

WHITE PAPER

The Next Normal: Outlook for Australian Retail in 2022

February 2022



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Since the formal declaration of COVID-19 as a pandemic in March 2020, consumers, businesses, and entire industries have grown accustomed to ‘disruption’ as a normalised state of affairs. Australia has been no exception to this rule, and retail as a sector has grappled with a particularly challenging operating environment.

Australian retailers have needed to swiftly respond to evolving consumer behaviour and preferences, disrupted and unpredictable supply chains, shifting operating models, organisational gaps and talent shortages, and inflationary cost challenges, among several more topics.

As we commence 2022 in earnest, our goals in writing this perspective are twofold: (1) to share BCG’s insights on retail-specific trends that will serve to inform the ‘next normal’ and (2) outline the key strategic and operating implications that follow for our clients.

This perspective document only scratches the surface of the trends that are currently unfolding, and how businesses can successfully position for comparative advantage. We would welcome the opportunity to unpack the trends and strategic implications in conversation, together with your leadership team.

Australian Retail in 2022 | Key sector trends

Like other industries, retail in Australia is being hit by a confluence of factors that continue to shift as new COVID variants emerge and in turn consumers, markets and regulators respond.

Despite this volatility, BCG posits that seven key trends will serve to structurally shift (or in some cases continue to shift) the retail landscape in 2022, which are critical for our clients to understand. Refer to exhibit 1 for the full trend overview.

1. New Consumer behaviours post COVID-19 will stick.

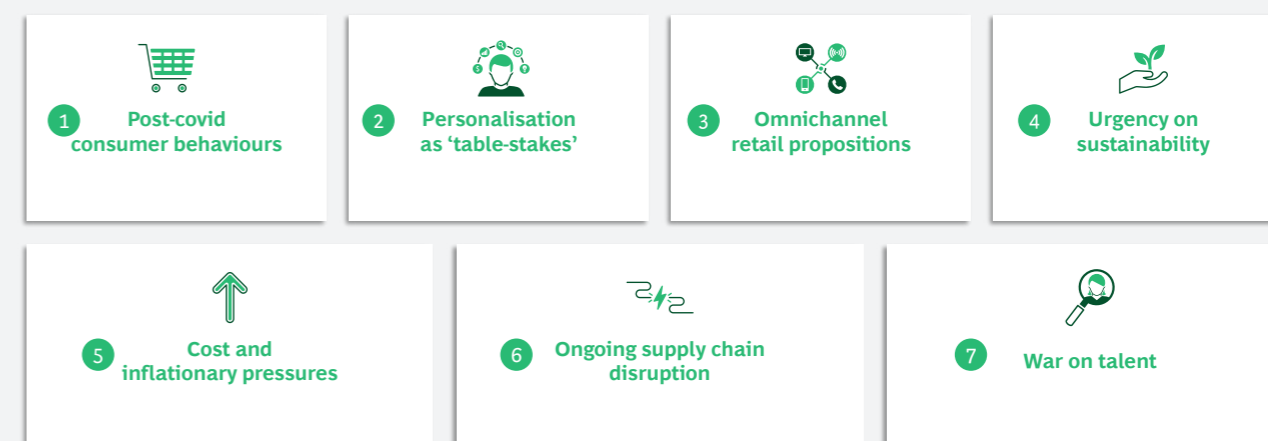
COVID-19 has created many new consumer purchasing behaviours, and in several instances accelerated and cemented the adoption of existing behaviours by 2-4 years (e.g. online share of total retail sales in Australia have reached 15%, which was accelerated by 3 years). We maintain that whilst the pandemic structurally forced adjustments to consumer behaviour, these new behaviours will continue to persist even as the challenges of COVID-19 subside.

Here are a select few consumer behaviours we expect will persist strongly in 2022 (and beyond):

- **Fewer trips, bigger baskets:** Lockdowns, restrictions and general safety concerns migrated customers to

Exhibit 1 - The Next Normal

Seven key trends shaping Australian retail in 2022



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fewer top-up trips and larger overall baskets (+8-15% bigger baskets on average across retail subsectors), with pronounced impacts to grocery.

