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Retail reset: A new playbook for retail leaders

In light of unprecedented industry disruption, a retailer's actions today could determine whether it spends the next 20 years as a leader or a laggard. Here are four must-dos for retail executives.

This article is a collaborative effort by Steven Begley, Becca Coggins, Carson Green, Jad Hamdan, Dymfke Kuijpers, and Franck Laizet, representing views from McKinsey's Retail Practice.

It now sounds like a cliché, but that doesn't make it any less true: the retail sector has experienced as much disruption in the past five years as it has in the previous 25. Consider this: perhaps never before in the history of the industry has every single one of retail's primary stakeholder groups—customers, suppliers, employees, and investors—dramatically changed their behavior and expectations, all at the same time.

Consumers aren't browsing like they used to and are abandoning their once-preferred brands; they're also demanding speed and sustainability. As retail ecosystems evolve, suppliers are, in many cases, becoming customers. Employees are seeking workplace flexibility, which retail jobs traditionally haven't offered. And, amid all this disruption, shareholders expect profitable growth. The pace and magnitude of change have been jarring to even the most seasoned retail leaders.

This confluence of challenges calls for a radical rethinking of long-held beliefs and practices—a retail reset. In this article, we explore the major trends shaking up the industry and recommend a set of focus areas for the retail C-suite. Now is a critical juncture: a retailer's actions in the next two to three years could position it for success in the next 20.

Why a new playbook?

Retailers pivoted fast when the COVID-19 pandemic struck, so their ability to move quickly isn't in question. But without the urgency posed by mass illness and global

lockdowns, only the most forward-thinking and ambitious retailers will continue to make bold moves at speed. The others, as history has shown, will destroy value.

Here's what we mean: nearly one in five retailers have posted negative economic profit since 2015.[1] And while the retail sector in aggregate has created value over that time, the gap between winners and losers is widening. The top 10 percent of publicly traded retailers now account for 70 percent of the sector's economic profit (Exhibit 1). It's a winner-take-most industry.

Becoming a winner isn't easy; staying a winner is even harder. And it's a particularly Herculean effort when the rules of the retail game are changing as drastically as they are right now. Let's take a closer look at how retail's stakeholders are challenging retail norms.

The 'zero consumer' has emerged
Consumers are increasingly shopping across channels, showing little loyalty, and expecting fast shipping and sustainable products. Meet today's "zero consumers."

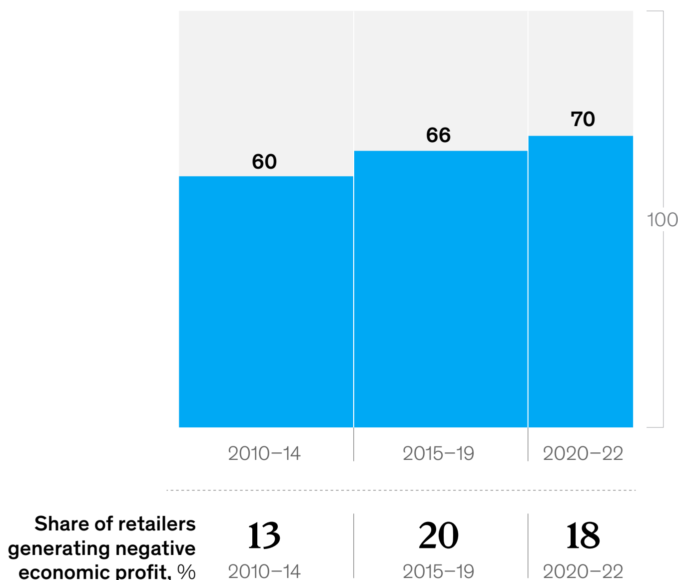
Zero boundaries. Browsing in stores used to be one of the primary ways that shoppers came across new products. But the purchase journey is now more fragmented. Nearly half of consumers—and approximately 70 percent of millennials and Gen Zers—say they

[1] Economic profit is the measure of the spread between return on invested capital and the cost of capital.

Exhibit 1

The top decile of retailers creates 70 percent of the value in the sector.

Share of sector economic profit created by top decile of retailers, %



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rely on social media, celebrities, and articles or blogs for purchase inspiration.[2] And they're shopping fluidly across channels. Even grocery, once a stubbornly store-based category, is becoming solidly omnichannel, with nearly 40 percent of US consumers saying they do at least some of their grocery shopping online.[3]

Zero in the middle. Consumers are moving away from the middle of the market—they're either scrimping or splurging. Total consumer share of wallet spent on mid-priced goods and services has declined almost 10 percent in the past five years.[4] As of April 2023, approximately 80 percent of US consumers said they're trading down to lower-priced options.[5] At the same time, in recent surveys of European and US consumers, roughly 40 percent of both populations said they plan to splurge, especially on restaurants, travel, and apparel.

