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2023 retail industry outlook

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Introduction

Retailers should embrace the changing consumer and consider strategic investments that could enable profitable growth during inflationary times

Change can be good, but constant change can be daunting. Retailers today are feeling the hangover of such volatility occurring in the most condensed time frame of any recent business cycle. Retail executives are preparing for the tides to shift again in 2023 as the reality of economic headwinds, geopolitical strife, a rapidly changing consumer, supply chain disruptions, and lingering labor issues come into play. As we head into the new year, only one-third of retail executives surveyed are very confident about maintaining or improving profit margins in what are expected to be turbulent times.[1]

Of course, many of their top concerns are beyond their control. Notably, nearly all executives surveyed expect inflation to pressure their profit margins. Six in 10 respondents expect inflation to raise operating costs, and while passing higher prices on to consumers has been the norm, many question how long they can continue the trend. These retail executives are also predicting hard times for consumers, with nearly all anticipating diminished consumption in 2023, resulting from rising financial concerns.

In addition, many retailers face difficult year-over-year comparisons from nesting preferences during pandemic lockdowns that created a strong durable goods cycle. Other retailers benefited from government stimuli and consumers returning to work and school and are now left forecasting and providing guidance based on trends that can be difficult to decipher, if structural or episodic.

But the retail outlook is not all gloom and doom; retailers have learned much about resiliency in the past few years. Massive demand fluctuations during the pandemic forced retailers to rethink archaic systems in favor of more pliable operations. Seemingly overnight, retailers rolled out health and safety protocols and established omnichannel capabilities. And they learned that rapidly evolving consumer preferences require more effective analytics and tools to build loyalty. If anything, the past few years should give executives confidence in their ability to weather the next storm.

The work for executives in 2023 is to advance the innovations created during the pandemic: to drive more profit from the curated experiences, last-mile options, and conveniences that retailers rolled out—all at a time when the purse strings may need to tighten.

To check the pulse of retail executives, we asked 50 leaders about their expectations regarding challenges and opportunities in the upcoming year. We wanted to better understand what traits separate leaders from the rest of the pack and analyze planned strategies and investments for 2023. The results provide a unique outlook on how today's market, future expectations, and changing consumer needs inform strategies for the year(s) ahead.

Economic outlook for the retail industry

A note from Deloitte US Economists Danny Bachman and Akrur Barua

Three key economic trends will likely influence retail sales.[2]

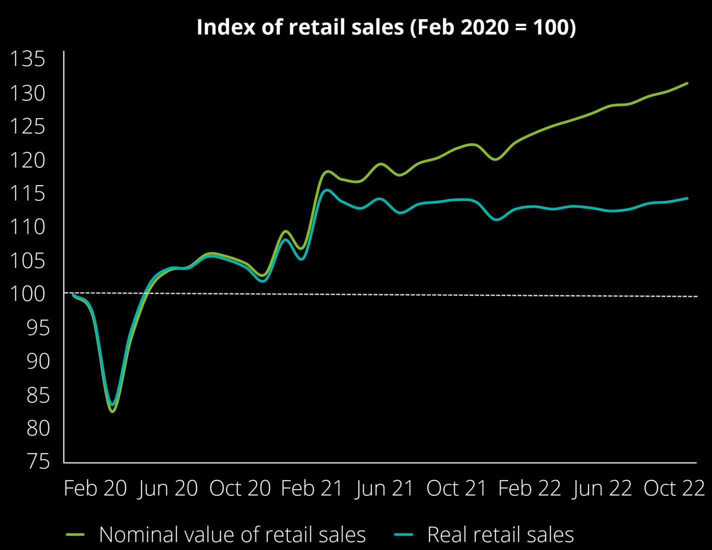
First, a slowing economy will keep retail sales growth in check.[3] In our baseline scenario (55% probability), we forecast GDP growth to slow to 0.9% in 2023 from an estimated 2% in 2022 and 5.9% in 2021.[4] A relatively healthy labor market will, however, continue to boost sales. And there is a significant chance that a recession would make things much worse. In the event of a recession (which Deloitte rates at a 35% probability), the economy would contract, and unemployment would rise. Such a turn of events would likely hit consumer and business demand harder than expected, thereby denting retail sales.

