Retail after COVID-19: A challenging new reality

When the COVID-19 lockdown is over, retailers will face a difficult reality. The unfolding recession and high unemployment will depress consumption. E-commerce adoption is likely to accelerate, across a wide range of categories, thanks to new home-shopping habits. And there will be far more store closings, as sales volumes may not generate enough profits. Some retailers may seek bankruptcy protection or find new owners. Organizations that plan carefully for the post-COVID future—and are agile enough to modify those plans as the new reality unfolds—have an opportunity to prosper.

Introduction

The COVID-19 outbreak has shaken the U.S. retail sector to its foundations. In March 2020, retail activity suddenly froze following government-mandated social distancing measures and shutdowns of non-essential businesses. The fallout has been staggering as major retailers have furloughed employees in the millions and indefinitely closed stores across the country. Only essential retailers, like grocers and retail pharmacies, have remained open and are—temporarily—benefiting.

As a result of COVID-19 and the recession, both essential and non-essential retailers will face a future landscape vastly different from the one that existed prior to the outbreak. Three forces will shape this landscape (Exhibit 1):

— Weak demand and a long recession
— Accelerating e-commerce adoption
— Accelerating store closures

The near-term fate of the retail sector will depend largely on the length of the lockdown and the effect of possible government support for retailers and their employees.

But as they make plans to reopen, retailers should also be developing strategic responses to the longer-term challenges. In this paper, we discuss how retailers can prepare for this new reality. There is no time to waste.

Exhibit 1: Snapshot of retail sector trends (2012 – 2024)

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A long recession and weak demand

When stores reopen, nobody expects a rapid return to normal consumption. By mid-May, more than 36 million Americans had filed for unemployment benefits. According to the Commerce Department, in April 2020, U.S. retail sales fell 16.4 percent from the previous month, and were 21.6 percent below the April 2019 level. KPMG’s latest economic model estimates that U.S. GDP will fall by 4.9 to 5.5 percent for the year and recession in the U.S. will continue through mid-2021 (Exhibit 2).

Exhibit 2: U.S. real GDP growth

Depressed consumer spending will disproportionately impact the same retailers that were forced to close their outlets during the lockdown. We expect sales volumes at apparel, specialty and department stores to decline sharply and remain depressed until employment and consumer confidence rebound.

Stores may also suffer from continued social distancing behavior—with consumers staying home and avoiding public spaces, even after they are not required to. This has been the pattern in countries that are ahead of the U.S. in flattening the infection curve, such as Denmark, South Korea and China.

Exhibit 3: Expected impact of COVID-19 and recession

<table>
<thead>
<tr>
<th>Physical retail</th>
<th>Consumer Demand</th>
<th>E-comm. adoption</th>
<th>Footprint Impact</th>
<th>Key Long-Term Considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food/Grocery</td>
<td>🟢</td>
<td>🟢</td>
<td>🔴</td>
<td>Demand will increase as people continue to eat at home, supported by a permanent change in e-commerce adoption, with delivery and in-store pickup as key services.</td>
</tr>
<tr>
<td>Drug</td>
<td>🟢</td>
<td>🟢</td>
<td>🔴</td>
<td>The swing to online will continue, favoring larger, sophisticated players, with already developed omni-channel services.</td>
</tr>
<tr>
<td>Discount &amp; Dollar</td>
<td>🟢</td>
<td>🟢</td>
<td>🔴</td>
<td>Consumers on limited budgets due to recession will spend more at discount stores.</td>
</tr>
<tr>
<td>Mass &amp; Club</td>
<td>🟢</td>
<td>🟢</td>
<td>🔴</td>
<td>Top players with strong omni-channel capabilities (e.g., Walmart, Costco) grow; smaller chains struggle.</td>
</tr>
<tr>
<td>Apparel</td>
<td>🔴</td>
<td>🔴</td>
<td>🔴</td>
<td>Apparel sales suffer in recession; high-end/luxury will be hit disproportionately as shoppers trade down.</td>
</tr>
<tr>
<td>Specialty &amp; Department</td>
<td>🔴</td>
<td>🔴</td>
<td>🔴</td>
<td>Highly exposed to recession/changing shopping habits (e.g., avoiding public spaces); online growth potential.</td>
</tr>
</tbody>
</table>

