



CONSUMER SPEAKS

New Rules: Challenges and opportunities for the retail industry

- Moderator:** • Sam Loughry
- Guest speakers:** • Lupine Skelly and Jonathan Rothman

Sam
Welcome to Consumer Speaks, a Deloitte podcast series, where you'll hear industry specialists share their perspectives and insights on emerging topics impacting the consumer industry. I'm Sam Loughry, the leader of our Consumer Industry Audit & Assurance practice of Deloitte & Touche LLP. Today I'm joined by Jonathan Rothman, US Retail, Wholesale & Distribution Audit & Assurance leader and partner at Deloitte & Touche, LLP, and Lupine Skelly, Retail, Wholesale & Distribution research leader and manager at Deloitte Services LLP's

Consumer Industry Center. Today, we'll be discussing the 2021 Retail Industry Outlook and how executives are addressing retail transformation and critical investments to make this year and beyond. Thank you both for joining us. Lupine, as one of the contributors of the Retail Industry Outlook, can you tell us about this year's report?

Lupine
Sure, and thanks, Sam, for the opportunity to share our findings with your listeners today. To start, I wanted to give a little background about the report and how it

unfolded this year. Our Retail Outlook¹ is an annual report that addresses current and upcoming market challenges, and we also like to identify opportunities we see in the marketplace. This year we interviewed 50 retail executives and 15 of our subject-matter specialists, and really the takeaway was that COVID accelerated trends that were already taking shape in the industry, and it became apparent that the traditional thinking and rules about retail were no longer at play in this environment. So, we identified four key areas where executives told us the largest investments will be taking

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place in 2021, and then provided context on new ways to approach them. Those areas include digital investment, supply chain integration, health and safety, and cost realignment. In our findings,⁴ it was very apparent that the industry is bifurcated right now. In most cases, those retailers that were deemed essential businesses are in a much better position than those that were forced to close. So, the specific action required to address those four investment areas will differ by company, but I think the bifurcation of the market will only define where a retailer has to act first.

Sam

So, Lupine, one of the most discussed topics coming out of the pandemic is digital acceleration, so I'm not surprised to hear that it made your list. As the demand for digital engagement increases, what do retailers need to consider?

Lupine

Differentiation will be key. While having a digital touchpoint might help retailers meet minimum consumer expectations, retailers should differentiate themselves as customer acquisition costs continue to rise. In the e-commerce space, it's not just competing with other retailers anymore. You've got digitally native companies, subscription models, and consumer product companies all vying for the same consumers. So, a few ways retailers can differentiate themselves is by first creating connection and convenience to the right portfolio of digital assets. Many shoppers want to mix and match their channel journey based on convenience needs, leading to a growing opportunity for new customization expectations and cross-channel avenues, such as reverse logistics. Secondly, driving the potential of data to predict and react quickly. The panic buying spree of 2020 and the resulting whiplash effect on supply chains exposed several weaknesses in retailers' data analytics capabilities. Nearly half of executives⁴ said they plan to use better analytics in 2021 to improve decision-making. The third suggestion would be to meet shoppers' privacy concerns with clarity and transparency. Only 5% of consumers

ranked the retail industry as a top three industry for data privacy, compared with 63% for banks. These issues have come to the forefront again, as pandemic-driven contact tracing and the gathering of health data by employers have brought attention to data privacy once again. And then finally, seeking out digital-savvy talent. More investments and incentives will likely be needed to attract top-tier versatile talent, especially as competition for digital skills is already quite intense.

Jonathan

Sam, if I may add to Lupine's earlier point about subscription models, these models, and even the formation of new partnerships and alliances to create a profitable digital omni-channel, have also been accelerated by the pandemic. For example, mall operators continue to announce the acquisitions of struggling retailers. This preserves jobs and guarantees mall occupancy levels. An interesting partnership example involves a mass merchant retailer and a direct-to-consumer company. This partnership enhances the power of data and allows both companies to share it. It gives the retail of the direct-to-consumer data it has on loyal e-commerce customers and allows the direct-to-consumer company to better measure sales of one brand to multiple brands, thus better assessing trends and competition. Another example of the partnership model was recently announced where a big box retailer superstore and a telecommunications company are currently collaborating to add 5G capabilities to retail locations. The increased connectivity is intended to help the big box retailer implement digital health solutions, adding a new source of revenue, and the telecommunication company benefits by demonstrating to other companies the value of 5G technology.

Sam

Jonathan, thanks for the additional insights and examples. Lupine, one of the things that the disruption has exposed was inefficiency in the supply chain. How are retailers addressing this area in 2021?

Lupine

Retailers understand the importance of being able to react more quickly to consumers' needs and realize they should be more resilient and agile. Our study revealed that eight out of 10 executives⁴ expect moderate to major supply chain investment in 2021. Order fulfillment, such as last-mile delivery and curbside pickup, will see the heaviest investments, followed by warehouse management and procurement. Given the disruption during the pandemic, it will be important for retailers to build back confidence by considering focusing on four areas. So, the first would be winning the last mile, which will require moving beyond the doorstep. Consumers will push for more contactless formats and last-mile delivery solutions for immediate needs. And what's interesting is that in our Global State of the Consumer Tracker,² we found that at the beginning of the pandemic, consumers were seeking out these contactless formats because they were safer, but now they're choosing "BOPIS," which stands for buy online pickup in store, and curbside pickup because it's faster and cheaper than delivery, indicating that this trend is here to stay. And given the demand for these contactless formats, there are certainly opportunities for retailers to offer new services, such as porch pickup and curbside returns. Our second recommendation is to fortify every link in the supply chain. To be a trusted destination, retailers should have clear visibility into their supply chain networks. Incorporating much-needed transparency into the supply chain is viewed as important by more than half of the US retail executives in our survey.⁴ Our third point is that retailers need to drive decisions through the consumer lens. Many digital channels still struggle to demonstrate profitability because they're often bolted onto systems still dominated by human analysis and reaction. If deployed correctly, tools such as AI could create efficiencies throughout the business and the supply chain. And finally, retailers need to focus on resiliency measurements. Based on lessons from recent disruptions, retailers should measure how these investments drive supply chain resilience. Eight in 10 US⁴

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retailers view measuring resiliency as increasingly important. Without such measurements, retailers' supply chains may be vulnerable to future disruptions, rendering these current investments obsolete.

