiration, a clear plan, and concrete milestones. In our experience, successful digital and analytics transformations have the following elements in common:

— Strong support (or even direct sponsorship) from the CEO during the entire journey.

— A pragmatic approach that starts with an understanding of the consumer and the drivers of value creation; digital for digital's sake will not deliver results.

— A clear road map and prioritization of initiatives, combining actions that help set up the enablers for the organization with the implementation of use cases that generate quick wins.

— A focus on getting to a minimum viable product (MVP) within two to three months—a rapid timeline that allows the company to iterate while generating value, avoiding large up-front investments.

— A central team to monitor value capture. This team also helps build the road map by scanning opportunities, allocating budgets, and coordinating implementation, ensuring that all efforts are focused on delivering tangible impact rather than gold plating.

— Well-defined key performance indicators (KPIs) to measure success.

The first step in the transformation program should be the definition of digital priorities, which will differ based on each company's business model and digital starting point. Digitization is much more than just selling online; a quick diagnostic may be required to select and align on key value areas.

Typically, digital and analytics priorities can be categorized according to their place in the value chain: customer experience (front), distribution and supply chain (middle), and product development and support functions (back). Exhibit 6 shows high-impact use cases in each of these three areas.

Provide an excellent omnichannel experience

The pandemic has elevated digital channels as a must-have for fashion players. Therefore, take this opportunity to leapfrog into the digital arena by making it the center of your operating model: move your traffic- and engagement-generation engine to digital, and leverage digital channels to drive store traffic and vice versa.

Besides scaling up digital sales efforts, reconfigure your store footprint accordingly—for example, by reducing presence in "B" areas (markets with lower population density and lower profitability per square meter), devoting less store space to product categories with high online penetration, experimenting with innovative formats (such as drive-through windows or pop-up stores), and making it easy for customers to perform any omnichannel operation, including complex ones (such as buying online from a store if the product isn't in stock there, and then picking it up from another physical store in the next 12 hours). Use data and analytics to tailor the assortment in each store and to streamline and optimize assortments overall.

In our experience, fully integrated management of stock in stores and warehouses is core to any omnichannel operation. Making all stock (even stock shortly arriving to warehouses) visible to customers in any channel has proved to boost sales.

Exhibit 6

Digital and analytics can transform domains in every part of the apparel value chain.

Customer experience (front)

- Seamless omnichannel experience
- Personalized customer journeys, activations, and promotions to maximize customer value
- Prescriptive merchandising optimization
- Online artificial-intelligence-powered sales associates
- Markdown optimization powered by advanced analytics (AA)
- Shelf, format, and macro space optimization
- Store of the future

Supply chain and distribution (middle)

- Allocation of new collection merchandise (no sales historical record)
- AA-powered granular demand forecasting and replenishment
- IoT-enabled warehouse optimization and automation
- Optimal warehouse picking and slotting
- End-to-end digitized supply-chain planning
- AA-powered network, transport, and route optimization
- Platform for last-mile delivery

Product development and support functions (back)

- Digital collection development and management
- End-to-end digitized product management (including design, virtual sampling, production visibility)
- Digitized and robotized finance and back-office processes
- Talent and HR analytics

Digital and analytics can not only drive top-line growth but also significantly improve speed, cost, flexibility, and sustainability across the supply chain.

Bet on personalization
Personalization has helped several industry players achieve 20 to 30 percent increases in customer lifetime value across high-priority customer segments. It has proved even more valuable in subsectors with more stable and predictable purchasing patterns, such as beauty products.

Use cases for personalization have mostly centered on personalized offers, personalized promotions and benefits (such as access to new products), and reductions in generic traffic-generation costs. To go further, add personalization capabilities to your digital war room—for example, by collecting and analyzing all the available data to generate detailed insights about your customers. Build actionable microclusters based on customer behavior. For instance, entice the highest spenders with special incentives (such as triple loyalty points for purchases of at least $1,000), target customers who tend to buy in the categories where you have the largest inventory buildup, and give online customers coupons to redeem in-store once physical stores reopen.