Second, inflation has lowered consumers' purchasing power, despite gains in nominal income due to the strong labor market. Even though nominal average weekly earnings have increased by 8.3% since December 2020, real earnings have fallen by 5%.[5] This will weigh on consumer demand and, hence, retail sales volume. Rising prices, however, will raise the nominal value of retail sales. Figure 1 shows nominal retail sales and real retail sales[6] since February 2020, with the two series diverging since March 2021 due to the impact of inflation.

While nominal sales have risen 11.7% since March 2021, real sales are down by 0.7%. Also, high home prices and rising mortgage rates will dent demand for housing, thereby affecting sales at store types that include building materials dealers and furniture and home furnishings.

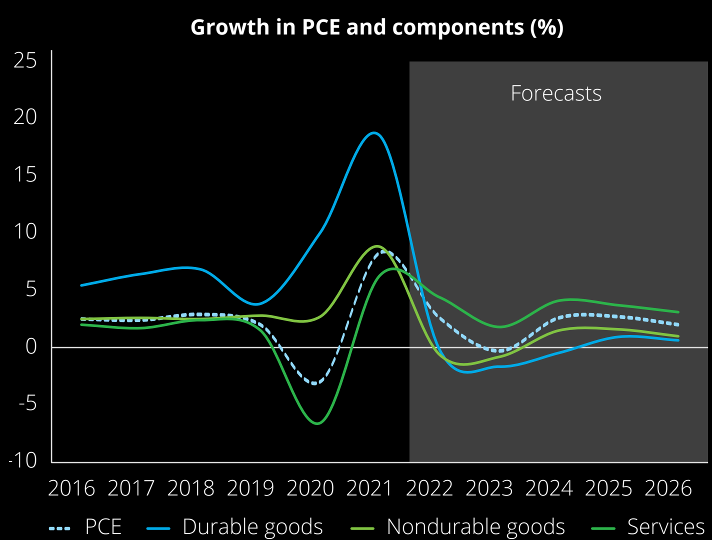
Third, consumer spending[7] on services has been picking up steadily as consumers return to bars and restaurants, take vacations, and enjoy sporting events as they did before the pandemic. To some extent, consumers are dipping into their savings to make up for what they missed during 2020 and 2021. The personal saving rate is now at 3.1%, much lower than pre-pandemic levels. A shift in spending to services will therefore weigh on retail sales at stores selling consumer goods. However, the transition to services is expected to provide some tailwind to food services and drinking venues. Overall, we expect real personal consumer expenditures (PCE) on durable goods to contract by 1.8% in 2023. In contrast, services PCE is expected to rise 3.6% in 2023, according to our baseline scenario (figure 2).

Figure 1. While retail sales volume is slowing, nominal value of sales has gone up due to inflation



Notes: The data is seasonally adjusted. Real retail sales are calculated by adjusting nominal sales with headline inflation.
Sources: United States Department of Commerce; Deloitte Services LP economic analysis.

Figure 2. Consumer spending in durables is expected to contract by 1.8% in 2023



Notes: Forecasts are by the Deloitte US Economics team.
Sources: United States Department of Commerce; Deloitte Services LP economic analysis.

A challenging environment

A changing relationship with consumers

As noted in the economic outlook, shifting consumer behavior will likely weigh heavily on retailers in 2023. And other consumer transformations will likely compound the issue.

Retailers' role in the consumer journey has changed. The pandemic accelerated a trend already in motion: Consumers expect the best price in the most convenient way possible. To compete, retailers have rolled out the actual (and virtual) red carpet, offering fast last-mile services like curbside pickup and same-day delivery, personal shoppers, fit predicting tools, and payment plans. And retailers have met consumers where they are—from traditional brick-and-mortar stores to metaverse storefronts and everywhere in between. So, it may come as no surprise that customer acquisition and retention costs are rising. Even before the pandemic and discussion of the metaverse, acquisition costs increased by more than 60% between 2013 and 2018.[8]

This situation could become more problematic in 2023. Nearly all executives in our survey say consumers will expect a seamless shopping experience across channels in the upcoming year. But they expect consumers to be significantly more price-conscious, making consumers more likely to shift from source to source, powered by peer recommendations and price comparison shopping as they go.