Zero loyalty. About half of consumers reported switching brands in 2022, compared with only one-third in 2020. What's more, about 90 percent said they'll keep switching. Absent truly differentiated, exclusive offerings, the retailer will soon become a utility—just a means of distribution.

Zero patience. Consumers are much less willing to wait. Free standard shipping, once offered by only a few retailers, is fast becoming table stakes. Amazon's delivery speed and the rise of "buy online, pick up in store" have raised consumers' expectations: a plurality of customers today report that three-day shipping is the slowest they'll tolerate before looking to other retailers.

Net zero as a buying factor. Consumers are no longer just *saying* they care about sustainability and social responsibility; they're now voting with their wallets. A recent analysis by McKinsey and NielsenIQ revealed that products making sustainability-related claims on their packaging averaged 28 percent cumulative growth over the past five years, versus 20 percent for products that made no such claims.[6]

As retail ecosystems develop, suppliers are becoming customers

Retail used to be about buying products through supplier networks and reselling them for a profit. Today, retailer–supplier relationships are about not only products but also consumer access, data, and insights—and, increasingly, *suppliers* are the ones buying the latter from retailers.

Retailer–supplier dynamics are changing as retailers start to tap into new value pools beyond omnichannel retail, such as third-party marketplaces and retail media networks (RMNs).[7] We estimate that these "beyond retail" opportunities—including adjacent services, customer data monetization, and new tech assets—currently account for less than 10 percent of retailer profits but could represent up to 40 percent by 2027.

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[2] McKinsey US Consumer Pulse Survey, March 2022.

[3] McKinsey State of Grocery Consumer Survey 2023.

[4] Based on a joint analysis conducted by data company Affinity and McKinsey.

[5] Christina Adams, Kari Alldredge, and Andrew Pitakos, "A monthly update on the state of the US consumer: May 2023," McKinsey, May 23, 2023.

[6] "Consumers care about sustainability—and back it up with their wallets," McKinsey, February 6, 2023.

[7] Marco Catena, Richard Mayfield, and Rakhi Williams, "Beyond retail: Why retailers should think 'services' and 'ecosystems'," McKinsey, January 11, 2023.

In the past five years alone, more than 20 major retailers have launched third-party marketplaces. This model gives retailers a low-stakes way to experiment with new merchandising, categories, or products before onboarding them to first-party selling—or a path to replacing first-party selling altogether. RMNs, too, are increasingly popular: some are rapidly generating both significant incremental revenue (at an operating margin of more than 50 percent) and valuable new consumer insights. These emerging businesses hold promise for retailers but also present fresh nuances in how to successfully manage supplier partnerships.

The work is changing—and so are the workers

Job openings outpace workforce availability around the world. In the United States, there are nearly twice as many job openings as unemployed workers. Wages are climbing and employees are expecting more from employers, putting pressure on operating profit. At the same time, the nature of retail work is changing, both in stores and at corporate offices.

The front line wants flexibility—and more. In a 2022 survey, frontline retail employees cited flexibility as the top reason for leaving a job.[8] Career development opportunities were also a significant factor in frontline retention (Exhibit 2). The evolving macro environment may, of course, cause employee priorities to change—but, as they refine their talent strategies, retailers should bear in mind that what's good for workers is good for consumers: there's a positive correlation between frontline employee satisfaction and consumer experience.

Every team needs data science skills. Consider the merchandising function: traditionally, merchants and planners relied on gut instinct and pattern recognition based on years of experience. Today, leading merchants augment instinct and experience with data science. At Amazon, almost every short-term pricing decision is algorithmic. Many longer-range decisions—such as in merchandising, supply chain, and real estate—are also informed by AI. Retail leaders of the future could very well have a data science background. If all your data science talent sits in your IT department, you're already behind.

For investors, growth isn't good enough

Investors have become accustomed to high—and profitable—growth in retail. Sector gross margins in 2021 reached their highest point since 2009, as retailers reduced promotions and markdowns amid constrained supply. But rising inventory levels have forced some retailers to take heavy markdowns, and logistics costs are further cranking up P&L pressure, threatening to erode the past decade's margin gains.