Prioritize use cases based on your business context, advanced-analytics capabilities, and customer segments. Create a prioritized use-case road map and a technology-investment plan. Integrate personalization into all delivery channels to ensure consistency in your customer communications.

Leverage big data and analytics to manage the supply chain
Digital and analytics can not only drive top-line growth but also significantly improve speed, cost, flexibility, and sustainability across the supply chain. For instance, some leading companies are using radio-frequency identification (RFID) to track products more precisely and reduce in-store merchandising manipulation. Companies' RFID investments typically yield operations simplifications and service-level improvements.

In addition, automating logistics through digital warehouse design and predictive exception management can significantly increase efficiency. The benefits will flow to consumers as well—in the form of better product availability and faster, cheaper, and more accurate deliveries. Leading online players, for example, are using models powered by artificial intelligence (AI) to predict sales of specific products in certain neighborhoods and cities, then stocking the predicted amount of inventory in nearby warehouses.

Digitize product development and support functions
During the COVID-19 crisis, the digitization of product development has proved to be a competitive advantage. Companies that were already using cutting-edge tools such as 3-D product design, virtual sampling, digital material libraries, and AI-supported planning have fared better than their peers during the crisis. Their designers and merchandisers could react faster to market trends, significantly reduce both sample costs and time-to-market, and collaborate remotely across teams. The past several weeks have shown that it's possible to do much more on this front than some in the industry initially thought. Indeed, the pandemic may have shattered historical preconceptions and biases against digitization in core product-development processes.

Digitization of support functions is another key lever for improving efficiency. By automating repetitive tasks in back-office functions such as

indirect purchasing, finance, legal, and HR, you can simultaneously reduce costs and free up time and resources to reinvest in more valuable activities. Companies that have automated their finance processes—such as claims collection and financial reconciliation—have found that they've also increased the agility and accuracy of these processes while capturing significant synergies. Speed up the digitization of all support functions through robotic process automation and other leading-edge technologies.

Build data and tech enablers to support your transformation

Technical enablers play a key role in powering digital and analytics growth. In our experience, three core principles are the most relevant:

— Use cloud infrastructures to sustain scaling and to access best-in-class services, particularly for use cases that best benefit from the cloud's features (for instance, data consumption across the globe, very high storage and processing needs).

— Think data from the start. Build solid data foundations as part of every digital and analytics initiative in a way that allows rapid scaling and forward compatibility. Design and build out pragmatic data governance focused on enabling business value by helping to ensure data breadth, depth, and quality. Establish a strong data culture and ethics.

— Design your technology stack for faster integration and development, with applications broken down into microservices and isolated through the use of application programming interfaces; use unified DevOps toolchains to enable automation and reduce time-to-market to a matter of hours instead of weeks.

These enablers shouldn't become causes for delay. Rather, they should follow the same agile timelines and sprints as the core initiatives. Implementation should be pragmatic and clearly linked to value generation.

Attract and retain top digital talent

After the crisis, financially stable companies may be able to attract top-notch digital talent, including in-demand profiles such as digital-marketing specialists, data scientists, data engineers, user-experience and user-interface designers, and software and data architects. Retaining these kinds of employees will require fashion companies to develop new talent processes—with tailored initiatives in recruiting, career growth, learning and development, and performance management—specifically for engineering and digital talent, similar to what many fashion players already do for designers and creative directors.

In addition, fashion players should adopt agile ways of working to speed up development of digital and analytics products and projects. Agile techniques enable companies to release MVPs into the marketplace quickly and refine them iteratively based on consumer feedback.

There's no denying that the COVID-19 pandemic will make for a difficult 2020. For some fashion companies, even survival may be a struggle. However, if they lead with empathy and undertake bold actions in digital and analytics—particularly around e-commerce, data-driven stock management, and digitization of key functions—we believe they can not only endure the crisis but also build competitive advantage and strengthen their business for an omnichannel, digital-centered next normal.

