



Executive Insights

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The Future of Retail: Get Ready for the Revolution

Technology is transforming the retail sector. Developments in the pipeline in artificial intelligence (AI), virtual reality (VR) and innovative delivery systems will by 2030 enable dramatic changes in consumer behavior, challenging the economics of many retail business models and rendering some obsolete.

If retailers are to avoid being left behind, they must act now. At present, most view their businesses through the lens of a three-to-five-year strategic planning cycle, preparing predominantly only for the next wave of incremental change within that period. The deceptively slow penetration of digital retail to date, and its uneven impact across the sector, have created a false sense of security. Yet while planning in the medium term, retailers are also making longer-term commitments to retail store networks and format concepts that may prove unsuited to the future of shopping.

In this paper, we explore the technological advances that are changing the retail sector and their likely impact. We look at the prospects for existing business models and set out the questions that retailers must address to prepare for the future.

The slow path to digital

Many retailers have been slow to introduce digital technology. While online shopping channels such as Amazon have sprung up on the back of the internet and mobile technology revolution of

the past two decades, brick-and-mortar retailers have tended to offer digital to supplement existing physical distribution channels rather than to replace them. In part, this generally limited development has been a result of two landmark economic events: in the 2000s, after the dotcom boom and bust, many physical retailers chose to focus on driving in-store sales; and since the recession hit after 2008, they have been forced to cut prices in an attempt to draw customers to stores through a prolonged period of weak consumer expenditure. Cash for transformational investment has often been in very limited supply.

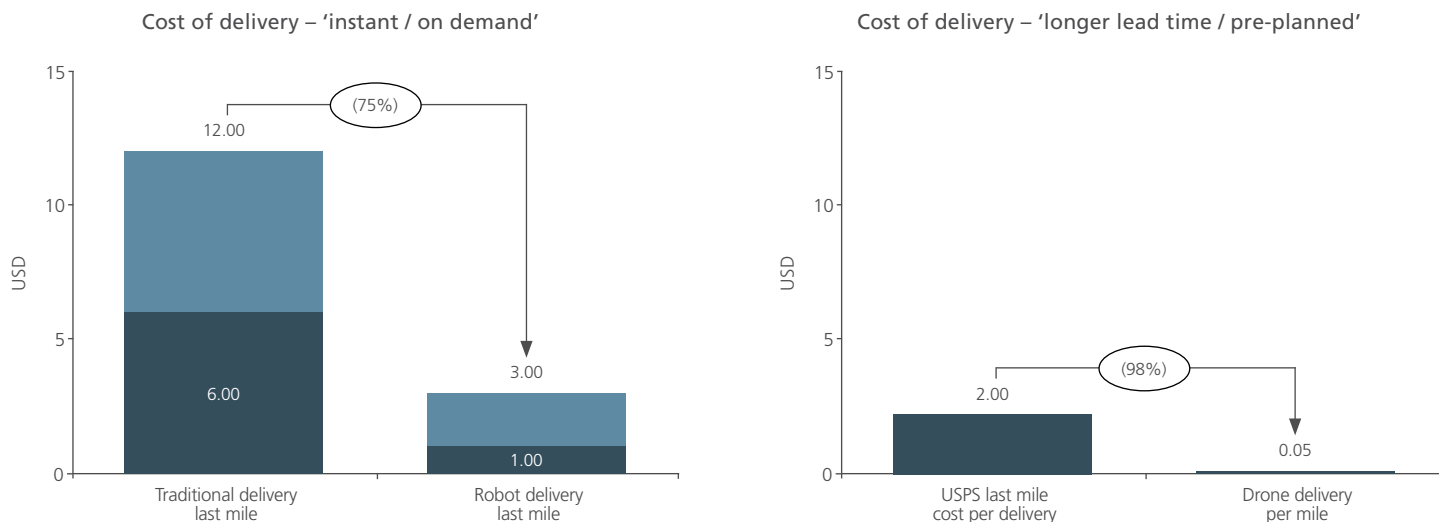
The lack of investment in digital infrastructure is likely to have serious consequences in the long term. Canadian sci-fi writer William Gibson says, "The future is already here — it's just not evenly distributed." This is true of digital retail. Digital retail is already important in electronics and appliances, accounting for almost a fifth (19.5%) of U.S. sales in 2017, according to U.S. Census Bureau data. By contrast, all other major categories are below 10%, including clothing (9.5%), furniture (6.4%) and general merchandise (3.3%). Digital also has only moderate impact overall, accounting for 14.8% of retail spend in the U.S. and 16.8% in the U.K. in 2016. Consequently, a fundamental rethink of business models has seemed unnecessary to many retailers.