- **Accelerated and expanded online:** eCommerce transactions as a share of total retail sales were already reaching up to 10% in Australia pre-COVID, but adoption has increased to 15% as of 2021. This phenomenon is expected to continue as more first-time digital buyers join the segment (+22%) and a large portion of existing customers (+88%) are buying more products across expanded categories online.
- **A greater focus on health (and many more category winners and losers):** As the pandemic shifted health and wellness to the forefront of consumer minds, the willingness to spend on holistic wellbeing (across products and services) is expected to significantly increase in Australia; with >20% of Australians looking to expand spending to enhance wellness (including using accumulated savings). For a full list of expanding and contracting categories based up BCG's Australian Consumer Sentiment Snapshot #5, please see exhibit 2.

acceleration on consumer expectations for simplified, clear, excellent value personalisation offers and communication over the past 24 months.

Digital advertising has grown to a \$10B+ industry in Australia, and the proliferation of information and mass-market advertising has heightened consumer frustration and lowered overall engagement with content.

In this context, leading retailers are already 12-24 months into the personalisation journey – as shown in exhibit 3 - with an end-state capability that allows for dynamic, targeted 1:1 offers, experience and communication with consumers – including such capabilities as personalised content and offers, dynamic pricing and promotions, advanced customer insights and identifiers, and real-time range curation. The requirement to invest has become more urgent, with 75% of customers now expecting retailers to understand their individual needs and expectations.

In 2022, the gap between innovative retailers and laggards will widen quickly. In fact, 80%+ of BCG's transformation efforts in Australia today have a focus on digital and customer (incl. of personalisation use cases).

2. Personalisation will become 'table-stakes' within three years.

Personalisation has been a pervasive topic in retail boardrooms and leadership teams for the past three years or more. However, we have observed a significant

Exhibit 2 – Post-COVID winners and losers

Top 10 category winners

- Appliances
- Cars
- Cosmetics/make-up
- Fresh meat, fruit and vegetables
- Health and fitness activities
- Household care products
- Leisure travel
- Spas/salons
- Theme parks/ Cinema
- Women's clothing

Top 10 category losers

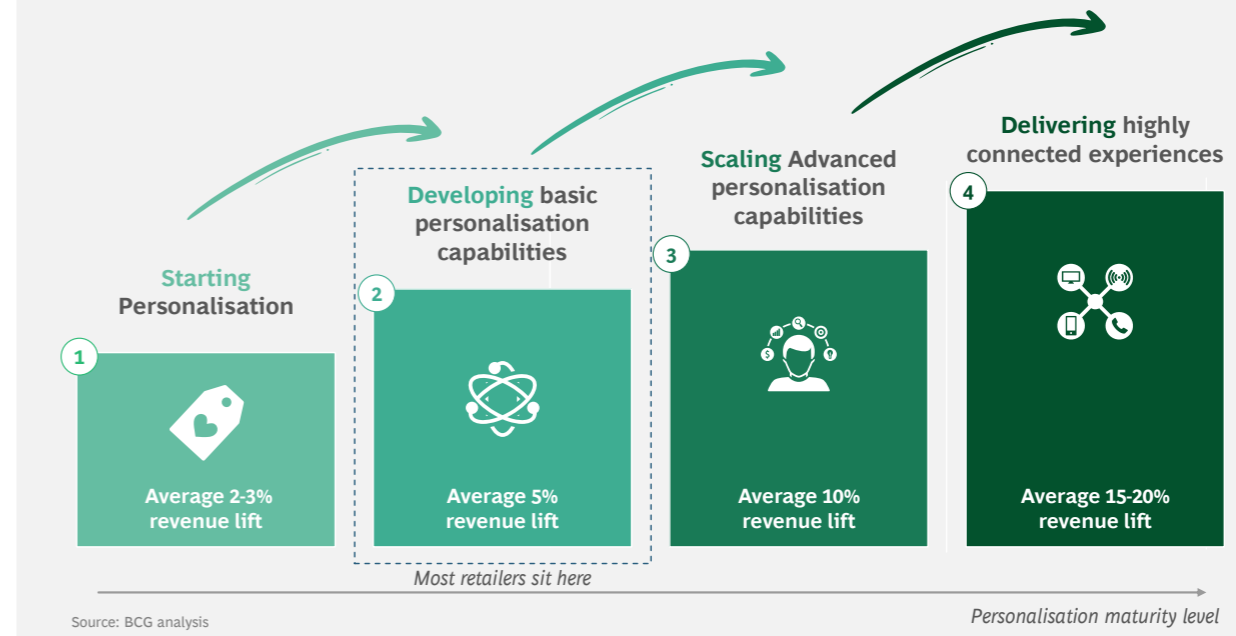
- Alcohol
- Apps & video games
- Business travel
- Carbonated soft drinks
- Chocolates/ candies
- Direct to home services e.g., Foxtel
- In-home entertainment
- Kitchen appliances
- Luxury goods, jewellery, handbags
- Tobacco

