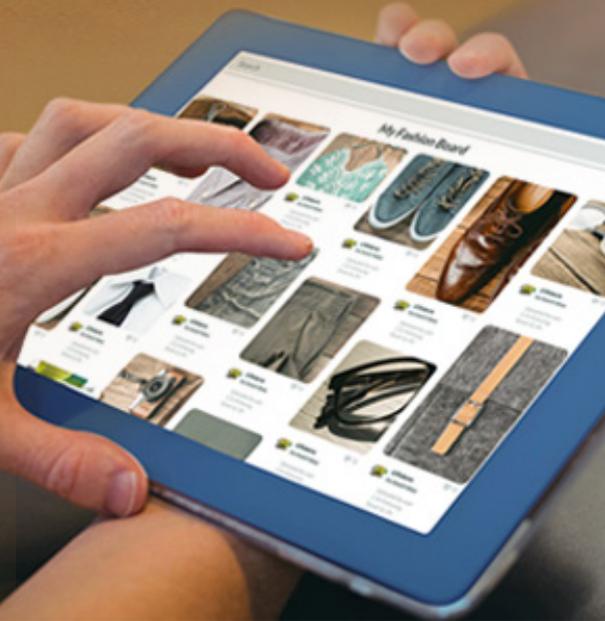




Retailing in the New Reality

Our reflections on the NRF Big Show Chapter 1



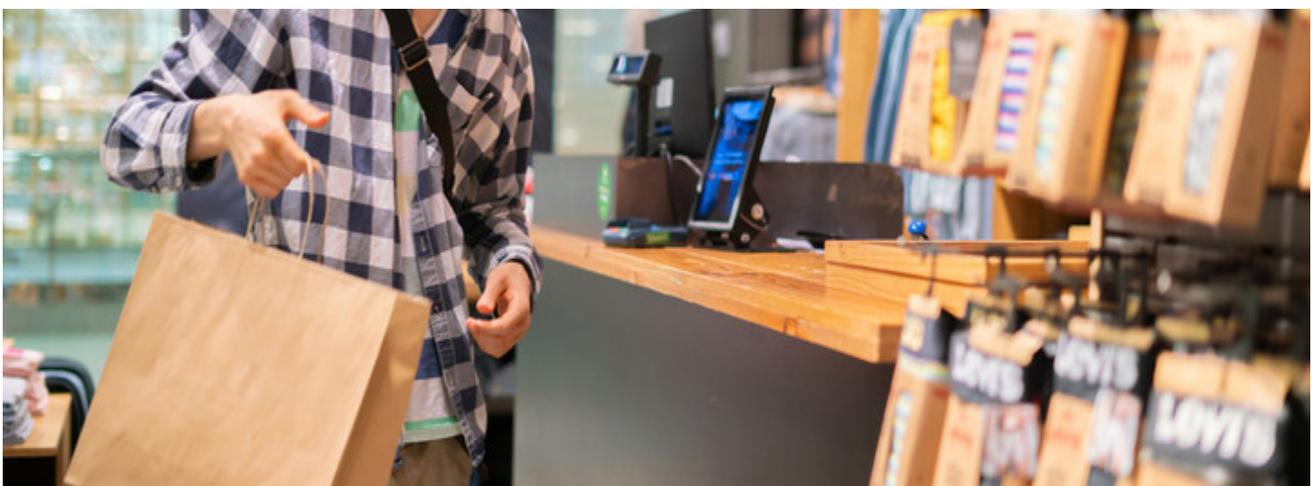
Retail in transition: Exploring the outlook for the sector

NRF 2021 was, in and of itself, symbolic of the times. Held entirely virtually, it was a real reminder of the new world in which retailers now operate. The show was forced to rapidly adapt, virtualize, develop new channels and learn how to engage stakeholders in a new way. Sound familiar?

The agenda was also reflective of the current environment. Some topics (digitization, in particular) had advanced 5 years in the space of months. But what was clear was that everybody was focused on radically accelerating the pace of their transformation while simultaneously dealing with the increased complexity of the everyday challenges of the pandemic.

Many retailers (and their ecosystem partners) are thinking and acting on a range of topics — from business model evolution and managing the cost of doing business through to their relationship with the customer and the impact of values and purpose. Radical solutions may have been few and far between at NRF 2021, but radical ideas were aplenty.

Four main themes are emerging onto center stage for 2021. By and large, they are themes the industry has been talking about for some time now. But the pandemic and the rapidly evolving marketplace has provided a new lens through which to view them.





Business models are rapidly evolving

Retailers have been talking about the death of the traditional retail model for years. COVID-19 has accelerated its demise and nobody at NRF 2021 spent any time mourning; they were far too focused on the urgent need to reinvent themselves.