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How restaurants can thrive in the next normal

We lay out potential timelines for the US restaurant industry's recovery—and actions that restaurants should take to cater to consumers' new dining needs and preferences.

by Stacey Haas, Eric Kuehl, John R. Moran, and Kumar Venkataraman

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This article first appeared on McKinsey.com in May 2020.

After weeks of quarantine and physical distancing, what does the future hold for US restaurants—and for the more than eight million restaurant workers across the country who have been laid off or furloughed since March? How quickly will US consumers feel comfortable eating out again?

COVID-19 has not only been a devastating public-health crisis; it has also been the restaurant industry's greatest challenge to date. Never before have so many restaurants been forced to cease operations; some will never reopen. Early indications—from China and other countries where the pandemic seemed to be under control—suggest that consumer demand won't immediately rebound when restrictions are lifted. However, restaurants that plan ahead to adapt and refine their restaurant model for the "next normal"[1] will be better positioned to bring sales back to precrisis levels.

In this article, we describe COVID-19's impact on the US restaurant industry to date and explore two likely scenarios for recovery. We then recommend a set of concrete actions for restaurants to return to stability and help shape the next normal.

The pandemic's impact to date

COVID-19's economic toll on the restaurant industry hasn't been evenly distributed. Whereas pizza chains have maintained or increased sales during the pandemic, casual-dining and fine-dining restaurants have seen their revenues decline by as much as 85 percent (Exhibit 1). For some fine-dining establishments, revenues fell to zero.

Each restaurant's performance during the crisis has depended largely on the following factors:

— *Off-premise versus on-premise sales mix.* Unsurprisingly, restaurants with high off-premise sales prior to the crisis are faring better than those that relied more on dine-in sales.

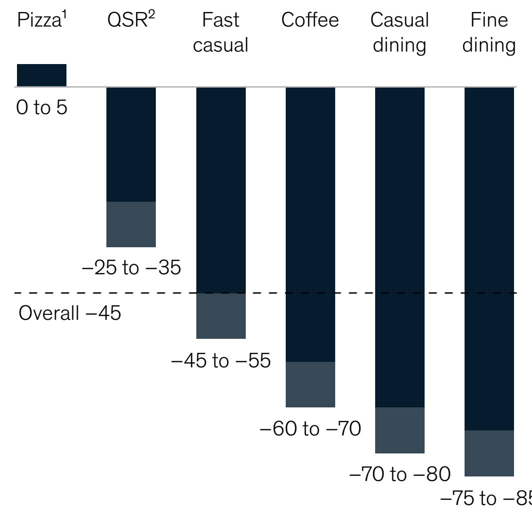
— *Reliance on day-part occasions.* With many people working from home, restaurants that generated much of their business from daytime eating occasions—such as people getting breakfast or coffee on the way to work—have been disproportionately affected.

— *Urbanicity.* There are large disparities in restaurant-traffic declines across states. Declines have been highest in densely populated states such as Connecticut and New York (Exhibit 2).

Exhibit 1

The pandemic's impact has varied across restaurant types and subcategories.

US sales by restaurant type during COVID-19 crisis, % change from 2019 as of April 17, 2020



[1] Includes fast-food pizza only.
[2] Quick-service restaurant. Includes burger, chicken, Mexican, and sandwich; excludes coffee and pizza.

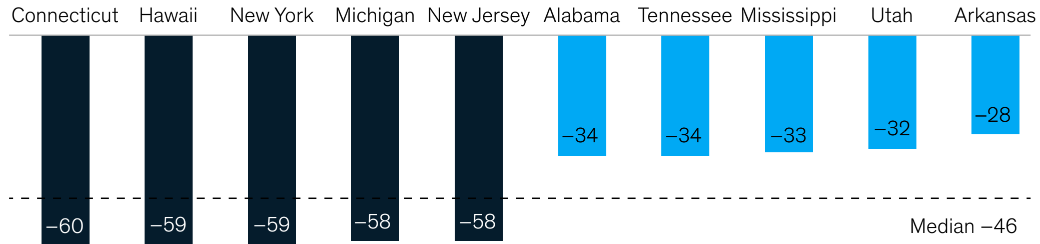
Source: Bernstein Research; Datassential; McKinsey research and analysis

[1] Shubham Singhal and Kevin Sneader, "The future is not what it used to be: Thoughts on the shape of the next normal," April 2020, McKinsey.com.