Source: Australian Consumer Sentiment Snapshot #5, Oct 27–NOV 02, 2021 (N = 3030 AUS, unweighted, representative within ±3% of census or market demographics)

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Exhibit 3 – Retailers are typically 12–24 months into the personalisation journey



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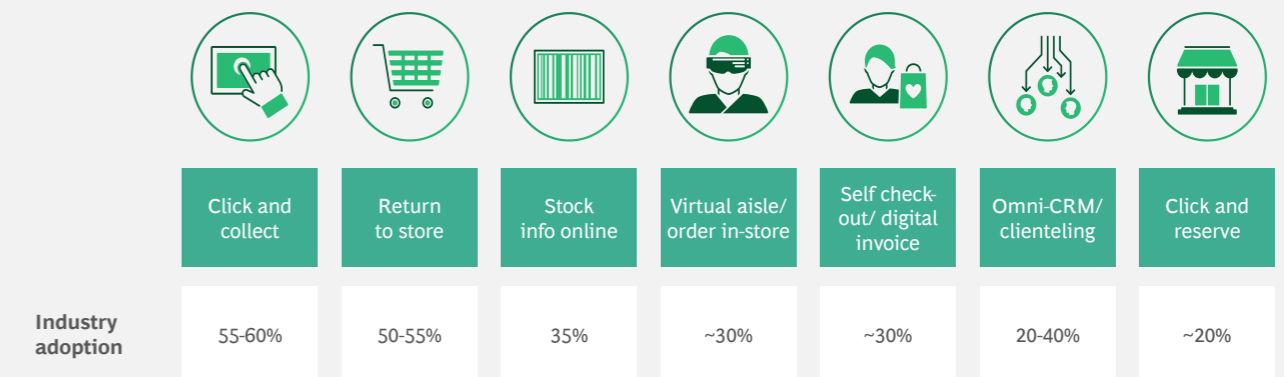
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3. Leading retailers will get the omnichannel experience right.

On a relative basis, Australia has lagged other mature markets (US, UK) on eCommerce adoption and expectations of seamless omnichannel propositions. However, COVID has served to heighten consumer expectations of an integrated online and offline experience, supported by frictionless fulfillment, through click and collect and/or home delivery.

Australian retail has commenced the shift away from a single channel focus to a multi-channel proposition, that helps to meet customers where they prefer to transact (see exhibit 4). Whereas online has typically been an 'add-on' service, up to 65% of retailers are doubling down on effort to deliver a fully integrated experience across branding, offer, communications and value.

Exhibit 4 – Omni-channel proposition and seamless transacting becoming the norm



Where adoption is 'up to date technology in place' or 'started but not finished major upgrade'

Source: "2020 RIS/Gartner Retail Technology Study", RIS News and Gartner; "The State Of Retailing Online 2020", NRF study conducted by Forrester; "Omnichannel in Europe today: Lessons From Leading Retailers", Coresight Research; "Omnichannel Leadership Report 2019-2020", New Store

3

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As omnichannel scales rapidly, we can expect significant flow on effects to the role, format and size of bricks and mortar stores, expanded abilities to leverage deep customer data, and significant reconfiguration of supply chains to cater to channel shifts.