However, technological developments will soon make both the experience and economics of online shopping attractive to consumers for a much greater number of categories. This will drive acceleration in the rate of digital adoption, reinforce the scale advantages that the leading ecommerce marketplaces already command, and amplify the significant challenges for businesses across the entire retail sector.

The Future of Retail: Get Ready for the Revolution was written by **Geoff Parkin** and **Dominic Miles**, Partners in L.E.K Consulting's Retail and Consumer Products practice and **Philip Meier**, a Principal. Geoff, Dominic and Philip are based in London.

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Figure 1
Unmanned delivery solutions will dramatically reduce delivery costs



Source: L.E.K. analysis

Technologies that will transform the consumer experience and retailer proposition

We expect two important changes to boost adoption of online shopping over the next few years. Their combined effect will become so compelling that customers will be able to shop without ever needing to set foot in a physical store.

1) The next wave of digital technology

Advances in AI technologies, powered by faster mobile device connectivity, mean shoppers will be able to access near-perfect information whenever and wherever they want. In the U.K., a 5G mobile network is expected to be deployed from 2020, offering a 100x increase in speed compared with the current top-level 4G connections. With superior machine learning algorithms, product selection will become automated, taking into account individuals' preferences and maximizing value for money. The inevitable consequence of this price transparency will be erosion of retailers' gross margins.

The adoption of augmented and virtual reality — driven by innovations such as Microsoft's HoloLens and Facebook's Oculus Rift, and supported by enhanced natural language processing and speech recognition — will also improve the shopping experience, allowing digital systems to offer tangible experiences for the first time. Consumers will be able to "try on" clothes via a virtual model, or set home furnishings in their own homes. As Marc Lore, CEO of Walmart eCommerce, said recently, "[That] is where shopping is headed and it's not as far away as people think."

2) Innovations in distribution and delivery

For many retailers and brands, the cost of delivery has been a significant impediment to take-up of nonstore-based propositions, particularly for those digital shopping baskets with low sales value and / or category margins. This has meant that, for many categories, digital delivery has not been feasible without margin-enhancing measures such as encouraging larger basket sizes, restricting some purchases to click and collect only, or by requiring subscriptions. But new solutions — particularly for the last mile — will cut delivery costs and time frames and progressively enable low-value, small-basket delivery. Shared vehicles in local areas are likely to be the first step, followed by autonomous delivery vehicles. All of these options will make last-mile delivery easier and cheaper, opening up new categories of the retail sector (see Figure 1). In the longer term, retailers and brands (serving direct to consumer) may choose to share warehouse capacity in order to increase utilization and cut fixed costs. This will likely make most sense where retailers have different demand patterns and timings.

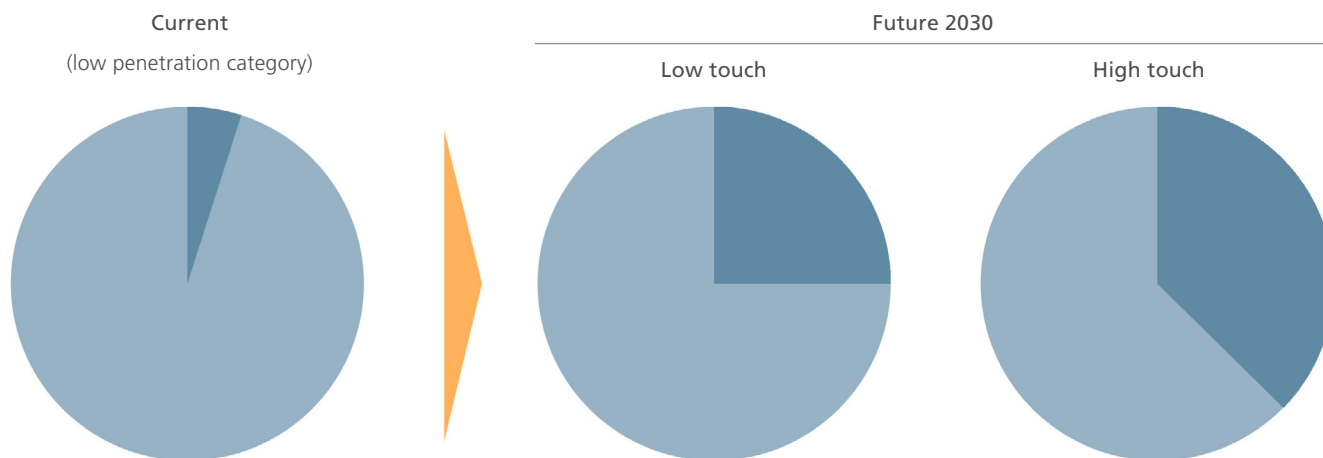
The retail sector will become polarized

This combination of faster communication, AI, VR and new delivery systems will create a tipping point for retailers, boosting digital sales, changing the role of physical stores and forcing a fundamental rethink of retail value propositions. In this new world, retail is likely to polarize into two winning models.

