



# FRESH OR FAIL

## SIX KEYS TO WORLD- CLASS FRESHNESS

Grocers are under renewed threat as online retailers ramp up their food options. But traditional food stores still have a vital card to play: freshness. Customers like seeing and experiencing food before they buy it, potentially giving physical stores a huge advantage. In our experience, moving from average to best in fresh food can drive a rise in supermarket revenues of up to 10 percent.

That gain is by no means automatic: Many customers are dissatisfied with grocers' current fresh offerings. So, to take advantage of the opportunity, retailers must optimize the journey food makes "from farm-to-fork."

Exerting control of quality means, first, working with the ultimate suppliers – everything from fruit farmers to fishermen. Crucially, it entails minimizing the time spent at each stage of the supply chain and making sure the products are kept in the right conditions. Temperature control needs to be rigorous and enforced by effective, risk-based quality checks. Retailers can also increase freshness by getting deliveries of the right quantities of food at the right time, so that it spends less time on shelves. In order to do so, retailers need to use the most sophisticated approaches available today, such as demand forecasting based on seasonal fluctuations and customer behavior in individual stores.

Presentation is also a critical element of freshness. Piling fresh fruit and vegetables high may look good but also brings the danger of spoiling if they do not sell quickly enough. So it is better to allocate shelf space according to how well individual items sell by store. Grocers can also generate additional revenue from a dynamic assortment that seeks always to give customers something new to discover.

To implement these ideas, grocers will need to change the way they work internally, as well as with their partners. If suppliers have better access to data from retailers' forecasting systems and advance information about promotions, for example, they can organize their production more effectively to deliver fresh produce and reduce waste. However, these efforts will only work if staff work as an integral part of this process and embody a culture of freshness. Managers need clearly defined best-practice processes combined with intensive hands-on training to make them recognize the advantages of the new ways of working and encourage their staff to follow suit.

## COMBATTING THE ONLINE CHALLENGE

Online retailers of everything from fashion to furniture have reached double-digit shares of their markets. Food is an exception, and many consumers still view online offers with a skeptical eye. A recent Oliver Wyman survey conducted in Europe found that a lack of trust in the quality of products kept 44 percent of the respondents from ordering fresh goods online. Higher prices and inconvenient delivery times also put them off. As a result, online retailers still only have a very modest share of the market – a mere 1 percent – making fresh food perhaps the last bastion of a brick-and-mortar retail competitive advantage.

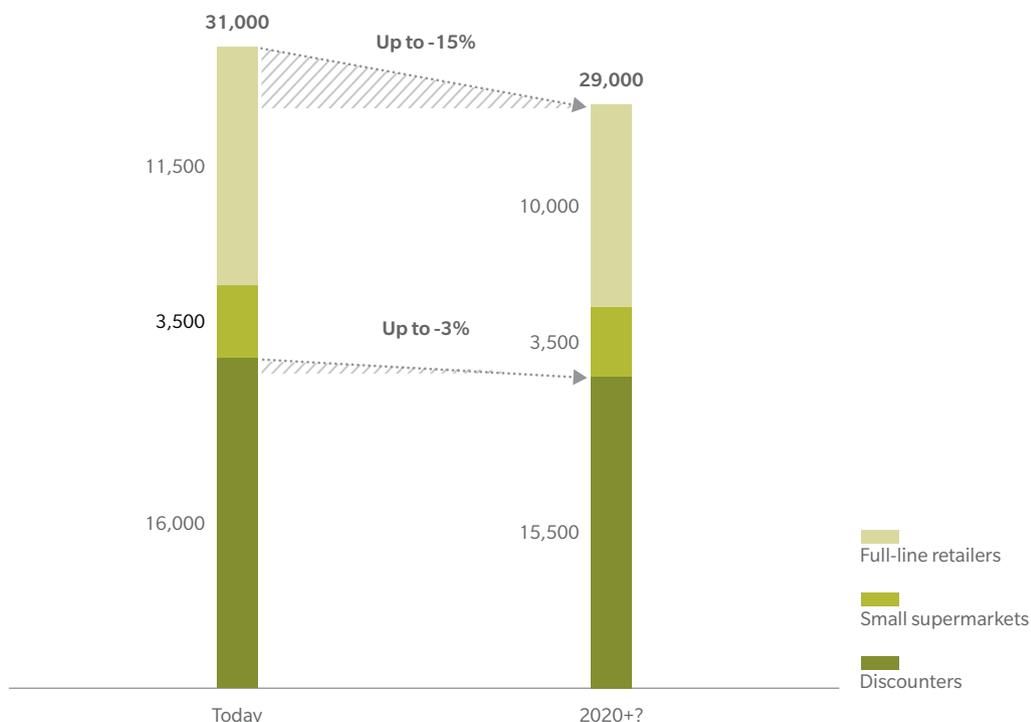
But things can change fast, and online grocers will almost certainly succeed in breaking down such barriers in the medium term. To date, the vast majority of online competitors have focused on dry goods and non-food. Now – led by Amazon Fresh – they are launching an assault on fresh food, with Germany as a crucial battlefield. Amazon launched its first online supermarket there in 2015; today, its prices are scarcely different from those of grocers, even on fresh offerings. Thanks to its partnership with parcel distributor DHL, the internet