4. ESG agendas will increase in urgency and levels of investment.

ESG agendas will be critically important in 2022, as the pandemic continues, climate predictions gain greater awareness and corporate Net Zero commitments expand in scale.

Australian consumers have increased vocal support for making a positive impact to people and our environment, and >80% convey their willingness to reduce consumption to help tackle climate change and >10% are willing to pay more (see exhibit 5).

The increased discourse on ESG, however, should be approached with a measured strategy. The translation from principled alignment to sustainable consumption into greater willingness to pay is as yet not fully proven, and investments into ESG initiatives (e.g. sustainable packaging) should be measured and staged. It will also be critical to understand core customer segments more deeply, for example ESG initiatives align much more strongly with millennials in Australia, and for repeat purchases segments such as grocery.

5. Rising costs and inflation will drive operating pressures in 2022.

We are already observing rising costs and inflationary pressures in Australia, and this is expected to be a continued theme throughout 2022. Headline inflation in the December 2021 quarter was 3.5%, compared to Australia's 10-year average inflation of 1.9% (see exhibit 6). While this is a moderate rise compared to the 6.9% (annual) increase experienced in the United States, we can expect this to create significant pressure across retail value chains.

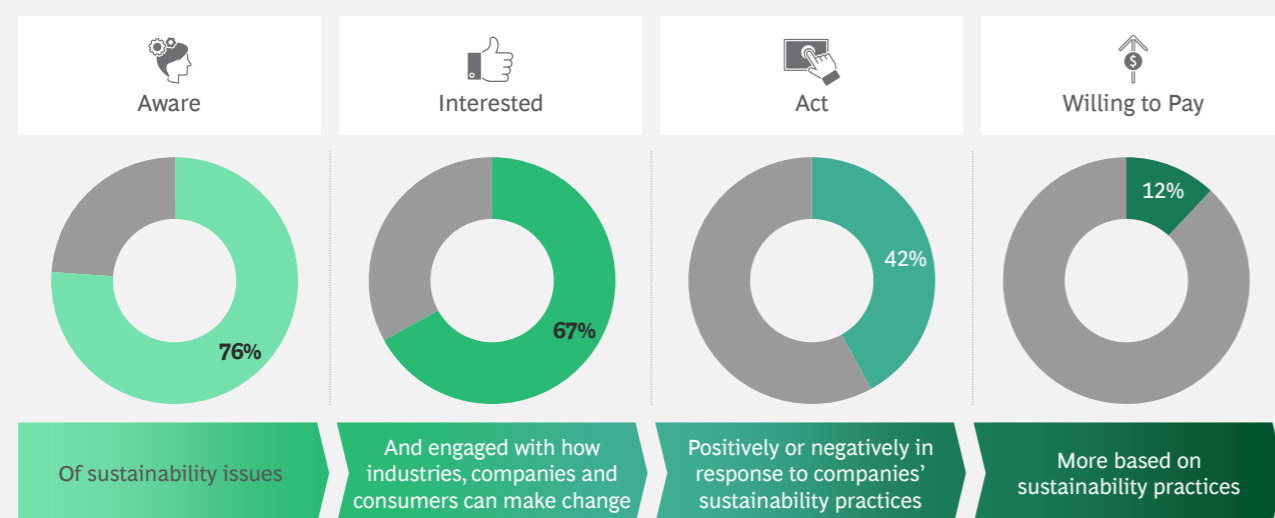
Retailers have grappled with increased shipping costs as overseas container prices have quadrupled in the last 12 months. While we see supply chain costs gradually unwinding as supply and demand imbalances are corrected, we expect shipping costs to remain elevated for most of 2022.