Two-thirds of surveyed executives expect price to be more important than brand or retailer loyalty, a potentially troubling predicament when investors are pressuring retailers to push price increases.[9]

Over the next decade, consumer sociodemographic shifts are expected to occur at an unprecedented rate creating ever-expanding and diverse needs and desires. The emerging consumer is getting older, more obese, multi-ethnic, gender-positive, sex-positive, sexual-identity authentic, mobile, more digitally reliant, and less financially secure (see figure 3). They also have higher expectations for companies to uphold higher ESG (environmental, social, and governance) and DEI (diversity, equity, and inclusion) initiatives.[10] In a 2021 study, three-quarters of Gen Z said sustainability was more important than brand when making a purchase decision.[11] As the consumer transforms into a complex mosaic of unique needs, wants, and preferences, it may be an important moment of adaptation for an industry built for mass production, distribution, and marketing. Nearly all executives surveyed felt the changing consumer would be a key challenge for the foreseeable future.

Figure 3. The changing consumer

Wealth distribution

Middle class holds less wealth than top 1% affluent Americans[12]

A millennial at age 40 has ~20% less net worth than a boomer did at the same age[13]

Non-white Americans' buying power increased from 13% to 19% from 2000–2020[14]

30% of the nation's wealth is held by 0.25% of US households[15]

Rising obesity

4 in 10 US adults were obese in 2020, compared to 3 in 10 in the late '90s[16]

Falling birthrates

US birthrates have declined 19% since 2007; 2020 witnessed the lowest number of births since 1979[17]

Population

The population of age 65+ grew by more than one-third in the past decade[18]

Increasing diversity

As of 2018, 48% of 6- to 21-year-olds were non-white, versus 39% in 2002[19]

Simply put, retailers are getting squeezed from both sides of the value chain—from demanding, price-conscious consumers to increasing operational and supply chain costs. As the industry deals with these immediate constraints, it also feels additional pressures from three hot-button issues:

- **Organized retail theft:** Retail theft grew 22% from 2018 to 2019, accounting for $61.7 billion in losses.[20] Some retailers have noted the problem has worsened during the 2022 holiday season and has gotten so dire that costs to cover lost products and security may require closing doors or raising prices.[21] As many experts anticipate an economic slowdown in 2023, it would not be surprising to see an even further increase in organized theft. Citing the 2008–2009 downturn, experts noted that retail theft sees an uptick in times of economic stress.[22]
- **ESG:** Six in 10 executives surveyed said the industry will face increased scrutiny over ESG decisions in 2023. However, when push comes to shove, many retailers say they will choose to focus on margin enhancement opportunities. More than half are planning minimal to no ESG investments, and the topic did not make the top five list of executive priorities. With only 26% of 250 leading global retailers making commitments to carbon reduction based on Science Based Targets,[23] they (and the world) may not be able to afford these initiatives being on the back burner for long.
- **Labor issues:** Seven in 10 executives surveyed said labor was the number one challenge heading into 2023. As of November 30, 2022, 879,000 retail jobs remained unfilled.[24] Hiring and retaining employees has been a lingering issue, and competition for hourly workers remains fierce, with retailers forced to offer higher wages and more flexibility. The 12-month moving average of median wage growth for low-skilled workers increased by 6.7% in November 2022, up from 3.8% the year prior.[25]

Lessons from leaders

Retailers don't expect a one-size-fits-all solution to uncovering profitable growth in this environment, but we wanted to investigate whether top-performing retailers exhibit any common behaviors.