giant already offers convenient time slots in a number of German pilot cities. Amazon Fresh will soon be available in other major cities, and achieve extended coverage in the country over the next few years.

What is happening in Germany will soon come to other European markets. And in the United States, it is already a fact of life; with the recent acquisition of upscale brick-and-mortar Whole Foods chain, Amazon is entering the mainstream. By 2020, online retailers' share of the food market could quadruple or more, to between 4 and 6 percent, putting at least 15 percent of full-range retailers' brick-and-mortar stores at risk. (See Exhibit 1.)

Notwithstanding what seems to be an inexorable trend, traditional grocers can fight back, and even thrive, if they play to their natural strengths in fresh. Despite today's digital environment, consumers still appreciate the advantages of shopping in a real store. Sumptuous cheese and meat counters, freshly picked fruit and vegetables, and the scent of fresh bread are still luring customers to grocers week after week. And as long as customers are satisfied with the quality of a store's fresh products, they will be difficult to convert to online. Crucially, these happy customers tend to buy not only more fresh but also more ambient and non-food products – up to one-third more.

**Exhibit 1: Online retail is primarily a threat to full-range retailers' store networks**  
 Food retail stores in Germany: profit simulation based on a 5% online market share



Source: Oliver Wyman analysis

# A SIX-STEP PROGRAM FOR OPTIMUM FRESHNESS

How can retailers achieve a quantum leap in freshness? To date, many have focused on optimizing individual functions such as buying and logistics. For example, buyers tended to concentrate on selecting suppliers to secure availability while logistics staff focused on minimizing delivery cost to stores. Further, stores attempted to manage the balancing act of ensuring availability while minimizing shrink. The result is local optimization of individual functions but a sub-optimization of the system as a whole. This approach tends to yield only gradual progress, not enough in a competitive environment challenged by disruption.

Our experience suggests that a dramatic step forward in fresh performance can only be achieved by an approach whose scope stretches from farm-to-fork; here, the system is optimized rather than just the functional units. We have found that this is the only way in both the short and long term to drive gains.

This journey towards world-class freshness is a significant one, and it consists of six steps. (See Exhibit 2.)

## Exhibit 2: “World-class fresh” requires good teamwork



Source: Oliver Wyman analysis

## OPTIMUM PRODUCT QUALITY UP TO THE SHELF

Fresher products on the shelf have greater appeal to customers, which boosts sales and reduces waste. Optimum product quality is the result of seamless operation along the entire supply chain. To achieve this, strict supplier management, rigorous standards, and effective, risk-based quality checks in the incoming goods department are needed.

For example, for fresh pioneers it makes no sense to keep products at the right temperature until arrival at the store, only to leave them for hours in the incoming goods area or in the aisles at the wrong temperature. But ensuring fresh does not stop at the store. Some best-practice supermarket chains even communicate with customers to inform them on how best to store a product at home so it does not spoil prematurely. The factors influencing customers' experience of product quality are many and multifaceted – coming to grips with them can only be done in an interdisciplinary fashion. (See Exhibit 3.)

## THE RIGHT QUANTITIES AT THE RIGHT TIME

A smarter ordering process with shorter lead times and integrated goods flow control can dramatically increase the freshness of a retailer's products nationwide. This typically requires an upgrade of hardware and software throughout the value chain.

New technologies, including machine learning and recurrent neural networks, are already providing a leap in forecast quality and, consequently, in-store volume planning. These approaches go beyond data on sales at a particular store, and include information such as weather forecasts that can help predict the demand for individual products. (See Exhibit 4.) Order data is fed into an integrated goods flow control system, which integrates information from category management, logistics, and sales.