The pandemic has also magnified supply issues, and in turn, supply imbalances. As a result, certain pockets have been impacted by cost pressures, with retailers also burdened by increased raw ingredient and commodity costs. As an example, red meat prices have increased by more than 10% in the September 2021 quarter, and shortages in wooden pallets and aluminium have put price pressure on soft drinks.

Exhibit 6 – Inflation increased by 3.5% in Dec-21 quarter compared to 1.9% mean



Exhibit 5 – Consumers are at different stages of their sustainability journey



Source: BCG sustainability consumer survey, August 2021

6. Supply chain disruptions will persist and drive challenges across the value chain.

The COVID-19 pandemic has triggered significant and widespread supply chain disruptions. These disruptions have been caused by a combination of factors including port congestion, limitations in cargo space, container and pallet shortages, and labour constraints. Service levels have decreased across the entire value chain, with a decrease of up to 7pp on shelf availability at the peak of the pandemic.

Both structural and cyclical supply chain disruptions will endure in 2022.

- **On-shelf availability** – Service levels will continue to be challenged, driven by logistics delays and workforce shortages. In 2022, the Omicron outbreak has already resulted in up to 50% of labour shortages for some of Australia's largest logistics businesses. This created a significant spike in out-of-stocks for retailers across Australia.
- **Working capital** – Inventory and working capital may continue to fluctuate given unexpected demand shifts and supply constraints along the value chain. During COVID-19, inventory fluctuated by more than 10% for many players in the value chain, which has had ripple effects upon retailers.
- **Supply chain complexity** – Supply chains are expected to experience added complexity as e-commerce continues to accelerate in 2022, and retailers will need to diversify their supply base to meet evolved consumer needs.

7. The race to attract and retain top retail talent continues.

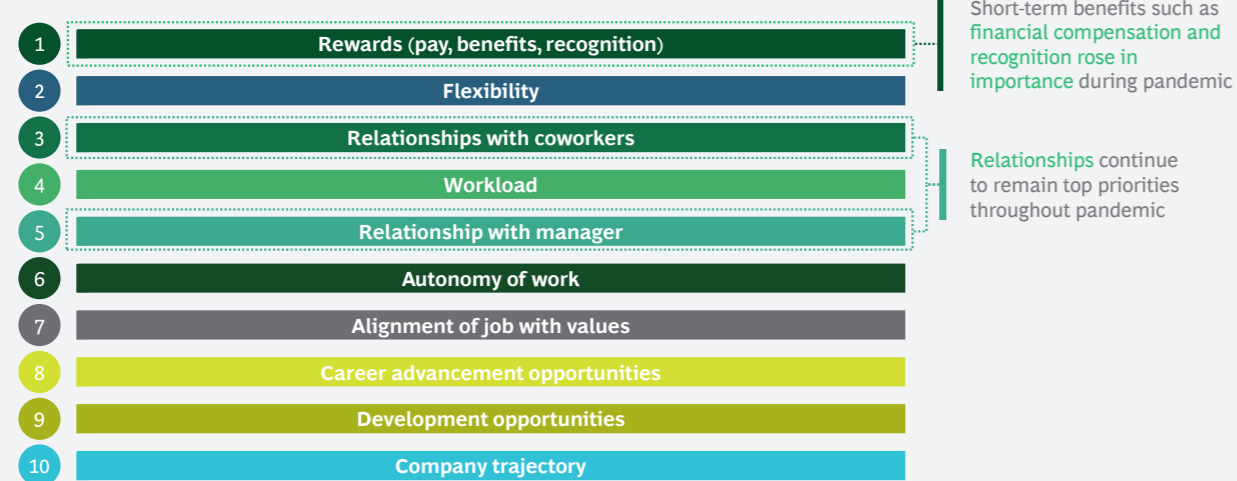
In Australia, COVID-19 has rapidly evolved the workplace, expectations on Employee Value Proposition (EVP) and the relative bargaining power between employers / employees. In 2022, Australian retailers will struggle to attract and retain the best talent, with pronounced challenges in key roles (for example, data scientists and category managers).

Getting the EVP right in 2022 will be essential. Our experience shows that new EVPs must accommodate for and prioritise newly emerging employee preferences (see exhibit 7).