A financial analysis of 100 retailers during the past three years found several key enablers for solid growth during the pandemic that put them in preferred positions.[26] Pre-pandemic investments in e-commerce, expanding omnichannel capabilities, and optimizing portfolios to manage costs were all common traits of outperformers.

While most also benefited from the pandemic-induced demand, many are now facing tough year-over-year comparisons and a consumer base shifting from goods to services. For example, one retailer recently announced it was experiencing a slowdown with big-ticket discretionary items as it lapped difficult year-over-year comparisons but benefited from sales of consumables and travel services.[27]

Given these macro consumer shifts, sell-side Wall Street analysts are painting a bleak picture for the industry. Of the top 10 performing companies we examined, only three were predicted to have EPS growth over the next three years.

For those retailers that analysts expect to be top performers going forward, exposure to relatively resilient segments and strong balance sheets have bolstered their sentiment. In addition, meaningful progress on key long-term strategic initiatives to create efficiencies is seen in a favorable light:

- **Supply chain** – Investing heavily in fulfillment capabilities
- **Omnichannel** – Heightened focus on the customer experience and tapping into loyalty programs
- **Digital** – Improving the margin profile of their e-commerce capabilities

Leaders have prioritized areas for moderate to major investments
Unlike laggards, which are planning for minimal to moderate investments across areas, leaders tend to prioritize investment in areas such as marketing and merchandising, omnichannel capabilities, digital transformation, and supply chain.

Leaders vs. laggards

We see these themes echoed when we examine leaders with self-reported top-line and operating margin growth expectations in our survey. Leaders tend to be data-driven and can swiftly respond to the changing consumer. They prioritize investments in marketing and merchandising, omnichannel capabilities, digital transformation, and supply chain. Given that many leaders are confident in their company's ability to successfully execute business strategy and maintain or grow margins even in turbulent times, their methods may act as a road map to a more profitable future.

Executive Survey: Identifying leaders and laggards

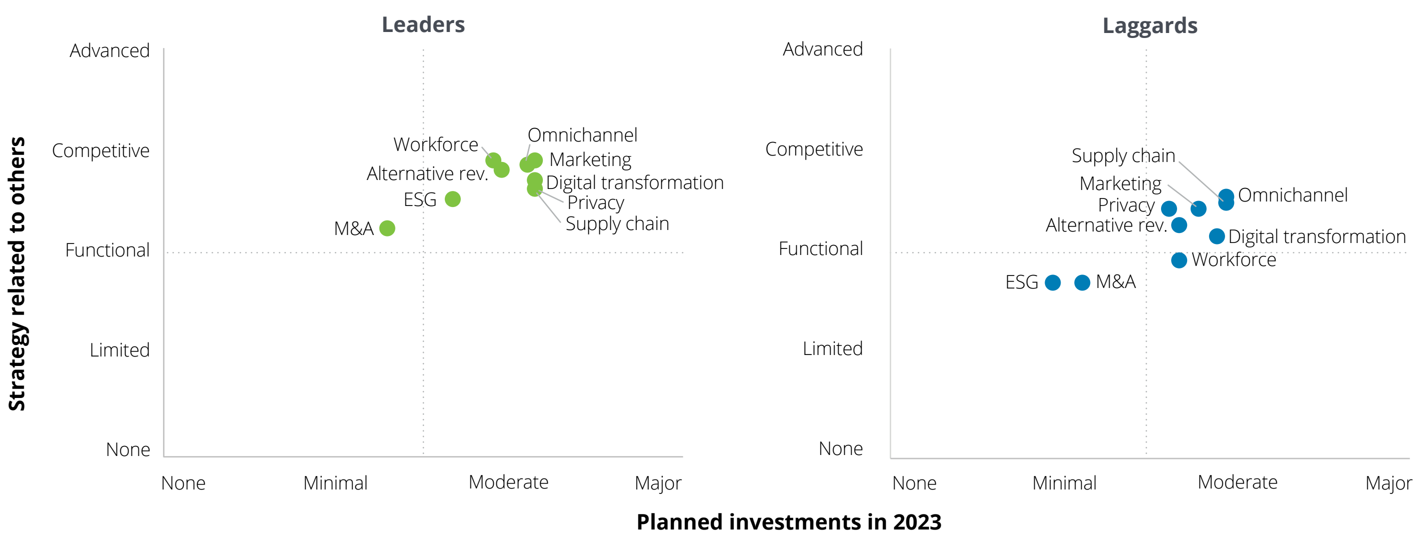
For every respondent, we assigned scores for their responses below.