Exhibit 2

Restaurants in densely populated states are experiencing the highest traffic declines.

Customer traffic to limited-service restaurants, % change from Feb to mid-April 2020



Source: Foursquare

— *Digital maturity.* A strong online-ordering presence, digital loyalty programs, and robust customer-relationship-management (CRM) systems have been lifelines for restaurants during this crisis, as levels of digital engagement among consumers have soared. If trends in China are any indication, consumers could remain more digitally engaged even after the crisis. Starbucks China, for instance, saw a 12-percentage-point increase in the share of digital transactions postcrisis—from 15 percent in January to 27 percent in late March (down from a peak of 80 percent in February).

— *Role of value.* Consumer perception of value and the prevalence of deals have buoyed some restaurants' sales during the crisis, as customers—suffering financial losses and fearing continuing financial insecurity—increasingly look for ways to save money.

Just as the impact of the crisis isn't uniform across restaurants and regions, the pace and shape of recovery will also vary, not least because states have different approaches and timelines for allowing restaurants to reopen.

Scenarios for the industry's recovery

Although much remains uncertain about the pandemic's effects, hopes of a quick economic recovery are fading. Our colleagues have developed nine scenarios for the impact of COVID-19 on GDP, based on the extent of virus spread and the effectiveness of public-health and economic-policy responses (Exhibit 3).[2]

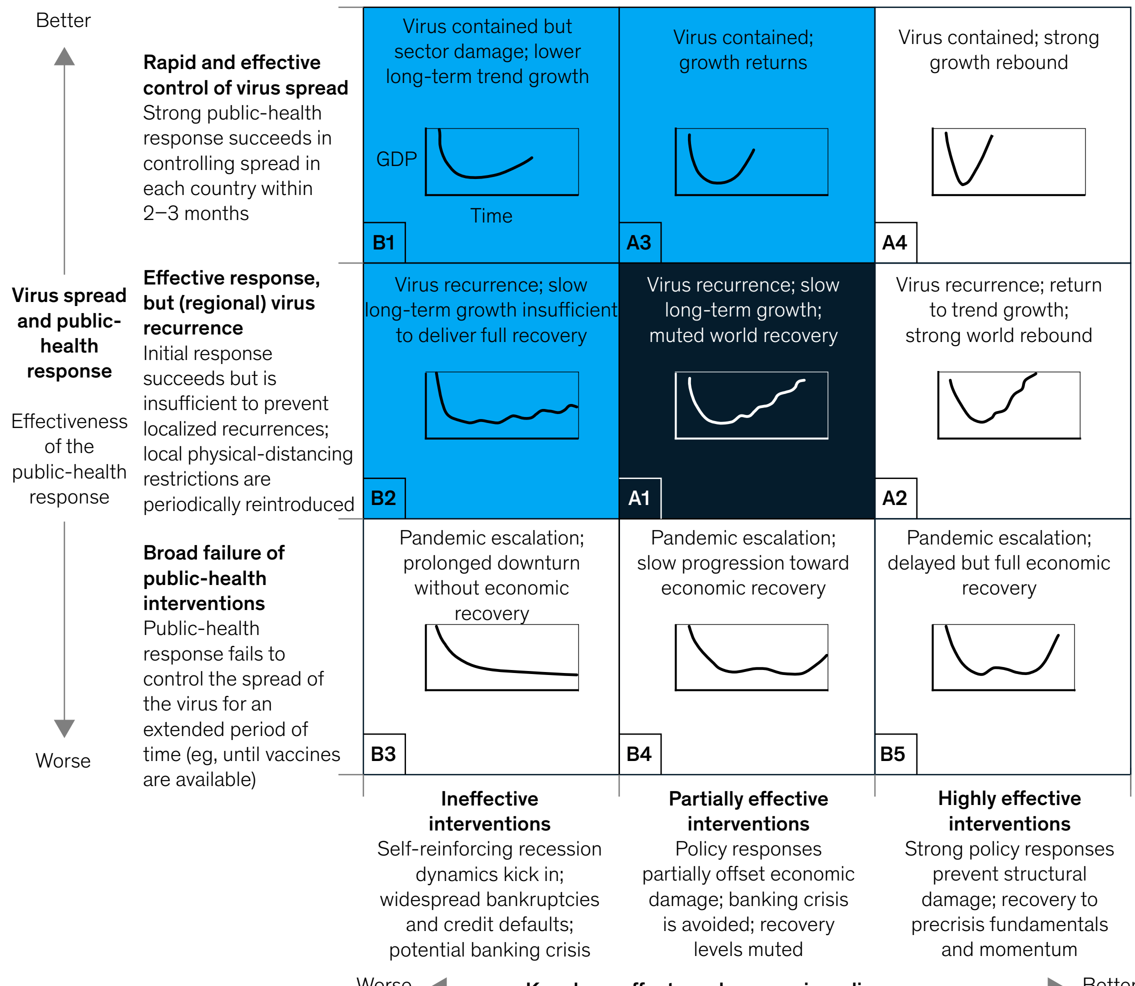
Just as the impact of the crisis isn't uniform across restaurants and regions, the pace and shape of recovery will also vary.