That said, there's clear evidence that investors take a through-cycle approach to the sector. While valuation multiples have remained mostly flat over the past ten years, COVID-19's disruption and impact on sector EBITDA margin revealed an investor base that looks beyond short-term shocks (Exhibit 3).

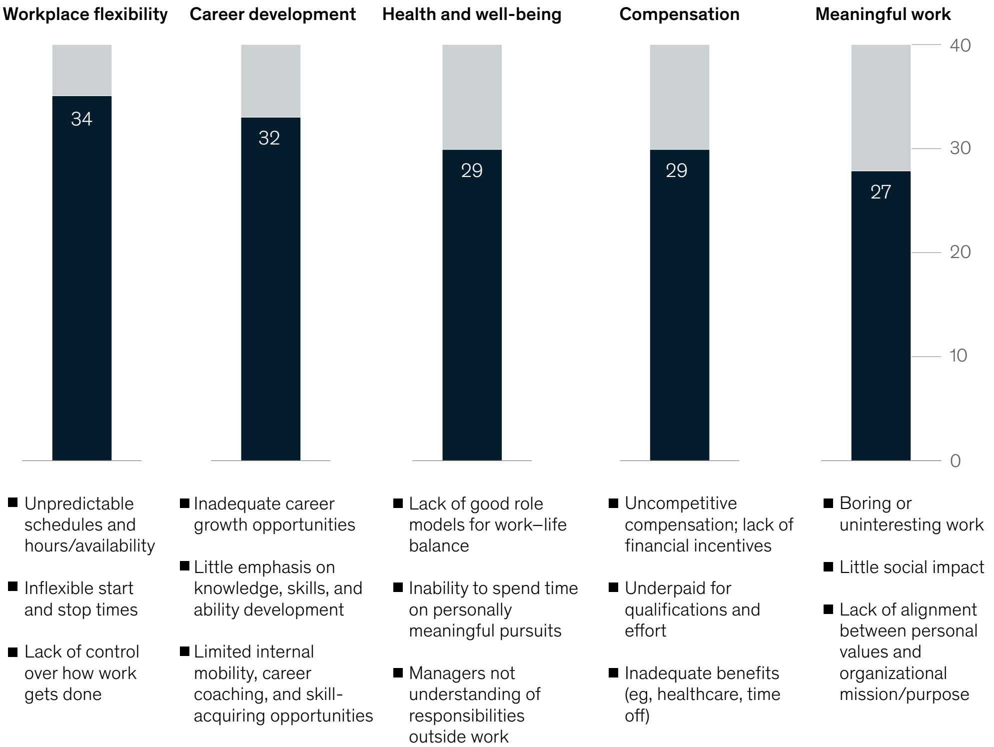
Retail leaders can take some comfort in knowing that a disciplined, long-term strategy will be rewarded. However, in today's fast-changing environment, the value of P&L agility

[8] David Fuller, Bryan Logan, Pollo Suarez, and Aneliya Valkova, "How retailers can attract and retain frontline talent amid the Great Attrition," McKinsey, August 17, 2022.

Exhibit 2

The desire for more flexibility is the most common reason US frontline retail employees leave their jobs.

Top 5 reasons US frontline retail employees[1] are considering leaving their jobs in next 3–6 months, % of respondents[2]



[1]Defined as frontline employees at apparel, beauty, and shoe stores; automotive supply stores; big-box stores; convenience stores; department stores; discount stores; dollar stores; drugstores; full-service and sit-down restaurants; furniture stores; grocery stores; home improvement stores; online players; and quick-service restaurants.
[2]Question given to respondents who indicated that they are at least "somewhat likely" to leave their current jobs in next 3–6 months: "Below are 12 categories of reasons why people leave their jobs. Please choose the top 3 aspects of employee experience that affect your plans to leave your current job." Other reasons include supportive colleagues (27%), inspiring leadership (26%), sustainable workload (21%), access to resources (20%), community (19%), workplace safety (19%), and geographical ties (19%).
Source: McKinsey Frontline Retail Great Attrition and Great Attraction Survey, Apr 2022

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and balance sheet flexibility have gone up massively; retailers need breathing room. We would argue that the CFO skill set has never been more important for the sector.