Source: KPMG
E-commerce adoption will accelerate

We expect e-commerce adoption to grow across all retail categories as a result of increased trial during the stay-at-home period and ongoing fear of public spaces, but food and beverage and personal care stand to benefit most. In 2019, only 3.2 percent of the $777 billion in food and beverages purchased in the U.S. were bought online. That was the lowest e-commerce penetration among all retail categories (Exhibit 4). However, grocery was the fastest growing e-commerce category, as Amazon/Whole Foods, and chains such as Walmart moved further into the market.

Exhibit 4: E-commerce penetration by select categories (2019) and expected impact (~2021)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Food &amp; beverage</td>
<td>777</td>
<td>3%</td>
<td>3–7</td>
<td>20–50</td>
</tr>
<tr>
<td>Personal care</td>
<td>365</td>
<td>11%</td>
<td>4–8</td>
<td>15–30</td>
</tr>
<tr>
<td>Apparel</td>
<td>270</td>
<td>29%</td>
<td>3–4</td>
<td>8–15</td>
</tr>
<tr>
<td>Consumer electronics</td>
<td>98</td>
<td>43%</td>
<td>4–7</td>
<td>4–7</td>
</tr>
<tr>
<td>Toys</td>
<td>80</td>
<td>37%</td>
<td>4–7</td>
<td>3–6</td>
</tr>
<tr>
<td>Books &amp; media</td>
<td>78</td>
<td>55%</td>
<td>3–5</td>
<td>2–4</td>
</tr>
<tr>
<td>Furniture &amp; home</td>
<td>117</td>
<td>24%</td>
<td>1–2</td>
<td>1–2</td>
</tr>
<tr>
<td>Office supplies</td>
<td>31</td>
<td>27%</td>
<td>3–5</td>
<td>1–2</td>
</tr>
</tbody>
</table>

Source: Census. eMarketer. KPMG estimates

COVID-19 has provided additional momentum for grocery e-commerce. Daily, online grocery sales jumped 110 percent in April compared with pre-COVID-19 levels, as consumers who had never shopped for groceries on the internet placed orders.1 More than half of all online grocery buyers in March said they bought online because of COVID-19. With this additional momentum, we estimate that e-commerce penetration in food and beverage could jump 3 to 7 percentage points by the end of 2021. That would lift annual online grocery sales to between $50 billion and $75 billion, up from $25 billion in 2019.

The March shutdown also brought a surge in online sales of personal-care products (including prescription drugs). Some 60 percent of online purchasers cited COVID-19 as the reason to buy online—even though drugstores and grocery chains were open. In 2019, 11 percent of personal-care products in the U.S. were sold online; we estimate that this could jump by 4 to 8 percentage points in 2021, or by about $15 billion to $30 billion a year.

Large incumbent players such as Amazon, Peapod and Instacart may be best positioned to benefit from accelerated growth online in grocery and personal care. For other grocery chains to keep up in online, they will have to react quickly and match the leaders with last-mile delivery and curbside pickup, either by themselves or through partnerships. As in-store traffic declines as a result of e-commerce, grocers may also need to address cost issues to improve overall four-wall profitability. For example, store labor models will have to be redesigned to support more online order fulfillment, while maintaining a compelling (and safe) customer experience.

The shift to online shopping in apparel will be less dramatic, given the already high e-commerce penetration of 29 percent and the fact that people still want to see and try on merchandise. Nonetheless, by the end of 2021, that figure could rise to as much as 34 percent, we estimate. Upscale retailers will be severely impacted as people trade down and further shift online. Conversely, fast fashion retailers that already have a strong online presence might benefit from trade-down behavior.