- Other factors matter beyond just compensation: 92% of employees want flexible arrangements in when they work, and 76% for where they work.
- Employees miss their colleagues and in-person activities: 28% of employees miss informal and social interactions, while 23% miss in-person collaboration and brainstorming.
- Employers can gain trust going forward: Over 20% of Australians state the top ways to regain trust are stability and security; good communication, and in-person formal meetings with colleagues.

Exhibit 7 - Employees rank compensation and flexibility as most important

Importance of workplace factors ranked according to a Future Forum¹ study as of May 2021



Short-term benefits such as financial compensation and recognition rose in importance during pandemic

Relationships continue to remain top priorities throughout pandemic

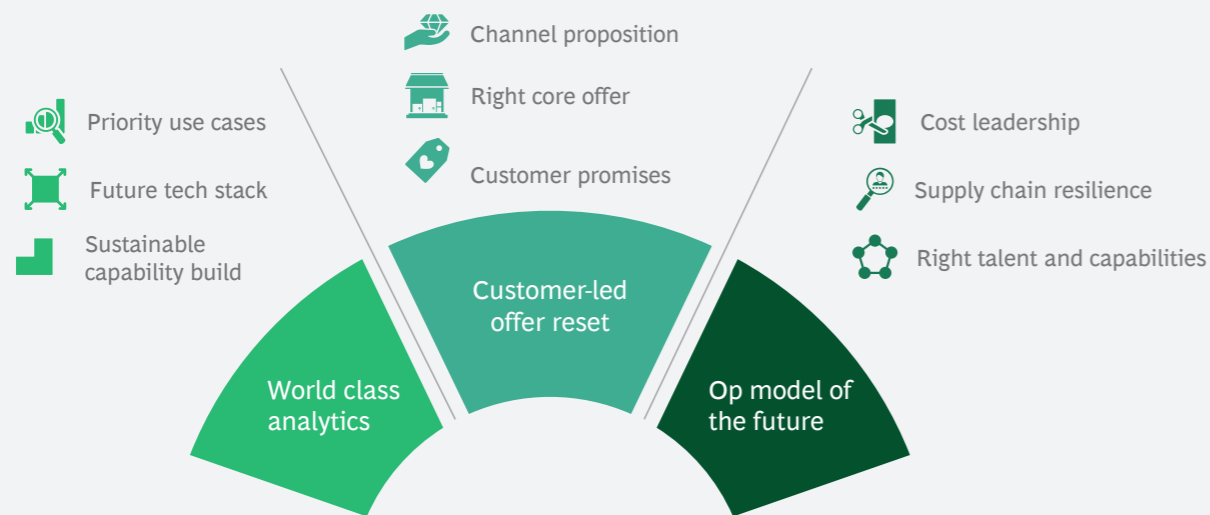
1. Future Forum consortium was launched by Slack and is also led by BCG, Herman Miller, and MLT. Source: Future Forum Pulse Survey, conducted April 26-May 6, 2021. Number of respondents = 10,541 knowledge workers across US, Australia, Germany, Japan, France, and the UK

Implications for Australian Retail in 2022

We expect 2022 will shape up to be a year of continued disruptions resulting in a host of challenges as well as fantastic opportunities for Australian retailers. As we look ahead, it is important that retailers prepare for the 'next normal', think boldly, continuously innovate, and strengthen core operations to adapt to this context.

Naturally, every retailer will face a unique set of strategic, operating and financial questions it must address. However, we posit there are three core topics that it will be critical for all retailers to consider and respond to during 2022: (1) becoming an advanced analytics-led organisation, (2) building a refreshed, customer-led offer and (3) developing a resilient operating model for the future as viewed in exhibit 8.