1. **Confidence** in their organization's ability to **execute** its business strategy successfully in 2023
2. **Confidence** in their organization's ability to **maintain** or improve profit margins in turbulent times
3. **Expectations** about their company's year-over-year **revenue** growth in 2023
4. **Expectations** about their company's year-over-year **change** in operating profit margin in 2023

Based on their aggregate scores, we split the sample of 50 respondents into three groups: Leaders (n=21) have the top one-third of scores, Laggards (n=18) have the bottom one-third of scores, while the remaining comprise the middle (n=11).

Figure 4. Strategy† vs. investment‡

Position on chart indicates average^Δ across executives



Source: 2023 Deloitte retail outlook executive survey.

† Question: For the following strategies, please assess how advanced your company's strategy is relative to others in your industry.

‡ Please choose the answer that best describes the size of the financial investment your company will make in the following strategies in the upcoming year (2023). Note: N=50.

Δ Averages are based on scores assigned; Strategy = None (0) to Advanced (4); and Investments = None (0) to Major (3).

Imperatives for profitability

The confluence of obstacles retailers face can make the next steps daunting. As such, we believe there are three key areas that retailers can—and should—consider now to help create efficiencies while addressing the changing consumer: last-mile capabilities, reverse logistics, and social commerce.

Supply chain: Last-mile capabilities

The news hit in November that the pandemic-induced backlog at California ports had finally cleared, more than two years after it had begun.[28] But supply chain problems persist. Several retailers announced that inventories were heavy heading into the holiday season[29] as they worked through delayed shipments. In contrast, others warned of holiday shortages caused by zero-COVID policies that closed factories in China.[30] Given the continuing struggles, seven in 10 executives surveyed said supply chain disruption will impact retailers' growth during 2023. That leaves only three in 10 very confident in navigating supply chain disruptions in the year ahead.

At the other end of the chain, retailers struggle with a shift in consumer expectations and digital preferences that may create a need for multiple last-mile solutions. As retailers look to solve inefficiencies, eight in 10 executives said they plan to make moderate to major investments to modernize their supply chain in 2023.

Last-mile guzzles profits

During the pandemic, demand for fast last-mile deliveries soared, and retailers obliged, often offering free services and shipping to offset a lack of in-store sales. For example, curbside pickup during the holiday shopping period more than doubled from 2019 to 2020 and held steady in subsequent years.[31] Free shipping was ubiquitous, but clawing back offerings now is proving difficult; more than half of consumers will bail on their basket when notified that they are responsible for shipping fees.[32]

As these preferences for conveniences remain, retailers are left grappling with high-touch (e.g., picking, packing, and processing) transactions that are often unprofitable. Compounding the problem is that retailers may owe fees to third-party vendors that support the shopping journey with services, such as fit-predicting tools, product viewing technology, and financing. Companies pay more to grow their revenue in these channels, which, in turn, shrinks their profits, all at a time when consumer spending will likely contract.

Retailers are in a tough spot as nearly all executives surveyed say consumers will expect faster fulfillment in 2023, but rolling back services that have become table stakes could hurt loyalty. Given the severity of the problem, it may be time to consider enticing nonprofitable customers to shop in-store while reserving the best services for loyal shoppers with large cart values. This could entail retailers offering in-store coupons or paid memberships that include last-mile perks. For example, one large retailer with a same-day membership service is seeing sales growth with the service, despite a minimum order threshold.[33]

