

Forging the future: The forces that are shaping US retail



Hindsight is always 20-20, but such clearheadedness is of little use when it comes to running a successful business. In that regard, seeing the future is much more valuable.

By Rebecca Wahl, Greg Kelly, Mary Ellen Coe, and Emily Reasor

Consider, for example, what happened to the book industry in the last decade. Those who foresaw the rise of online retailing and e-books have made a fortune; those who thought traditional book stores would stay strong would have lost one. Ditto for video stores versus streaming content. And the transition from desktops to laptops, mobile devices and now tablets has meant big losers as well as big winners.

Indeed, the ongoing transformation of the digital landscape is a key strategic challenge, although perhaps in an unexpected way. Despite the hype about e-commerce, multichannel revenues (offline purchases influenced by online activity) are the fastest-growing segment of retail sales in the United States, influencing as much as \$1 trillion in offline purchases, twice as much as in 2007. Moreover, emerging sectors like health and beauty products, apparel, and furniture are seeing a marked increase in online purchases and research. Combined, multichannel growth and online sales account for approximately 45 percent of US retail sales, and these segments are

growing at a 19 percent compound annual growth rate.

In addition to these digital trends, McKinsey has identified six others that could define the next decade.

1. The polarization of spending:

Since the onset of the recession, Americans have paid down debt and built up their savings. According to the Bureau of Economic Analysis, the US savings rate is more than 5%, though incomes are stagnating and even dipping. And the middle-class squeeze isn't just about income and taxes; it also affects spending.

One of the most intriguing trends of the last decade is that growth in spending is occurring at the high- and low ends of the consumer market, while declining in the middle. Consumers are increasingly "straddling" their spending habits, going to value on the basics and paying a premium for those categories and brands that demonstrate differentiation. Considering this, manufacturers and retailers alike

need to develop a portfolio strategy that creates a clear good-better-best offering with particular emphasis on the opening price point and value segment as well as the premium offering.

2. The new generation gaps:

In the US, consumer spending patterns are becoming older....and younger. Between 2010 and 2020, the fastest-growing age cohort in the US will be the over-65s—from 40 million to 55 million people. The next fastest? That's 55-to-64-year-olds (8 million more people). To put it another way, there will be 23 million additional over-55s by 2020 compared to now, and only 11 million additional under-35s. While generally spending less per capita, that demographic bulge will translate into overall higher spending and greater influence as a segment.

At the same time, though, it is the Millennials—the 79 million people born between 1985 to 2004—who will be the largest population, and they have unique behaviors and demands. The

Millennials have grown up with the realities of globalization and diversity. They have known both prosperity and recession. They love to try new things and technology is second nature. And yes, they are a little spoiled: They are used to the market (and their parents) delivering what they want, when they want it.

At the same time, though, they also show a high degree of brand loyalty: When they find a company or product the like, they keep coming back. This matters because in certain areas, this cohort is already extremely influential. Though their income is lower than average (\$26,881, less than half US household income), in apparel and services, they already spend more than older Americans; the females among them spend more than the national average. They also punch above their weight in categories like booze, furniture, footwear, phones and used cars and trucks

3. Healthy and green are edging toward the mainstream:

No, the US is not becoming a nation of triathlon-running skinnies. In fact, obesity continues to, well, widen. In 1990, according to the Centers for Disease Control, not a single state reported an obesity rate of more than 15%; by 2008, every state (except Colorado) had rates at least that high. Two very different trends result from this. First, because obesity contributes to a wide range of health problems, it is helping to drive growth in spending on health and pharmaceuticals.

And whether it is overweight people trying to slim down or slim people trying to stay that way, there is a striking increase in spending in health-related categories like fitness apparel, sports centers, women's athletic footwear, and health-monitoring devices. Companies that find the next big thing in exercise could do enormously well. Pilates training almost quintupled