Speeding up the store's order and delivery rhythms and reducing delivery times almost always has a dramatic impact on freshness performance. If the ordering lead time for meat products is reduced from 36 to 24 hours, these products are fresher on the shelves and waste decreases typically by more than 20 percent. So it makes good sense to have different delivery schedules for different stores, depending on when customers usually shop. Switching deliveries of fresh products from early morning to early afternoon in some stores drives maximum sales readiness at peak shopping hours and, in our experience, can generate more than 20 percent additional revenue.

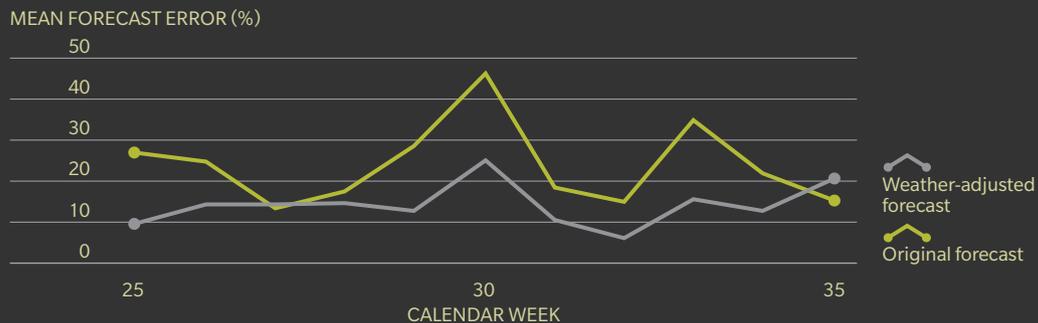
## THE PERFECT ASSORTMENT FOR EACH STORE

Local factors have a significant impact on demand, and grocers are in a good position to take advantage of them. Shops in certain places will face surges on Mondays and Fridays from weekly family shopping trips. Local demographics have a major impact too:

### Exhibit 5: Product quality and freshness needs a multi-disciplinary approach



### Exhibit 3: Accurate weather forecasting can be a key factor in determining success in fresh Impact of weather on forecast accuracy. Example: German Bratwurst



Other success factors include:

- Seasonality and trends
- Holidays and events
- Promotions and price changes
- New and discontinued products
- Cannibalization
- Weather impact

### Exhibit 4: Four key elements enable a “quantum leap in the approach to ranging in fresh”



Source: Oliver Wyman analysis

High-income areas will have a greater appetite for pricier offerings, and, if there is a large proportion of ethnic shoppers in an area, demand for corresponding products will be high.

More important in future, however, will be the insights that big data provides into what people actually want to buy and when. This allows individual stores to arrange direct deliveries of seasonal goods from local farms and suppliers that will make it stand out competitively. A dynamic assortment is exciting and increases the likelihood that customers will discover something new, like it, and come back. (See Exhibit 5.)

The ability to adapt a product range to local circumstances represents a fundamental competitive advantage for full-range retailers versus discounters and online retailers. This is a “trump card” that should not be underrated, and retailers are well-advised to play it more often in individual stores, especially in the fresh goods segment. Typically, grocers have focused primarily on such factors as local disposable income, with mixed success – with good reason. The demand for foods and fresh products is much more complex; understanding and adapting to specific local factors can have a massive positive effect.

## OPTIMUM PRESENTATION

Many fresh managers still stick to the rule of thumb “pile them high and watch them fly”, especially for the presentation of fruit and vegetables. But there is always the danger of a rapid fall in quality at the bottom of the pyramid. Optimum, modern-style presentation starts out by adapting the size of each department and product display to reflect its revenue contribution in a particular store. Appropriate order units can then be introduced, avoiding excessively large batch sizes, which can be a significant driver of wastage. Skillful presentation, on the other hand, can nonetheless give the impression of abundance even when a store has minimal quantities of a product.

## SUPPLIER COLLABORATION, NOT CONFRONTATION

Get together twice a year, fight over commercial terms, then go back to your workplace and continue your own work. Rituals like these between buyers and suppliers are increasingly outdated in a digital age. Our experience is that retailers alone could save billions by increasing the quality of their fresh products through better collaboration with their suppliers.