1) Super value: for low-touch products

Scale-oriented digital providers will provide compelling value and convenience in low-touch categories in which consumers

Figure 2
Forecast digital share of retail spend by 2030



Source: L.E.K. analysis

have less emotional involvement. As delivery costs fall, these highly specified commodity products, such as household staples, will see a sharp rise in digital sales (see Figure 2) and a corresponding reduction in physical store presence. Amazon is already simplifying the migration to digital for these goods through its Wi-Fi-connected dash buttons, which allow shoppers to reorder commodities whenever they need them.

2) Experiential: for high-touch, emotionally involving products

High-touch products, such as homewares and fashion, are more experiential in nature. They too will experience migration to digital, driven by the same trends of near-perfect information and improving virtual visualization.

But physical stores will continue to play an important role in order to engage, educate and entertain consumers and to reinforce emotional connection. The store estate, however, will not require such extensive high street presence as we see today. Shopping may progressively concentrate in hubs that offer clusters of category-specific stores in key locations to coax like-minded shoppers out of their homes and offices with a compelling retail and social experience. In this environment, physical stores will take their place alongside digital purchase and delivery solutions.

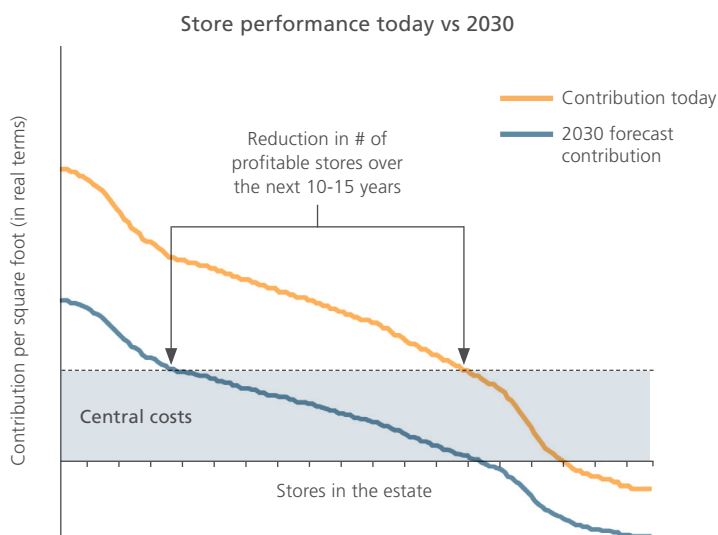
What can retailers do to prepare?

The magnitude of these changes will require a fundamental rethink in retailers' long-term strategies, even in those categories that currently have low levels of digital penetration. In a world where in-store shopping is forecast to fall by 20-30% over the next 10-15 years and gross margins will decline due to increased price transparency, the economics of existing store portfolios simply will not work. Retailers will find themselves with many economically unsustainable stores by the time their leases expire (see Figure 3). They will need to define a new model and a new role for a smaller, more focused store network.

There are four questions that retailers should ask themselves as they build this new model:

- What role do they want to play in consumers' lives?
- How will consumers expect them to deliver this?
- Which parts of the current proposition are fit for purpose, and what is missing?
- How do their supporting capabilities, processes and infrastructure need to change?

Figure 3
Projected impact of digital penetration on current store estate performance



Source: L.E.K. analysis

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Retailers and brands will have to adapt to selling different things in different ways and from a different space. To do this, they will need to better understand why they are relevant to their customers' lives and work to deliver this. An all-encompassing general offer is likely to disappear — except for the Amazons of this world — replaced by either brilliant curation or an authoritative but focused offer.

Conclusion

The barriers that have prevented digital retail from becoming more prevalent are coming down. The timescales for organizational change are long and typically beyond a board's traditional three-to-five-year focus. Nevertheless, the technological advances outlined above will see a fundamental shift in the way the retail sector operates over the next decade.

The changes that retailers need to make to combat the threat cannot be made overnight. As a consequence, companies must act now to make a realistic assessment of how they can adapt to survive the future of shopping.

Further reading

[How Will V- Commerce Arrive? Consumers Show the Way](#)

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