[2] Kevin Buehler, Penny Dash, Ezra Greenberg, Tom Latkovic, Audrey Lucas, Martin Hirt, Klemens Hjartar, Sven Smit, and Matt Wilson, "Crushing coronavirus uncertainty: The big 'unlock' for our economies," May 13, 2020, McKinsey.com.

Exhibit 3

The economic impact of COVID-19 remains uncertain.

GDP impact of COVID-19 spread, public-health response, and economic policies



As of this writing, the likeliest scenarios appear to be A1 and A3. While both assume partial to high effectiveness of economic-policy interventions, scenario A1 assumes resurgence of the virus across regions whereas A3—the more optimistic of the two—assumes rapid and effective control of virus spread. In a late-April poll asking more than 2,000 global executives which scenario they see as most likely, A1 was the most popular response, chosen by nearly one-third of respondents; A3 came in second, with 16 percent of the vote.

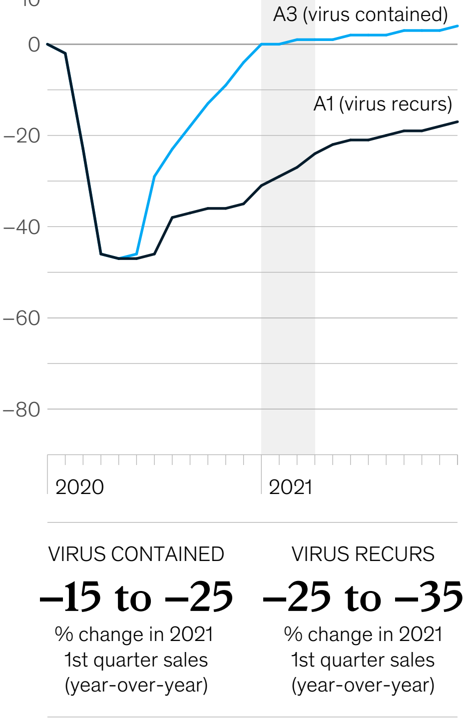
We modeled how quickly US restaurants might recover under these two scenarios (Exhibit 4). In scenario A3, restaurant sales return to precrisis levels in early 2021. In scenario A1, full recovery to pre-COVID-19 sales takes three years longer. The trajectories also differ by restaurant type, with pizza chains and quick-service restaurants (QSRs) recovering the fastest.

