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Changing retail landscape – successful transformation for retailers

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As the competitive environment constantly evolves, retailers face a never-ending parade of new challenges. Selective optimization is no longer enough – companies must fundamentally overhaul their business models.

The mail-order companies were the first to feel the tremors – the rise of online players like Amazon and Zalando had forever altered the rules of the marketplace. Suddenly, catalogs issued every six months left customers cold. The Otto Group responded by becoming one of the first companies in Germany to rigorously transform its entire business model.

Now the ground under bricks-and mortar retailers has become shaky as well. Online players have driven the level of competition to unprecedented levels. As a result, retailers must master a wealth of new challenges – not only finding convincing multichannel solutions, but developing and implementing innovative store concepts at the same time. It all adds up to significant investment, even as retailers deal with falling sales and profits.

Shifting consumer mindsets provide one example: in the future, customers will not visit stores simply to buy products, but to have experiences. The effort involved in a physical shopping trip must have an emotional payoff. New digital technologies such as augmented reality and gaming will play a decisive role in how physical points of sale develop – and enable retailers to increasingly individualize their approach to customers. Companies like Inditex Group show that countering the negative trend in retail is possible. With its up-to-date assortment, modern store concept, and deft intertwining of its online and offline worlds, the Spanish retailer is making a mark in a tough field.

In light of the scope and variety of challenges they face, conventional retailers need to go beyond optimizing specific aspects of their existing business models. Instead, they must fundamentally transform them – refocusing processes and structures, building new (especially digital) capabilities, and often improving their cost positions in their stores and administrative functions as well. And the clock is ticking. Succeeding requires an entirely new approach: classical multiproject management is no longer up to the task. The mission today is to transform the entire company and involve the whole organization in the process. Doing so entails far more than successfully completing a series of discrete projects. The change management involved is much more extensive, and the organization must develop new resources and skills. Since the financial means to do so are often limited, companies must first build up the maneuvering room they need to make changes.

Many retailers find themselves asking how they can make their transformations work. While they understand where change is needed, they lack the tools to make it happen quickly and reliably. But answers exist: experience shows that successful rapid transformation programs generally follow five principles that clearly lay out the transformation's direction and objectives. As retailers set up and run their programs, they should also keep a series of specific success factors in mind that can make or break their efforts.

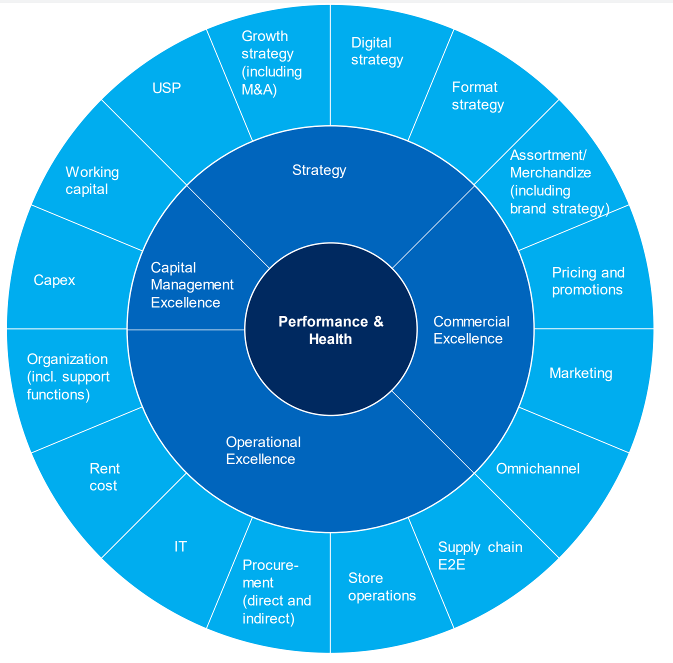
PRINCIPLES: WHAT MAKES TRANSFORMATIONS SUCCESSFUL

Punishing competition, falling profitability, an eroding competitive position – the starting point for bricks-and-mortar retailers could hardly be more difficult. But in a challenging and complex situation like this, a transformation's prospects improve when it follows five principles:

Act fast. Capital is not the only scarce resource for retailers – time is in short supply as well. With far-reaching disruption rattling the market, waiting is not an option. Those who act fast have the best chance to tackle their transformations from a position of strength.

Focus on both costs and growth. Incremental improvements are not enough. Retailers need a holistic plan for both reducing costs and generating growth. Nothing should be left unquestioned – from the strategy to operational excellence, capital productivity, and even the brand image **(Exhibit 1)**. The aim should be to identify the full potential that the company can realize.

Exhibit 1



Consider different time horizons. Short-term improvements should first bring quick wins that open up breathing room for longer-term initiatives. Starting with fast action in pricing and promotions has proven to be best practice, but inventory optimization, category management, and operations are also promising areas to tackle early on. In the medium term, retailers can move on to topics such as optimizing store operations and formats. Finally, they can tackle format updates and changes to the store portfolio in the longer term.

Be daring. Openness to ambitious goals and decisive action increases the likelihood that a transformation will succeed. A recent McKinsey study on strategy shows the impact that can result when companies actively reallocate their resources: those with a high willingness to do so generate 30 percent more total return to shareholders (TRS) than their more cautious peers. Retailers who invested early in e-commerce business models provide one example – they were largely able to compensate for the pressure on their stationary business. But even less extensive actions, such as recruiting external experts to provide missing skills or hiring a Chief Digital Officer, can send a much-needed signal.