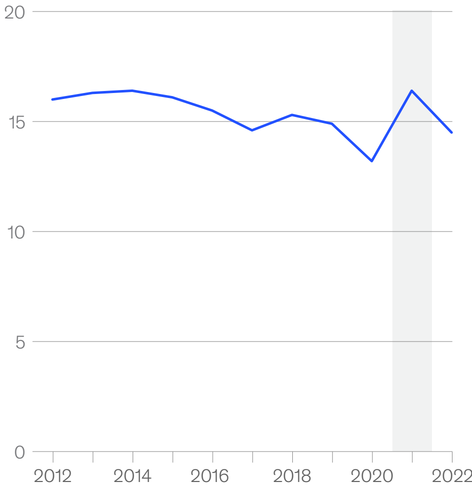
Reinvention required: Priorities for the C-suite

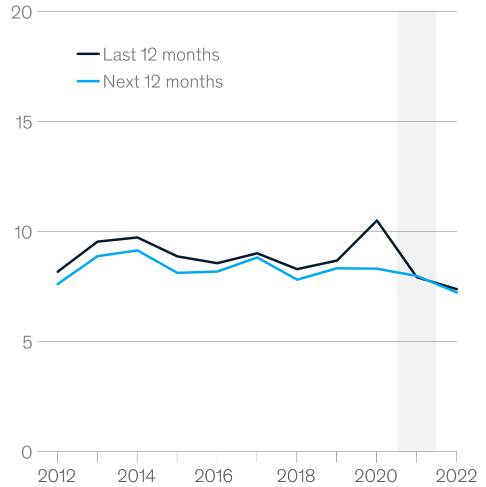
These trends are gaining strength, making it urgent for retailers to act now. Yes, experimentation can be expensive—and given that interest rates are likely to remain elevated for the foreseeable future, avoiding big bets is a tempting default option for retail executives. But standing still can be a bigger risk. History tells us that retailers that take decisive action and focus on the long term outperform peers both during and after a downturn by as much as fivefold in total shareholder returns.

Exhibit 3

Even when margins in the retail sector reached peak levels during the COVID-19 pandemic, investor expectations remained relatively stable.

Total retail sector, 2012–22[1]





[1]Based on sample of 136 large retailers with substantial North American presence, excluding quick-service restaurants.
Source: Corporate Performance Analytics by McKinsey

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The sooner a retailer reinvents its relationships with customers, suppliers, employees, and investors, the better off it will be. The following four areas should be at the top of retail executives' agendas.

Own the consumer relationship

Strong consumer relationships are the currency of the modern retailer. Indeed, the successful retailers of the future will be those companies that can cultivate a massive—and massively loyal—set of consumers, because other companies will pay for access to that customer base.

As "zero consumers" begin to constitute the mainstream, retailers would do well to gauge the strength and depth of their consumer relationships. Our recommendation: pursue and measure "share of life," instead of just share of wallet. In practical terms, this means introducing more and varied ways to become indispensable in as many aspects of people's lives as possible, while continually creating and communicating savings that are invested back into the customer—thus reinforcing the loyalty loop. Retailers still need to excel at selling products, but first-party product sales will become only one element in a broader ecosystem—one that includes services, experiences, inspiration, advice, and content—to keep consumers coming back. (We discuss ecosystems in greater detail later in the article.)

Physical stores will be instrumental in helping retailers capture greater share of life and own the relationship with the zero consumer. Stores will serve as not just showrooms and service centers but also hubs for speedy fulfillment. For some retailers, two-thirds or more of e-commerce orders already touch stores; ship-from-store could account for 30 to 50 percent of physical store volume in the next several years. Retail store networks will encompass traditional stores, distribution centers, "dark" stores, e-commerce-first stores with smaller selling floors and large back rooms, and even shared fulfillment centers via alliances across retailers. Managing these more complex networks will require retailers to double down on analytical infrastructure and capability.

In addition, to win greater share of life, retailers will need to evaluate business decisions using an environmental, social, and governance (ESG) lens. They'll not only prioritize and invest in ESG-related actions but also make consumers aware of these actions. For example, winning companies will use a design-for-sustainability approach when developing new private-label products and will work with suppliers to offer "better for you" products that are sustainable and affordable. (We note that true winners will also engage their employees in sustainability and social responsibility efforts, recognizing that purpose and meaningful work are significant factors in employee satisfaction and retention.)

Set a vision for your retail ecosystem

Recent McKinsey research has shown that consumers are willing to buy adjacent services from retailers.[9] Walmart has long offered financial services; Amazon is making inroads in healthcare; leading pet retailers are providing pet grooming and veterinary services. Offerings in education, travel, and entertainment are all plausible areas into which retailers can expand—and some are already doing so. We're seeing the beginnings of retail ecosystems, and the opportunities aren't just in B2C but also in B2B: for instance, the aforementioned third-party marketplaces and RMNs, plus offerings such as business intelligence and logistics as a service.