Exhibit 8 - Three pillars for focus in 2022



World class analytics

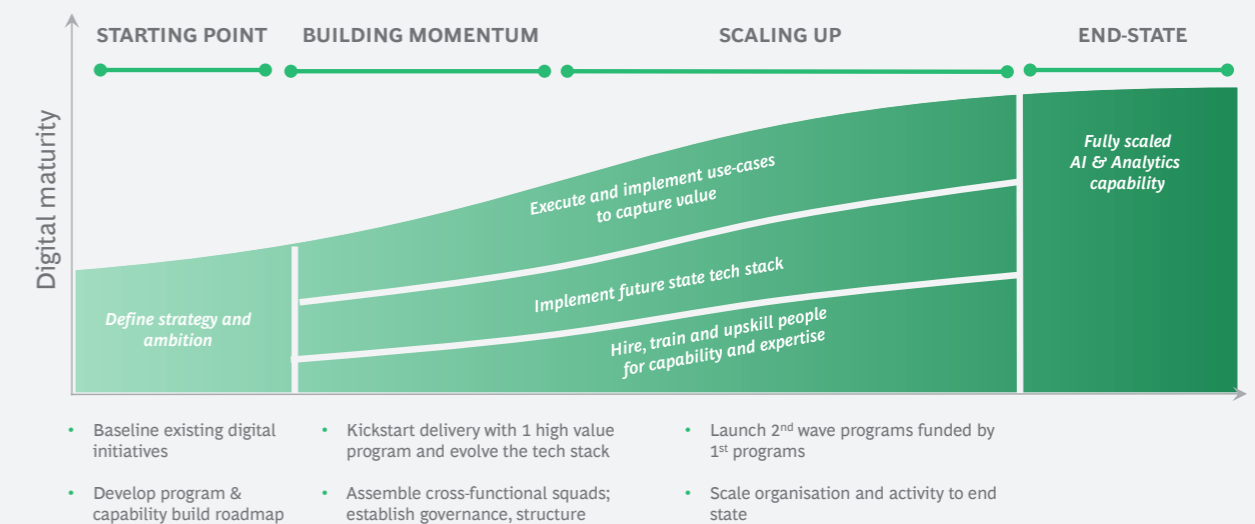
Over the past 3-5 years, Advanced Analytics (AA) solutions have scaled and developed considerably to provide greater processing power, storage, and more mature predictive insight technologies. Together with heightened Consumer expectations and increased eCommerce transacting, this creates the right breeding ground for rapid innovation and capability build.

Leading retailers (globally and locally) have begun investing with urgency into digital transformations, and we are seeing

this first-hand with our client partners. At this stage, this is no longer the territory of 'first movers' but becoming a table stakes investment into future-proofing the business.

As the AA journey requires significant capital and capability builds, the way to 'win' is to start small and iterate. It will be critical to galvanise the organisation around AA becoming central to how decisions are made, and to develop a very deliberate sequence of use cases (aka programmatic efforts) that helps to fund the journey and unlock priority customer outcomes as shown in exhibit 9.

Exhibit 9 – Start small and iterate as a world class analytics-powered retailer



Source: BCG experience; Andreas Lundmark

The AA investment can unlock significant benefits of 10-15%+ sales uplift, 500bps+ margin expansion, 5-10% labour savings (and redeployment), and 15-20%+ increase in supply chain efficiencies. This is compounded further when AA use cases are unlocked across the full value chain: customer experience, category management, upstream operations and in-store execution.

Customer-led offer reset

Customer preferences have evolved much faster than typical BAU assortment review and product development cycles. As a result, many retailers are out of sync with the latest preferences, category winners and losers and they are yet to reset category management fundamentals (e.g. pricing strategies) in response to the shift.

As retailers consider this imperative, we believe there are three core components that require addressing (1) getting the core offer right, (2) building a clear omnichannel proposition that gets products and services to customers, and (3) making and keeping clear customer 'promises' as seen in exhibit 10.

- Getting the core offer right:** 2022 provides a fantastic opportunity to rethink the core offer and build a profitable core business, together with supplier partners. We recommend retailers take a holistic, end-to-end approach to driving Merchandise and Category resets, that looks at white spaces for innovation, range curation, pricing and promotional effectiveness and in-store space and layout. A successful offer

reset can help to drive 5%-7.5%+ sales uplift (without channel expansion) and expand profitability through a more curated range of +250-500+bps. The effort will also help to significantly advance core Merchandise capabilities, data and analytics and core processes.