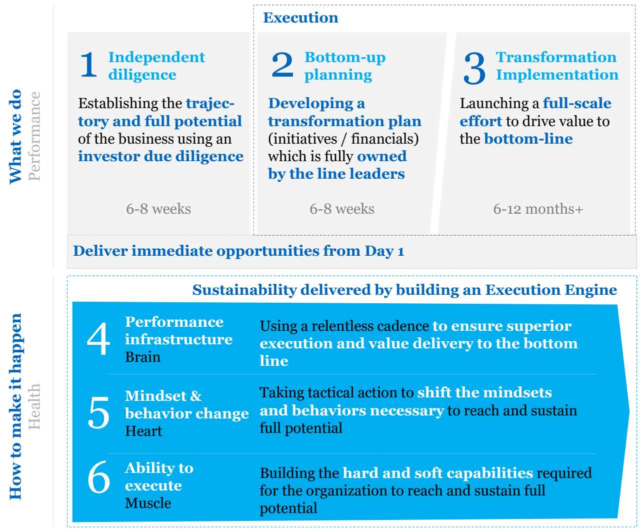
Empower employees. About 70 percent of all large, complex change programs fail to meet the targets set for them. The difference between success and failure never boils down to a single action, but some factors do correlate with success more strongly than others. They include effective communication, close involvement of employees, and the introduction of continuous improvement processes. In addition, best-practice retailers establish clear responsibilities for each level of management. Binding guidelines and directives for the transformation ensure a consistent approach across formats and stores. Studies also show the importance of assessment: the likelihood of transformation success is four times as high if project leaders' annual evaluations rate their contribution to implementation against predefined metrics.

SUCCESS FACTORS: POINTS TO COVER WHEN SETTING UP AND RUNNING A PROGRAM

To achieve change, retailers need an "engine" that will get – and keep – the transformation running. One method that has proven effective involves structuring the program in terms of both what to do and how to do make it happen (**Exhibit 2**). While classical transformation programs focus exclusively on developing and executing specific actions, this holistic approach quickly brings about profound, lasting improvement.

The "what" side of the equation covers classical action-focused transformation work. Many retail companies have long since identified the main areas where they need to act, but they can still benefit from structuring their activities into three phases. In the first, they determine the maximum potential they can realize. Best-practice companies set about answering this question as if they were performing due diligence. They consciously adopt the perspective of an external investor, scrutinizing their business to find any element with potential to increase their value lies. Their findings provide an objective basis for setting transformation targets, reprioritizing existing initiatives, and accelerating progress. The second phase involves working with the entire management team to plan concrete initiatives bottom-up and calculate their financial contribution. In the third phase the approved initiatives are implemented.

Exhibit 2



"How," in turn, includes all actions that enable the company to implement improvement actions seamlessly and anchor them in their organization and processes. Above all, retailers must ensure that they maintain the ability to continuously renew themselves. Three points are especially important:

Change management. One common reason why transformations fail is employees' resistance to change. As a result, every comprehensive change management program should include a communication plan based on a compelling change story that clearly lays why the desired changes are needed and what they should achieve. In addition, employees should receive encouragement and the skills they need to break old behavioral patterns. Managers, in turn, act as role models for the new way of working. One retailer chose the motto "focus on customers" to encapsulate its transformation and rigorously aligned its structures and activities accordingly. Responsibilities and decision making authority were shifted toward employees with more customer contact; at the same time, headquarters was streamlined.

Infrastructure. Best practice for retailers is to set up an independent transformation office charged with ensuring that the transformation runs smoothly. The office brings together managers and experts from departments like Finance and HR to collaborate closely. They monitor the implementation of the various initiatives, support those who are responsible for them, and prepare for needed decisions. One retailer set up a transformation steering committee staffed with all relevant members of the top management. At the weekly meetings, members of the transformation office – which was under the CFO's authority – reported on the program's status and got fast answers on needed decisions. Monitoring tools to support the office's work included not only dashboards but benchmarking analyses and value capture models as well.

Implementation capability. For retailers, the bar has never been so high: they have to anticipate customers' needs, intelligently collect and analyze customer data, manage different channels, introduce digital technologies – and much more. It is therefore essential that companies undergoing transformation precisely determine which capabilities already exist in their organizations, which can be developed, and which should be covered by external specialists. Skill building, especially in terms of digital capabilities, is likely to play an outsized role in future business success. For this reason, one retailer set up a "digital factory" to bundle digital capacity across units and develop digital talent. Maintaining the ability to be innovative for the long term is crucial as well: by introducing agile ways of working like scrum or design thinking, companies ensure that they can develop and implement new ideas faster.

Many observers have claimed that the days of store-based retail are numbered. But an obituary would be premature: McKinsey's latest research shows that bricks-and-mortar stores will remain the largest retail channel by far for the next five years. In 2021, in fact, they will still account for more than 84 percent of retail sales. Stationary retail continues to offer potential – as long as companies can transform themselves successfully.

Effective programs are capable of developing a comprehensive transformation concept incorporating all the elements described here in two to three months. Implementation then takes another 12 to 18 months. We regularly see sustainably higher profits result, including increases of up to 5 percentage points. Retailers that achieve improvement like this are in a position to build a secure future.

Key takeaways

1. Due to drastic changes in the competitive environment, retailers have no choice but to transform their business models.

2. Many companies recognize the need to act but do not have the tools they require to transform themselves – classical multiproject management approaches fall short.

3. Successful programs are based on five principles and incorporate factors that clearly determine the transformation's success, both in terms of what it entails and how it is accomplished.

Do you have questions or comments?
Our authors would be happy to hear from you.
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