Seven in 10 leaders say they are very confident that they will be able to deliver a seamless experience to consumers across channels, compared with only two of 10 laggards. To do so, retailers should consider creating more profitable last-mile delivery solutions by investing in automated micro-fulfillment centers (MFCs). MFCs can increase storage capacity and throughput rates, fill orders for multiple stores, and create efficiencies by freeing up employees who otherwise would be picking orders. In addition, MFCs can expand the range of same-day and next-day services retailers can potentially reach.[34]

Omnichannel: Reverse logistics

Changing consumer preferences for omnichannel services fueled by e-commerce have created headaches for reverse logistics. Consumers' inability to see, feel, and try on merchandise causes much higher return levels than in-store purchases (30% vs. 10%).[35] Compounding the problem, nearly half of consumers say they make "bracket" purchases, ordering multiple sizes and colors to find one item that works.[36] The business of merchandise returns is massive. It accounted for $761 billion in annual lost sales for US retailers alone in 2021.[37]

Nearly eight in 10 executive leaders from our survey foresee enhancing the omnichannel experience as a top growth opportunity in 2023, compared to half of the laggards. Executives should look at their reverse logistics systems to create frictionless transactions to reduce loss and save sales. As reinforced above, this also should be managed in the context of margin protection.

Understanding why returns happen in the first place can be a critical first step. Better analytics can help retailers understand the products, reasons, and processes that drive returns online and in-store. In turn, retailers can gain the ability to provide accurate product information online (e.g., sizes, images, and descriptions) while integrating tools to allow for more precise product representation (e.g., augmented reality). Such capabilities will likely be critical with the changing consumer. For example, when products are visualized in 3D, there is a 40% reduction in returns.[38] And AI (artificial intelligence), as part of an improved analytics system, can also help with fraudulent returns by identifying trustworthy customers and speeding up repayment times.[39] These tools together not only save costs but also significantly impact the customer experience.

Make returns frictionless

Retailers should embrace returns and exchanges, making them a marketable capability by simplifying them for all customers. A good return policy coupled with easy and quick processes can be essential, as shoppers are more likely to be loyal to a retailer with easy returns.[40] As consumer conveniences become table stakes, the time allowed for returns should meet customer expectations and be competitive but also encourage speed to prevent seasonal expiration. Retailers should create processes by which customers can self-serve and receive prompt refunds, such as conditional credit, to avoid costly customer service calls that cost upward of $5 each.[41]

Save a sale

Every return can be an opportunity for retailers to save a sale, whether it's by suggesting comparable products online or using in-store returns as an opportunity to engage the customer. It seems like a simple offering, yet providing exchanges online is an advanced capability not offered by many retailers. Allowing guests to exchange online purchases without having to return items first and then place a new order reduces costly touchpoints that can surpass product value. For example, a retailer's net profit is typically up to 5 cents for every dollar in sales. However, a return can cost a retailer 15–30 cents for every dollar in handling.[42] Using data analytics to suggest a replacement size, color, or even a new style further supports a frictionless experience and may help save sales transactions.

Retailers should also look to take advantage of in-store reverse logistics capabilities. In-person returns satisfy customers' desire for immediate credit while reducing expenses for mailed return delivery. They have the added benefit of allowing for staff engagement, creating opportunities to show similar styles or suggest high-margin items. And with the growing popularity of return bars—stores that pack and ship returns for partnering retailers—there is an opportunity to drive additional store traffic and expand the footprint of their client base, an ideal situation during inflationary times. Recent data suggests that retailers participating in return bars save more than 20% in processing costs.[43]

Figure 5. Reverse logistics recommendations

- Offer **exchanges** for online purchases
- Issue **conditional credit** upon carrier pickup
- Provide **in-person** return options
- Use electronic solutions to **simplify return processes** for stores and fulfillment centers
- Use **blockchain** to track transaction and return history
- **Sell returned items** at markdowns instead of incurring costs to move them to distribution centers
- Consider becoming a **return bar** to drive additional store traffic
- Hedge against **shipping volatility** by using multiple vendors

Digital: Social commerce

As retailers take stock of the changing consumer, six in 10 executives foresee strengthening digital commerce offerings as a top growth opportunity. Specifically, many see opportunities around social commerce, with six in 10 expecting consumers to purchase products directly on social media platforms in 2023.