These are grim projections. Many restaurants don't have the financial means to endure such a prolonged downturn. Especially vulnerable are small franchisees (those with ten or fewer locations) and independent operators not affiliated with a chain. To survive, franchisees will need to receive

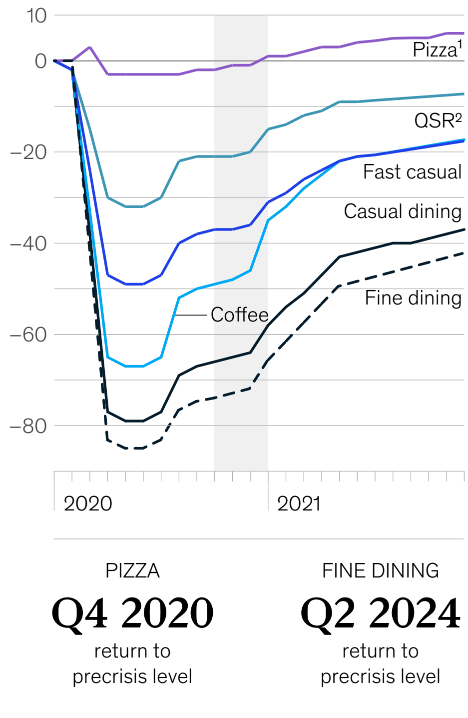
Exhibit 4

The shape of recovery will depend on the success of virus-containment policies and will differ by restaurant type.

Projected monthly restaurant sales by virus scenario, % change from 2019



Projected sales by restaurant type in scenario A1, % change from 2019



VIRUS CONTAINED	VIRUS RECURS	PIZZA	FINE DINING
–15 to –25	**–25 to –35**	**Q4 2020**	**Q2 2024**
% change in 2021 1st quarter sales (year-over-year)	% change in 2021 1st quarter sales (year-over-year)	return to precrisis level	return to precrisis level

[1] Includes fast-food pizza only.
[2] Quick-service restaurant. Includes burger, chicken, Mexican, and sandwich; excludes coffee and pizza.
Source: Bernstein Research; Foursquare; industry reports and expert interviews; McKinsey COVID-19 US Consumer Pulse Survey, March 30–April 5, 2020; McKinsey research and analysis, in partnership with Oxford Economics

financial assistance from franchisors and from the government, or drastically reduce their costs; independents could have an even harder time staying afloat because they don't have access to the loans and rent deferrals that franchisors can offer.

We estimate that, of the 650,000-plus US restaurant locations that were in business in 2019, approximately one in five—or more than 130,000—will be permanently shuttered by next year. Independents will bear the brunt of the closures, both because of attributes that make most independents more vulnerable in this pandemic (minimal off-premise presence, limited digital capabilities, low emphasis on value-based menu items) and because of their unfavorable economics (thin margins and poor access to capital). Independents' share of US restaurant locations could fall from 53 percent in 2019 to 43 percent in 2021.

That said, the situation across the country remains fluid. As states begin to lift restrictions and restaurants gradually reopen, the scenarios could change, depending largely on how well restaurants implement the necessary safety measures to prevent virus resurgence.

What to do next

Regardless of which scenario plays out, there's no denying that the coming months will be difficult

for most of the restaurant industry. For restaurant operators across the country, we recommend considering actions in two categories: those that can help you return to stability and those that can power you through to the next normal. With foresight and careful planning, you can equip your company to capture outsize value in the post-COVID-19 future.

Return to stability

In the recovery period, your top priorities ought to include updating operating procedures, reactivating customers to bring them back into restaurant dining rooms, adjusting menus to address shifts in customer habits and preferences, and enhancing your delivery capabilities.

Update operating procedures

As parts of the country ease restrictions on businesses, proactively create a reopening playbook. The playbook should include updated standard operating procedures that not only provide a safe store environment but also serve to reassure potentially anxious customers. In other words, simultaneously "go safe" and "show safe." Ensure that new hygiene and safety protocols are highly visible throughout the restaurant.

In addition, adjust processes to improve labor efficiency and to align with shifts in customer behavior. An important part of restarting dine-in service will be bringing back furloughed staff in a way that matches the restaurant's new needs with employees' skills. You will likely need to be innovative to do this successfully—for example, by using talent-exchange programs or partnering with other companies to share labor.