- **Build the omni-channel proposition:** With a market-leading offer, the growth potential becomes exponential when the right omni-channel proposition is executed. This involves mapping out specific customer journeys (across online / offline) and providing frictionless inspiration and communication,

building mission-led curated ranges across channels, investing into seamless user experiences and investing behind integrated E2E operations (e.g. flexible fulfilment, smart replenishment, etc.). This becomes a multi-year journey, with a specific sequence that aims once again to be self-funding.

- **Make and keep clear customer 'promises':** Lastly, it is important to be clear and simple on customer promises, on such topics as fulfilment and delivery, sustainability, communications and use of information. The nature of specific commitments will vary from retailer to retailer.

- **Right talent & capabilities:** As retailers expand omnichannel offers, add more digital and AA use cases to core processes, there will be a significant in the requires capabilities and talent to run the new organisation. This requires a rapid look now at key roles and functions that will require rebalancing – e.g. the addition of data scientists or eCommerce or user experience specialists. In a talent-constrained environment, this will require longer lead times.

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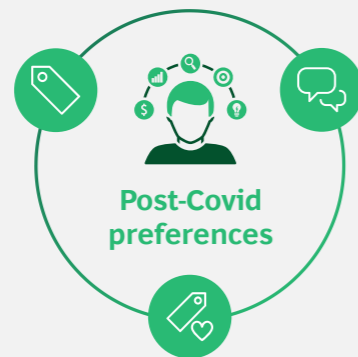


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Exhibit 10 – Build a refreshed, customer-led offer

Get the core offer right

- Capture new white spaces for innovation
- Curate range to meet new customer expectations
- Reset pricing and promotional strategies
- Rethink in-store space and layout in light of changed shopper habits



Build the omni-channel proposition

- Re-map online & offline journeys
- Provide frictionless inspiration & communication
- Build mission-led curated ranges across channels
- Invest into seamless user experiences & integrated E2E operations

Make and keep clear customer 'promises':

- Fulfilment and delivery guarantees
- Sustainability claims supported by action
- Use of data meets customer expectations

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Operating model of the future

We recommend three areas of focus on the future operating model: (1) cost leadership and holistic controls, (2) supply chain resilience and flexible models, and (3) right talent and capabilities.

- **Cost leadership:** Inflationary pressures as well as capital requirements for growth agendas (e.g. advanced analytics, omnichannel propositions) require unlocking funds via cost excellence. This requires a leadership-sponsored shift in cost controls, spanning holistic vendor management programs, setting up cost review processes and analytics (e.g. on commodity prices and vendor contracts), and driving harder on procurement programs, particularly for Goods Not for Resale (GNFR).

- **Supply chain resilience:** In the short term, companies can establish proactive supplier management, active risk management, and expand their contingency inventory. In the medium term, retailers can diversify their supplier base for core items both with regards to suppliers and geography. In the long term, businesses must appreciate and understand all elements of their supply chain, which is where digital supply chains become critical. Control towers – effectively an integrated dashboard of events and information across the entire supply chain - can provide visibility and help companies understand their risks and exposure levels, AI can support simulation and scenario analysis, and digital twins can virtually replicate an entire supply chain. For retailers, visibility is flexibility.

Conclusion

As discussed, we believe several trends will serve to create a disruptive and dynamic environment for Australian retailers in 2022: new and sticky customer behaviours, expectations for personalisation and an omnichannel offer, increasing prominence of the ESG agenda, rising costs and inflationary pressures, persistent supply chain disruptions and a war on top retail talent.

In this context, building a strategy that is bold, favours innovation and addresses the core business profitability is essential. As discussed, we recommend three core areas of focus that it will be critical for all retailers to consider and respond to during 2022: (1) becoming an Advanced Analytics-led organisation, (2) building a refreshed, customer-led offer and (3) developing a resilient operating model for the future.

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