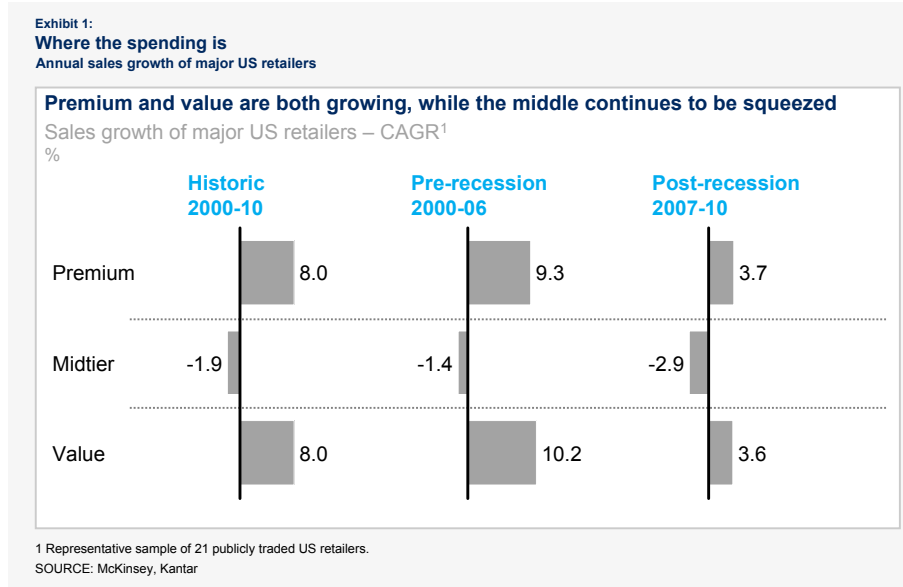
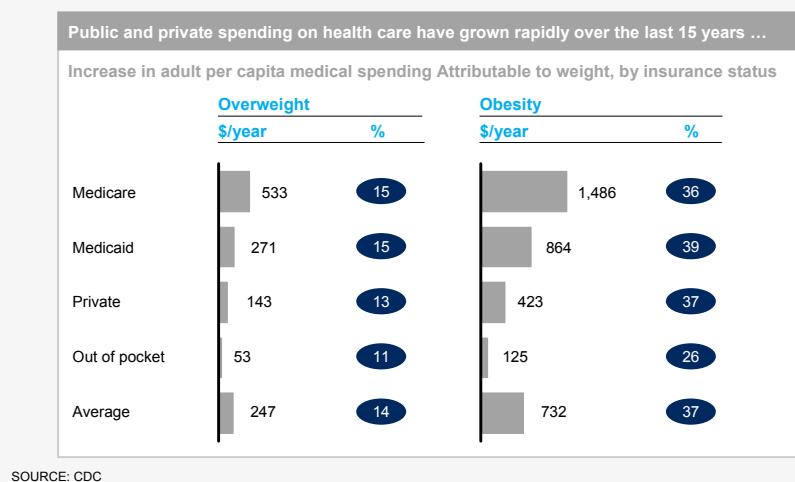


Exhibit 2:
Heavy spending



in the 2000s, for example, and elliptical training more than doubled.

Similarly, while buying green is still a minority option, in certain categories, behavior is approaching a tipping point. Green building practices, for example, are now part of one of eight new residences, and almost a third of new refrigerators are energy efficient. Organic fruit and vegetables and fair-trade coffee are also found in many an American kitchen.

What's the next green thing? Whoever figures that out could be counting green of a different kind.

4. The changing real-estate landscape:

The generation from 1970 to 2000 might be called the Big Box Era; it was characterized by supercenters and category killers. The following decade saw the rise of manufacturer direct stores

and the beginning of e-commerce. Now bricks-and-mortar industry dynamics are changing again. Consumers are increasingly savvy; they are demanding goods tailored to their needs as well as doing more research and shopping online. Given these pressures, the retail landscape is shifting. Boxes are getting smaller (i.e., square footage is being reduced), specialized formats are emerging, and new operating habits, such as tailoring store inventory for the local market, are emerging.

The pace of change has been hastened by a harsh reality. From 2008 to 2011, 53 different chains went bankrupt, and more than 13,000 outlets closed down. Such changes naturally ripple their way through local real estate markets—and offer interesting propositions to private-equity and other investors. As a result, M&A is rising. Every business needs to negotiate change to survive. When the waves of change wash over an established industry that dates back to the earliest days of commerce, the perils are obvious. But for the skillful surfer, so are the opportunities.

5. Data is getting bigger and smarter:

The numbers are unfathomable. A billion of pieces of information are exchanged over Facebook...every day. More than five billion mobile phones are in use. As of April, the Library of Congress has collected 235 terabytes of information (a terabyte is 1 trillion bytes) and is adding five more every month. And the amazing thing is that the information imbedded in these huge numbers is not only the purview of Big Business or Big Government. A mere \$600 can buy a disk drive that can hold essentially all the world's music; a smartphone can

hold multiple encyclopedias. McKinsey estimates that US retailers could see net margins increase almost 60%—and up to 1% annual productivity growth—through the effective use of Big Data.

Harnessing this data, in the form of more sophisticated analytics and automated algorithms, can help companies make better, faster decisions across all functions, including crucial areas like pricing optimization, marketing spend effectiveness, and supply-chain logistics. Collecting the right kind of behavioral and performance data is also crucial to segmentation and creating effective loyalty programs. These can improve a company's ability to target its efforts and manage consumer relationships. One European grocer, for example, through shrewd analysis of customer data gleaned through its loyalty card, learned that 80% of its discounts came from 20% of its offers; it has therefore been able to tailor its offers more carefully across 1000+ segments and efficiently deliver 150,000 different communications. Result: sharply higher market share.

6. The rise of the Hispanic consumer:

In 2009, Hispanics accounted for 9% of total income in the US. By 2020, thanks to population growth and economic mobility, that figure will be more than 30%. The Hispanic market has several distinct characteristics:

First, households are large and they spend generously on basics: about a third of them consist of five or more people, and they spend significantly more on basic items (such as food and clothing) than do their counterparts in the general population.

Second, the demographic is increasingly affluent. More than a million Hispanic consumers make \$100,000 or more a year.

Third, Hispanic households tend to be value shoppers who plan well. They shop fewer times per week; they spend more time and money per visit; and they plan ahead carefully. As a result, Hispanics are more likely to be bulk shoppers in search of value.

These are all important trends; no doubt others will emerge that are not even on the radar screen yet. But companies that can get ahead of the curve in these areas will be well placed to live long – and perhaps even to prosper.

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