Sam

In addition to witnessing trust issues with supply chain, there's been increased concerns around health and safety. Jonathan, what investments are retailers making in this priority area?

Jonathan

It is imperative that retailers build consumers' trust in this area. According to a recent Deloitte study, only 23% of consumers ranked the retail industry as trustworthy and 56% were anxious about shopping in stores.³ Executives are aware of consumers' concerns, and a majority of the ones we surveyed plan⁴ to make moderate to large investments in health and safety in 2021, with three-quarters investing in sanitation and barriers, while a third plan to invest in employee testing capabilities. To build trust with the consumer and to make the most from investments, it may be important for retailers to infuse health and safety throughout operations. This means going beyond standard sanitation practices to make shoppers and employees feel safe about the physical space. This could include scheduling alternative work shifts or using dark stores to pull buy online, pick up in store purchases in order to have fewer people in the aisles. And secondly, embrace technology and redesign the retail journey. Contactless shopping will likely remain an important purchase driver, and retailers should use their investment to differentiate themselves by improving store safety. This could include having 3D virtual showrooms, mobile and express returns, carts that act as a checkout, and cashier-less stores, all allowing a retailer to differentiate and stand out from competition.

Sam

Thanks, Jonathan, that takes us to the last priority area noted in the study, which is cost realignment. What should retailers bear in mind as they take this on?

Jonathan

Heading into 2021, the retail industry was already in a depleted position with heavy debt burdens, slower asset turnover, and increased competition. In fact, our analysis found "EBIT" (earnings before interest and tax) for the retail industry as a whole has been in decline for the past several years. COVID-19 has compounded retailers' financial problems, with margins becoming even more compressed as consumers shift online. New rules of profitability will likely require fresh ideas. Retailers can explore alternative ways to engage the customer, such as utilizing showrooms instead of bearing the heavy burden of stores. Showrooms can be set up temporarily to test markets or introduce new audiences to your brand, or it can be permanent setups to encourage customers to consistently interact with your products and place orders. An example of this is a luxury department store, which has created a new concept of service hubs, where customers work with personal shoppers and products are sourced from other locations. While this may also increase payroll, the personal shopping experience may bring in new customers that prefer the one-to-one service over browsing the shelves themselves. Retailers can also develop alliances. A great example of this is a department store chain that has established a partnership with the largest e-commerce retailer and a fitness center. These types of partnerships not only create ways to increase foot traffic, it enhances the operational efficiency of the department stores. Another idea is to redesign the talent model. For example, work-from-home platforms can allow retailers to rethink how they attract, retain, and elevate top talent. And lastly, another thing that retailers need to consider are accounting changes that might impact them, which include sublease arrangements for alliances; revenue recognition issues, such as gross versus net; costs related to potential staffing reductions; possible changes in cash models for showrooms, e-commerce conversion, and store alliances, which can impact segment reporting and impairment considerations. So, Sam, as you can hear, there's a lot of ideas retailers can incorporate. I'm looking forward to all changes on the horizon in 2021.

Sam

Jonathan, I'm looking forward to 2021 as well. Lupine, I understand your team is releasing a retail profitability report in the spring. Can you tell us what our audience can expect?

Lupine

Sure. Our findings in the Outlook really brought to life how a convergence of factors are affecting retailers' abilities to drive margin expansion. Everything is indicating that compressed margins are here to stay, unless retailers rethink their path to profit outside the core model. We're exploring what approaches retailers can take to transform their businesses, such as anticipating evolving customer needs and behaviors, understanding transformation, success factors in other sectors, and delivering new platforms through transformed business models. So, keep a lookout for that report. It will be published by Deloitte Insights on May 24.

Sam

Great, thanks, Lupine. Well, that's the time we have for today. I wanted to thank Lupine and Jonathan for joining this discussion. As we noted, retailers in 2021 are faced with more consequential decisions than at any time in the recent past. The old playbook and rules will have to be thrown out and bold differentiated actions will be required to stand out from the competition. We hope today's insights will help your business adapt to the new retail environment. For more consumer insights and the full 2021 Retail Outlook report, please visit our website at deloitte.com or email me, sloughry@deloitte.com. Thank you for listening to Consumer Speaks, sponsored by Deloitte Audit & Assurance business. Until next time, take care.

Endnotes

1. <https://www2.deloitte.com/us/en/pages/consumer-business/articles/retail-distribution-industry-outlook.html>.
2. <https://www2.deloitte.com/us/en/insights/industry/retail-distribution/consumer-behavior-trends-state-of-the-consumer-tracker.html>.
3. https://www2.deloitte.com/content/dam/insights/us/articles/6890_holiday_retail/6907_2020-pre-thanksgiving-findings.pdf.
4. Deloitte analysis based on interviews with C-suite executives in US Retail industry — Nov/Dec 2020.

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