Many of the presentations and conversations held at NRF 2021 focused on the rapid and dynamic evolution of the relationship between physical and digital business models. On the one hand, there is evidence the two are becoming ever-more tightly integrated as stores rapidly enhance their digital capabilities and start to reinvent their value proposition for a digital-first world. On the other hand, it is also clear that online and physical metrics aren't equal; those strategies that worked in the physical store may help during the transitional period, but they do not necessarily represent best practices in a digital world.

This evolving relationship between physical and digital is playing out through business model transformation and innovation. Changes are being made in real estate utilization: reducing floor space to make room for mini-distribution centers; implementing 'dark stores' for fulfillment and click-and-collect; platform players buying up retail spaces to serve as new regional distribution hubs. This evolution will continue to impact the shift on floorspace usage, suggesting a radical shift in purpose towards showrooming and customer services.

Expect to see a similar shift in labor models. Many will be exploring where employees are now adding value in an increasingly digital world while, at the same time, striving to avoid potential conflicts that are already looming and may collide (if stores serve as pick and pack locations, where should labor be focused and at what times during the day?).

Business model evolution is also being driven by efforts to enhance the value chain — supply chains have started to become 'demand chains' as customer expectations

change and last-mile fulfillment becomes increasingly important. Retailers are having to change their product range, their distribution and inventory models, and their channels to market. They see their value chain as an opportunity to drive innovation, to differentiate themselves with customers, and to create competitive advantage.

Ultimately, the big questions for virtually every retailer are how best to engage with existing platforms and where to engage in partnerships instead of 'going it alone' in their transformation. Retailers now understand they essentially have three choices: to become a platform player themselves; to become a true omni-channel player; or to specialize in smaller niche areas. Each comes with its own unique challenges and rewards.

In a recent piece of thought leadership on the *Future of retail*, KPMG identified the seven types of business models that we believe will succeed over the next 5-10 years. Retailers will need to decide which model (or combination of models) they want to operate in the future or risk their businesses failing.

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'Consumer commerce' is emerging

All signs suggest we are witnessing the evolution of 'retail' into 'consumer commerce' where, increasingly, consumer expectations dictate the model, demand shapes the value chain, and consumer-facing businesses offer products and services without first having proven themselves as a store-based retailer.

In this future 'consumer commerce' landscape, traditional retailers with a heritage in bricks and mortar will compete against businesses with deep capabilities in data, technology and supply chain. In some cases, the only real common denominator between these businesses will be the fact that they all sell products and services to the consumer. Store-based companies will compete against digital-only brands and hybrids alike; there is room for a range of models to succeed and win.

It is clear that pandemic-related shifts in consumer expectations have been influencing business model decisions for many retailers. The immediate tactical necessity in the pandemic was to shift the 'path to purchase' and create or expand BOPIS and BOPAC (that's Buy Online Pickup In Store and Buy Online Pickup At Curbside) capabilities.

Customer experience also required urgent focus in the pandemic, but in many cases remains a work in progress. Indeed, there seems to be a general recognition that, broadly speaking, customers are not yet entirely satisfied with the omni-channel and digital experiences they are receiving today. Missed expectations on deliveries and fulfillment are also creating challenges for some.

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During Target's recent Elevate Conference held in India, Target's CIO, Mike McNamara, talked about the challenges delivering an exceptional and consistent experience to customers across physical and digital assets. For Target, the answer was to build their own systems, capabilities and tools to essentially combine all of their customer data in one place. McNamara admitted that this strategy might not be practical for retailers with smaller IT budgets. For many, partnerships may offer a more viable path.

A number of retailers are also talking about how they use data and analytics to prioritize their customer investments and resources during lockdowns. Retailers remain deeply focused on ensuring their most valuable and vulnerable customers are being properly taken care of throughout the crisis. And they are rapidly harnessing customer data and analytics capabilities to do that. Retailers are also noting and noticing the impact on the customer experience of those who, presumably, were deemed lower priority. The connection between purpose and the evolving 'consumer commerce' marketplace is clear.

The landscape is also being transformed by the shifting expectations of the baby boomer generation. Throughout the pandemic, they have remained the most financially stable. Yet they are also the most concerned about the health risks of COVID-19. Their adoption of digital channels represents a massive change in buying patterns for a key demographic.

Retailers continue to struggle with the implications, scale and pace of this change. Baby boomers have not traditionally been the focus of digital marketing campaigns and customer experience improvement initiatives in the past. Many retailers are now exploring how they might rebalance their allocation of capital and update their digital marketing strategies in order to meet the needs of this demographic.

In KPMG International's report on the *Future of retail*, six key drivers of consumption were identified that are shaping consumer purchasing decisions going forward: value, convenience, experience, choice, privacy, and purpose. Understanding their influence on each of your customer segments will be key.