Executives see social influencers as an opportunity to acquire micro-segmented consumers as demographic changes lead to new needs, desires, and preferences. Another appealing factor is that digitally native generations are gaining more purchasing power and showing up in significant ways with social commerce. For example, 60% of Gen Z and 56% of millennials planned to use social media as part of their holiday shopping journey in 2022.[44]

Creating brand loyalty and profitability

Investing in this channel now is particularly attractive as social commerce may have cost efficiencies for retailers in customer acquisition and retention, among other ways. For example, paid social media search advertising can reduce acquisition costs, given the targeted nature of the advertising.[45]

Collaborating with influencers can produce efficiencies as well. The average consumer is more willing to trust a brand if they see it advertised by a creator they already know within the real world. The trust, interest, and love toward their favorite creators transfer to the brand.[46] When brands partner with the right creators, they can gain access to potential consumers who can be acquired, sidestepping a significant element of the brands' marketing work.

In addition, instead of trying to be omnipresent on all social channels, retailers can leverage the set base and community that creators have developed across multiple social platforms. Given the perks of the platform, seven in 10 executives surveyed expect retailers to collaborate with social media networks and influencers to benefit from growth in social commerce. It's such a promising channel that more than half of leaders and laggards agree that consumers will increasingly purchase products directly on social media platforms and acknowledge the strong growth prospects of social commerce in the next five years.

Social strategies for success

The cost of acquiring a new customer can be up to six to seven times more than retaining old customers,[47] and social commerce can help reinforce existing customer loyalty. Retailers should invest in technologies to provide a seamless purchasing experience within social channels and shoppable media to nudge users toward purchases and create loyalty. Enabling shoppable tags with product information, embedding the brand website into the social media app, and enabling in-app transactions can help reduce friction on the shopping journey. This can help users quickly identify and purchase products within a few clicks.

Loyalty toward influencers can translate into loyalty toward brands. Unfortunately, this extends to influencer controversies. To hedge against such risks, brands should build a real strategy involving diverse influencers from different walks of life and geographies that reflect the changing consumer.

Figure 6. Social commerce trends on the rise

Digital adoption

- **94.4%** of millennials are smartphone users, and **37%** are smart wearables users, as of 2022[48]
- Average time spent with digital media increased from **6.8 hours** per day in 2019 to **8.1 hours** in 2021[49]
- In 2022, **43%** of Americans used a buy now, pay later (BNPL) service, up from **31%** in 2021[50]

Social media influence

- Average time spent on social media increased by more than **60%** in the past decade[51]
- **61%** of social media users trust influencers, while only **38%** trust brand recommendations[52]
- **32%** of Americans have made a purchase on a social media platform in the past year[53]

Summary

Despite the spate of bad economic news, the keyword among retailers is resiliency.

They've done it before—not too long ago, during the worst pandemic-related lockdowns and shortages—and they can do it again. Market challenges will always be a factor, and retailers are learning that they cannot rely on traditional cost-cutting alone to navigate the latest downturn. Instead, retailers should examine how they've been most productive in recent years, honing omnichannel, supply chain management, and digital commerce to protect margins and aim for profitability in the future. And the real X-factor is the rapidly evolving consumer. Ensuring the consumer experience is at the heart of investments may be the key to prospering when the dust finally settles.

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Endnotes

1. This survey was commissioned by Deloitte and conducted online by an independent research company from October 21 to October 31, 2022. It polled a sample of 50 retail industry executives, of which 70% were from companies with annual revenues of $10 billion or more. The respondents included C-suite and senior executives who were directly responsible or exerted significant influence on major strategic initiatives in their organization.
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    Criteria 1: Nine retailers featured in the top 30th percentile across the following metrics:
    - 3-year TSR
    - 3-year average ROA
    - 3-year EM-productive

    Criteria 2: 13 retailers featured in the top 30th percentile across the following metrics:
    - 3-year revenue growth
    - 3-year EBITDA margin

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