Grocers need not only to be aware of the extreme fluctuations in demand – and, to some extent, supply – that suppliers face, but also to help them deal with these fluctuations. In the absence of good information on such things as changes in assortments or spikes in demand driven by promotions, suppliers are forced either to maintain high inventory in their warehouses or insist on long lead times for deliveries – understandable, but in both cases freshness and/or availability suffers.

## CASE STUDY

# PHYSICAL OUTLETS HAVE REAL ADVANTAGES – AN OLIVER WYMAN SURVEY

Traditional brick-and-mortar stores have natural advantages over online competitors, a recent Oliver Wyman survey reveals – but grocers need to be careful not to squander their head start by neglecting important details.

We recently surveyed over 1,000 European consumers; the results indicated an enduring affinity for the hands-on experience of fresh food shopping. Not being able to touch and choose an individual product features at the top of the list of reasons not to shop online. Indeed, three out of four respondents indicated this is their most important reason for shopping in brick-and-mortar stores in the future.

In addition, 68 percent of those surveyed placed major importance on being able to take products away with them immediately. (See Exhibit 6.) A lack of confidence in product quality

### Exhibit 6: Reasons why customers continue to buy in supermarkets

Question: “What are the main reasons for you to continue buying fresh goods in physical food retail stores?”



Source: Oliver Wyman survey of 1,000 consumers in May/June 2017

kept 44 percent of respondents from ordering fresh goods online – even more so than higher prices and long delivery times. (See Exhibit 7.) Despite this good news, there were some worrying signs for brick-and-mortar grocers. Better quality and in-store availability – considered by many to be the key advantages for physical stores – appeared to be diminishing in importance. Only one participant in five cited superior quality and only one in ten mentioned in-store advice as a key reason to buy from a brick-an-mortar provider. Most worryingly, more than 80 percent of all customers indicated disappointment with the quality of fresh products at their grocers, even though 58 percent admitted to having bought poor-quality goods. Despite this level of dissatisfaction, only a fifth of unhappy customers actually complained at the store, so retailers are likely to be unaware of the true scale of the problem.

This opens the door for online offers, especially if the quality is convincing. In fact, customers in our survey indicated that they would buy up to a quarter of their fresh food needs on the internet if they felt they could get the same, or nearly the same, quality as is available in supermarkets.

In summary, consumers confirmed that brick-and-mortar grocers are still first choice for their fresh needs. But the head start versus online is eroding.

#### Exhibit 7: Reasons why customers do not order fresh goods online

Question: “What are the main reasons preventing you from buying fresh goods online (again) today?”



Source: Oliver Wyman survey of 1,000 consumers in May/June 2017

By collaborating more closely, retailers can enable suppliers to forecast these fluctuations and organize their production around them. This could be done by letting suppliers have access to data from retailers' forecasting systems or giving them advance notice of promotions. Retailers can also substantially accelerate their processes and, ultimately, improve their level of freshness if they review current quality requirements and controls, and coordinate them with their suppliers.

## EXCELLENT IMPLEMENTATION IN THE STORES

All of a store's efforts to perfect its fresh offering will go up in smoke if employees do not practice a culture of excellence every single day. For the best performers in fresh, this has meant new ordering processes, planograms, and key performance indicators (KPIs), which fundamentally transformed the work of store managers and fresh managers. This has been achieved through comprehensive best-practice programs and intensive hands-on training, ensuring that managers and associates recognize the advantages of the new ways of working and can implement them.

For these freshness leaders, new KPI systems constantly provide managers and their teams with information about the store's fresh offerings, and play an integral role in outcome-based incentive systems. A key lesson has been not to define companywide average targets, because the differences between stores are too great. A better approach is to differentiate targets by store, taking into consideration such factors as the size of the store and its catchment area; fair targets motivate more than impossible-to-reach ones. Such a KPI-based culture can also help to improve performance by creating transparency about which stores are performing particularly well, and transferring their best practices to other stores in the network. A culture centered on quality and customers will benefit everyone with a stake in the supermarket: customers, staff, and the retailers themselves. (See Case Study.)

## CONCLUSION: BETTER FRESHNESS INCREASES REVENUE

Retailers who can persuade customers that their fresh products are of the highest quality will not only find a highly effective way to ward off growing online competition but also have a source of often dramatic incremental revenue and increased customer satisfaction.

The emerging winners in fresh have all recognized the scope of the farm-to-fork challenge, and addressed it in an integrated and multifunctional fashion. They have been rewarded with extraordinary increases in customer satisfaction, like-for-like growth, and margin enhancement. It is a challenging path, but one well worth treading.