Reactivate customers using a segmented approach

Over the past several weeks, customers have become accustomed to cooking at home more and ordering online—behaviors that will likely have some "stickiness" postpandemic. To entice customers back to on-premise dining, tailor your approach to each customer segment:

— *Loyal guests.* Encourage loyal customers to return to on-premise dining by sending them personalized messages with critical information: when your restaurants will be open and why they can be confident that it's safe to come in.

— *Customers who spent their money elsewhere.* Some fraction of customers may have shifted their spending entirely to your competitors during the pandemic—or made all their meals at home. Effective marketing levers for this segment could include loyalty-driven price promotions and just-in-time offers featuring the most popular items and personalized favorites.

— *People who became first-time customers during the crisis.* To retain these customers, look to initiate them into your loyalty program with a special offer. Also, make sure your digital presence is consistent across platforms: for example, the menu featured on your own app should match the menu on any food-delivery aggregators that these customers may have used during the shelter-in-place period, and should highlight the same family meals they ordered during that time.

— *Potential customers.* In a new dining landscape, some customers who previously patronized other restaurants will be "up for grabs." It's an ideal time to re-evaluate your spending mix with a marketing-return-on-investment (MROI) simulator, which helps determine how to invest marketing dollars across email, social media, search, apps, local mass media, and other channels.

Align the menu to new consumer preferences

During the recovery, consumer preferences will have shifted toward value and off-premise dining—but consumers will also be longing to return to some semblance of normalcy even as they remain concerned about health and safety. These new consumer behaviors and preferences will require restaurants to make menu and pricing adjustments. Start by reintroducing your full precrisis menu items such as breakfast, alcohol, and fresh produce, then emphasize core items and comfort foods. Reprice items to ensure they're competitive under the new market conditions. Build traffic by focusing on value items first, then upselling.

Optimize your delivery business

Though the percentage of off-premise sales post-COVID-19 won't be as high as it was during the crisis, a portion of the shift to off-premise dining will probably endure indefinitely. Many brands that treated third-party delivery as a low-margin afterthought before the crisis found that it suddenly became a primary pillar over the past two months. Take the time to step back and develop a strategy for managing—and deepening your commitment to—third-party aggregator relationships: think through the specifics of markup rules, access to end-user data, cost-effective packaging, and streamlined processes to make pickup as efficient as possible.

Shape the next normal

Instead of simply reverting to business as usual, seize the opportunity to innovate in the next normal, thus shaping not just your own company's future but that of the industry as well. Priorities should include rethinking restaurant design, reinventing the menu, assessing the store footprint, and digitizing the customer experience.

Rethink restaurant design

To achieve post-COVID-19 growth, most restaurants will need a redesign. Think about whether to change your restaurants' physical layout to benefit from the shift to off-premise dining. Layout changes might include the addition of drive-through and pickup lanes, for example. Traffic flow into and out of these zones will need to be carefully thought through.

Also, consider investing in advanced analytics and automation, both to drive efficiencies and to enable contactless services. Advanced analytics and the Internet of Things (IoT) can improve your ability to accurately forecast daily consumer demand and changes in consumers' eating habits. Labor automation can increase the productivity of restaurant processes as well as provide contactless solutions that address consumers' health concerns. Some restaurants are already piloting a range of technologies—such as robots that hand out takeout orders, pulley systems at registers to facilitate transactions with customers while maintaining physical distancing, and smartscreen-controlled shelves for storing pickup orders.

To explore ways to shift to contactless services and solutions, the four-step IDEA framework can be useful:

— *Identify interactions.* Identify the type and nature of each in-person interaction (for example, employee to employee, employee to customer, customer to customer) in employee and customer journeys.

— *Diagnose and prioritize risks.* Use a risk-scoring system that incorporates the intensity, frequency, and duration of interactions along the journey to inform the prioritization and development of solutions (Exhibit 5).

— *Execute solutions.* Implementation should proceed in an agile way, addressing immediate needs while also investing in distinctive long-term solutions.

— *Adapt and sustain.* Collect learnings and ideas from teams to rapidly iterate and refine solutions based on customer feedback.