Making costs sustainable

The cost of doing business may have been an ‘undertone’ topic at NRF 2021. But it featured in virtually every presentation and conversation. The big consensus is that COVID has accelerated and increased pressure on margins; the big question is how to bring them back under control while driving growth.

No matter where you look, costs are rising. Retailers are seeing costs mount in the supply chain, in the labor model, in logistics and inventory management, in IT systems and in health and safety measures. For many retailers, new channels like BOPAC and delivery are loss-leaders; growth in these channels carries a significant cost.

Retailers have also been pouring significant capital into developing, delivering and improving the channels and capabilities they needed to survive in the current environment. Some seem to believe these costs will be somewhat short-term; that investment requirements will eventually decline and economies of scale will enhance margins. Others, however, believe that the current levels of investment are the ‘new normal’; costs will continue to remain high as long as the market continues to rapidly evolve.

In fact, KPMG International’s calculations suggest that — generally speaking — if retailers hope to enhance their businesses’ profitability in the years ahead, significantly more cost optimization will be required. Those retailers deemed non-essential during lockdowns may need to cut costs by 20 to 50 percent. Even those deemed essential through the pandemic will need to reduce costs by 10 to 20 percent of current levels.

Most retailers would say they are already incredibly lean. Many will argue they have no more room for cost reduction. However, based on the sessions at NRF 2021 and conversations with leading industry executives, there are four main levers retail executives should be examining further.

First, they should be rethinking their range and assortment — especially in the physical environment — seeking out opportunities to refine their selection in ways that reduces working capital expenditure and optimizes price and promotion strategies.

Secondly, they should be continuously re-examining their real estate portfolio as the market evolves and progressively realigning their leases to reflect footfall and turnover.

Thirdly, they could be reassessing their workforce, identifying where humans deliver the biggest competitive advantage and reinvesting into the new capabilities (such as data scientists, automation technologies and digital marketing) and the training and development required to reflect their future workforce model.

Finally, retail execs should be looking at their existing Investment budgets to realign where investments are flowing and where the best returns can be had. Historically, the lion’s share would have flowed towards store openings and refurbishments; those looking forward will now be pivoting some of that investment towards technology and supply chain investments.

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Putting purpose at the core

Retailers recognize that their stakeholders — employees and customers in particular — are looking for brands that represent more than just the sum of their products and services. And at NRF 2021, we heard from many retailers who have focused on purpose, values and culture as a way to drive results and enhance resilience.

The range of topics in this space is as wide and varied as the definitions of purpose itself. Some are focusing on ESG (climate change in particular) activities and initiatives. The circular economy is also front and center: H&M, for example, is showcasing their support of Garment-to-Garment initiatives seeking to develop a viable garment recycling industry; IKEA is highlighting their efforts to consider the full life-cycle of their products and services.

While perhaps somewhat mundane in comparison, discussion of the incredibly important aspects of ESG such as reporting and accounting must also be highlighted. Many companies and countries are making impressive commitments to achieve 'net-zero' carbon emissions within the next two decades; everyone from investors and bankers through to regulators and customers want to know that the numbers can be trusted.

What is clear is that retailers and their executives are feeling the pressure mounting on all sides. Yet the demand from customers for purpose cannot be understated. Customers care deeply about a brand's stance on key issues: nearly two-thirds of consumers in a global poll conducted in 2018 said they would decide to either buy or boycott a brand based solely on its position on a social or political issue¹; passion for purpose has only been enflamed since the pandemic arrived.

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(CSR) agenda, brands with purpose demonstrate their commitment to that purpose in every action and interaction.

Senior executives — CEOs in particular — have found themselves in the spotlight. Indeed, customers are keenly interested to know their retailers' positions on a range of very important (yet often rather sensitive) topics. CEOs can no longer be silent on issues such as diversity and inclusion, racial inequality, and tax reform (occasionally, even on the electoral process). CEOs don't just need to be running a great retail business, they also need to be changing the world at the same time.

NRF 2021 demonstrated that purpose has broad meaning and can unlock significant value. Some attendees seemed to view the issue as a 'perfect storm' of interests combining at the same time; KPMG professionals prefer to see it as a 'perfect opportunity': an opportunity to engage customers; an opportunity to motivate employees; an opportunity to drive value with stakeholders; and — most importantly — an opportunity to make a difference in the world around us.

¹ Edelman News and Awards, 'Two-thirds of consumers worldwide now buy on beliefs', 2018



Want to learn more?

The NRF 2021 was spread over almost two weeks, covering hundreds of topics and sub-topics. For most attendees, it was a lot to take in and — even though it was a virtual event — it helped shape the conversation around the issues that should matter most to retailers.

To continue the conversation and to explore any of the points we have covered in more detail (and the potential impact on your organization), we encourage you to contact us.

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