Online sales in specialty categories such as sports, hobby, music and books have risen due to COVID-19, but not nearly enough to offset the overall decline in demand. To improve sales, specialty chains will need to continue improving the customer experience and further develop omni-channel capabilities.

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1 Source: Sarah Perez, “US e-commerce sales jump 49% in April, led by online grocery,” TechCrunch.com, May 12, 2020.
Bankruptcies and store closures are anticipated to substantially increase post-pandemic. Between 2015 and 2019, the number of bankruptcies grew significantly, with projections for 2020 suggesting a doubling of the previous year. Similarly, store closures have escalated, with expectations for a more than doubling from 2019. These trends reflect the challenges faced by retailers in adapting to the new economic landscape.

The COVID-19 pandemic has magnified existing difficulties for traditional retail, leading to closures of underperforming stores and increasing pressures on financial stability. Retailers are under immense pressure to adjust their operations, and some are likely to seek bankruptcy protection. The retail environment is undergoing a significant transformation, necessitating strategic realignment and readjustment.

Exhibit 5: The expected rise in bankruptcies and store closures (2015-2020)

<table>
<thead>
<tr>
<th>Year</th>
<th>Bankruptcies</th>
<th>Closures</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>75</td>
<td>5,077</td>
</tr>
<tr>
<td>2016</td>
<td>86</td>
<td>2,056</td>
</tr>
<tr>
<td>2017</td>
<td>83</td>
<td>7,795</td>
</tr>
<tr>
<td>2018</td>
<td>78</td>
<td>5,844</td>
</tr>
<tr>
<td>2019</td>
<td>92</td>
<td>9,302</td>
</tr>
<tr>
<td>2020P</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Sources: Yahoo Finance; Moneywise; CNN; Capital IQ as accessed in Mar 2020

Most retailers are experiencing a “tail” of underperforming stores, many of which are expected to become unprofitable. To mitigate financial stress and enhance long-term sustainability, strategic optimization of the retail footprint, redesign of labor models, and corporate restructuring are necessary. Some fast-growing digital-native retailers may also face challenges, with expansion plans on hold. These brands will need to reassess their strategies to ensure survival.

Two years from now, retailers that have adapted to the new reality will emerge stronger. Those that have invested in omni-channel capabilities, maintained a robust balance sheet, and preserved customer loyalty are poised to thrive in the post-pandemic retail landscape.
How to prepare for the new reality

Retailers need to be flexible about how they plan for the new reality. Nobody knows how long the recession will last, how badly it will hurt consumption, and how quick a recovery might be. Moreover, nobody knows the degree to which consumer behavior will be permanently changed. Preparing for this uncertain future requires careful scenario planning and agile execution.

Start with Scenario Planning

Retail leaders, like executives in many industries, are dealing with an unprecedented level of uncertainty. This makes rigorous scenario planning an essential first step in planning strategy for the aftermath of COVID-19. In the following chart, we lay out a four-step framework for scenario planning.

Exhibit 6: Four steps to create scenarios for the new reality

- **Market-back assessment**: Develop macroeconomic perspectives, review consumer behavior changes, and understand competitor recovery positioning.
- **Base case scenarios**: Make baseline revenue projections, develop an operational starting point.
- **Strategic direction and supporting initiatives**: Develop a strategic direction, and identify possible commercial and performance improvement initiatives.
- **New reality scenarios**: Develop multiple versions of the enterprise future, based on initiatives to reduce cost and invest in growth.

Market-back assessment

**Macroeconomic perspectives**
States and cities are at different stages of the COVID-19 public health response; they are also applying different levels of fiscal stimulus, and therefore will recover at different rates.

Develop perspectives on the profile of potential economic impacts across key markets, categories, and channels.

**Consumer behavior changes**
Review consumer base to understand likely recovery profiles and behavior changes, and model the rate of expected e-commerce penetration by category to develop a perspective on the new reality.