Reinvent the menu

Menu reinvention can be one of the most powerful tools to change a restaurant's long-term performance trajectory. As consumer behavior and sentiment continue to evolve, adapt your menu accordingly. Closely monitor emerging food trends, such as "clean" food, paleo diets, plant-based protein, and others. Introduce menu items to capitalize on these trends, price those items competitively, and market them to consumers.

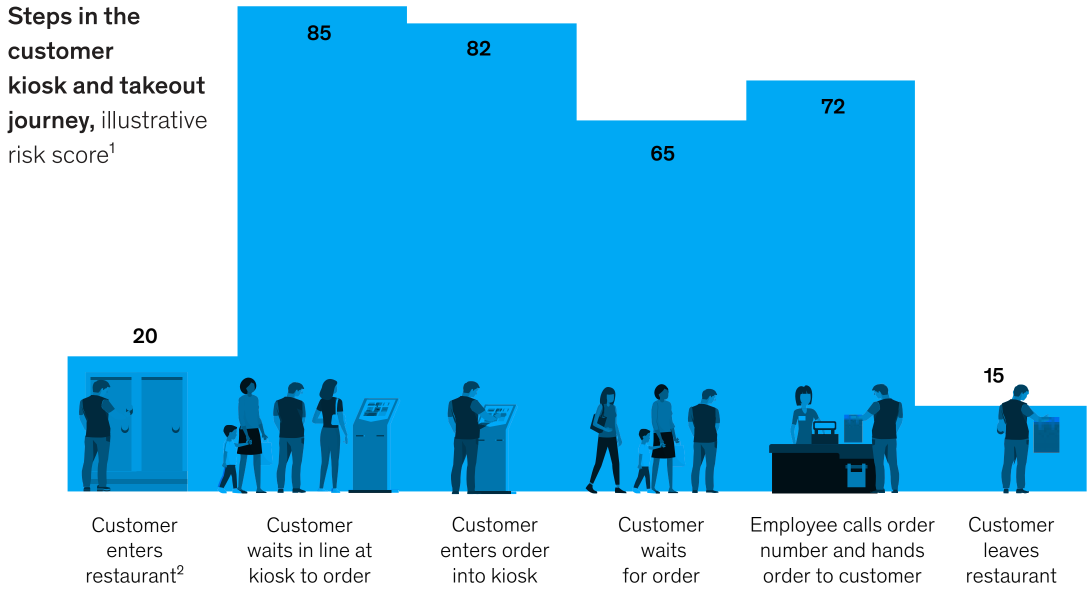
Optimize your footprint

As you emerge from the crisis, you will need to evaluate your store footprint and make tough decisions about entering or exiting certain geographies or shifting your strategies at a local level (for example, converting a restaurant to delivery/pickup only). Set up a footprint-optimization task force: a cross-functional team that uses real-time internal and external data and field observations to assess the health of specific locations, then decides whether to enter, expand in, or exit a market.

Exhibit 5

Restaurants can develop a scoring system to assess the risk levels of customer and employee journeys.

Steps in the customer kiosk and takeout journey, illustrative risk score[1]



[1] A scoring system that incorporates intensity, frequency, and duration can be used to assign a risk score to every part of the journey.
[2] Risk level dependent on automatic vs manual doors.

Digitize customer engagement
As mentioned, a shift toward off-premise dining options and physical-distancing behaviors will probably outlast the crisis. The digital customer experience will be critical to retaining current customers and capturing next-generation loyalty, and the best way to enhance the digital experience is through deep personalization. Engage customers with personalized offers across multiple digital channels; use customer data to make decisions about merchandising, pricing, and promotions.

The restaurant industry has faced severe challenges during the pandemic, including sharp declines in revenue and tremendous labor losses as well as some permanent closures. However, at some point, dining in restaurants will once again be a pleasure that people across the country can enjoy. The actions that restaurant operators take now will go a long way toward preserving their business through the crisis and equipping their restaurants to serve customers, not just during—but also long after—the recovery.

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