Ecosystem models will transform what it means to be a successful retailer. As a retail leader, start by defining an aspiration for your ecosystem: what new businesses and assets you'll build, what your revenue and profit pools will look like, and how you'll leverage and nurture supplier partnerships to scale your customer base. Treat all your suppliers as potential ecosystem partners.

With retail becoming more capital intensive, investing deeply in an ecosystem requires balance sheet scale and resilient revenue pools. Therefore, activating an ecosystem model might involve forming new collaborations and joint ventures, entering into profit-sharing agreements, and defining new "currencies" to trade in (such as privileged consumer access), as well as pursuing M&A.

You'll also need new talent. Building breakout businesses requires a different approach and a dedicated C-suite leader, which often means going outside traditional retail talent pools. For example, few merchants will have the in-depth media buying and planning expertise required to run an RMN and lead discussions with suppliers' agencies.

Overhaul your employee value proposition

Winners will be the companies that get the talent equation right, both on the front line and at headquarters. To attract and retain frontline talent, retailers must find creative ways to offer flexibility and make frontline work more engaging. Some retailers are already experimenting with gig work, and workforce management platforms are adding gig-like offerings such as shift bidding and "instant pay" options. The upside is substantial: we've found that at stores with the best employee retention rates, same-store sales growth is two to five percentage points higher than average. The savings from reduced attrition can then be reinvested back into the front line in the form of higher pay, better benefits, and learning and development programs.

In the corporate center, as facility with data science becomes table stakes, incrementalism—one data science hire at a time—won't work. Attracting the best talent will require building a community of practitioners and developing analytical talent to be corporate leaders. We've found that a few elements are critical to building data science capabilities: bringing analytical rigor to merchant teams by upskilling employees who already have an analytics background; aggressively recruiting early-tenure data science cohorts; and developing a nuanced retention, promotion, and review process tailored to analytics talent.

Find new sources of fuel

Winners will interrogate their value creation algorithm, balancing a focus on growth with a focus on margin and ROIC. Internal funding, such as reinvestment from productivity initiatives or advertising and data partnership income from an RMN, can provide fuel for new growth. However, if you're a retailer intending to use this moment of disruption as an opportunity to leapfrog your competitors, all forms of capital should be in the consideration set—public markets, private equity or credit, venture capital (VC), minority partnership stakes—to inject flexibility into your financial model and enable you to invest in growth-accelerating efforts, even amid macroeconomic turmoil.

Alternative investors (one example being Insight Partners, which invested $500 million in Saks in 2021) can be a source of not only capital but also unique execution expertise to manage growth and turnaround in high-pressure, low-margin environments. Experienced investors can provide an outside-in view of your growth plan and bring a VC-like mentality that looks to propel innovation instead of focusing only on quarterly results. Of course, alternative sources of capital often come with different costs and constructs, so a high-performing CFO and finance organization are must-haves.

Crucial enablers: AI and analytics

To get the most out of implementing the above imperatives, retailers should embed digital capabilities and advanced analytics throughout the business: digital leaders deliver over 2.5 times the TSR performance of their peers. In retail, digital leaders have invested in a range of AI and analytics use cases, from customer-facing to back-end operations.

Leading retailers increasingly use analytics to inform and partially automate merchant decisions on assortment, pricing, promotions, and more. Marketers benefit as well,

using new levels of customer insight to personalize experiences and offers in real time. Generative AI is now helping retailers create compelling copy and visual assets, improve customer service online and on the phone, or even provide virtual personal-stylist services.

Equally critical are the back-end applications of AI: optimizing complex omnichannel supply chains, managing a "gig-ified" workforce, and automating repetitive tasks. There are already commercially available AI solutions that can halve the time spent on store tasks in some retail sectors.

Retailers that are truly capitalizing on data and analytics are sweating these assets: they're treating data and insights as a product. They're monetizing customer-centric insights either directly via paid subscription or indirectly as part of joint business planning with vendors—securing win–win outcomes for both parties.

To be clear, what we're recommending aren't baby steps but giant leaps. The retailers best positioned for success are those that have already made headway on these priorities and are committed to reinventing not just their own companies but retail as an industry. For those retailers, the potential for value creation is limitless. Q

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