**Competitor recovery positioning**
Understand how competitors are positioned for the economic downturn. It is most likely that bigger business will emerge stronger based on stronger financials and more developed omni-channel/digital services. Others might be possible targets for M&A.

Base case scenarios

**Baseline revenue projection**
Evaluate current retail footprint and e-commerce channels in light of market-back trend assessment, quantify level of revenue exposure to identified market trends and respective projections.

**Operational starting point**
Develop an operational starting point for the business base case to inform the cost baseline – this may include current initiatives underway, or just represent the true current state of the business.

**Base case scenarios**
Analyze the impact of the market-back perspectives on the operational starting point. Use scenarios to vary the recovery profiles and the impact of consumer behavior changes, and review different versions of the future business, given current structure.
Strategic direction and supporting initiatives

**Strategic direction**
In light of baseline scenarios, develop an enterprise strategic direction and financial aspirations for the new reality. These could vary from stay the course to full structural transformation.

**Commercial and efficiency initiatives**
Identify and estimate value of possible commercial and performance improvement initiatives onto baseline scenarios.

Consider levels of risk / likelihood, timing, and required investments. The number and level of change of these initiatives become the building blocks of possible new-reality scenarios.

<table>
<thead>
<tr>
<th>Commercial initiatives:</th>
<th>Efficiency initiatives:</th>
</tr>
</thead>
<tbody>
<tr>
<td>☑ Prioritize markets for reopening and recovery based on key triggers.</td>
<td>☑ Optimize the store footprint and renegotiate rent concessions based on projected scenarios.</td>
</tr>
<tr>
<td>☑ Identify omni-channel initiatives and partnerships that should be accelerated based on increased consumer expectations.</td>
<td>☑ Modify store operating model, including operating hours and labor models to account for consumer behavior changes and reduced foot traffic.</td>
</tr>
<tr>
<td>☑ Assess and identify pricing and promotional power levers based on industry landscape and client positioning.</td>
<td>☑ Assess organizational restructuring in a detailed level to both match new demand levels and build new capabilities in priority areas like omni-channel.</td>
</tr>
<tr>
<td>☑ Evaluate M&amp;A opportunities.</td>
<td>☑ Identify opportunities to lower cost of goods sold and improve working capital across procurement.</td>
</tr>
</tbody>
</table>

**New reality scenarios**

Develop multiple versions of the enterprise future, based on varying combinations of initiative selection, respective investment, timing, success, and market optimism. The scenarios provide visibility on the potential trade-off between the various strategic initiatives. They should be evaluated against the relevant strategic direction, capability gaps, and investments. The selected scenario will feed into the creation of a roadmap to the new reality.

**Be agile in execution**

Given the fluid market conditions and the need for speed, the execution of the initiatives has to be agile. Retailers will still need to develop detailed execution plans for the identified initiatives supporting their strategic ambitions, including designating initiative managers and specifying targets and timelines. However, given the unpredictability of the current environment, companies will have to be willing to modify, reprioritize, and accelerate initiatives rapidly, if necessary. This is the time to prioritize good over perfect and now over later.
Retail has taken an enormous hit from COVID-19, second only to the damage to travel and leisure, and will suffer disproportionately during a long recession. It may take years for consumer behavior to normalize and for shoppers to feel safe going to stores. As a result, retail is likely to face a new reality that is far from the old normal. Consumers will continue to migrate online to shop, making fewer and fewer trips to physical stores. Competing successfully online will be crucial. Sizing the business to the new reality may be a matter of survival. This is why retailers must take bold steps now.

How KPMG can help

Moving with speed and precision during these unprecedented times will be the difference between survival and death. KPMG has developed a multi-disciplinary team approach and tools to provide insight at deal speed. In retail, we have significant experience in assisting both incumbents and disruptors navigate a challenging market. We bring real world experience and proprietary data and insights to build a fact-based view of the new reality, identify rapid commercial and efficiency opportunities, and accelerate execution.

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