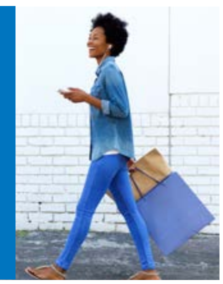
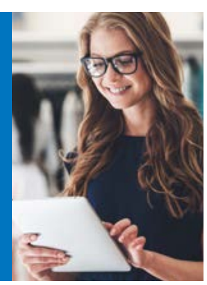
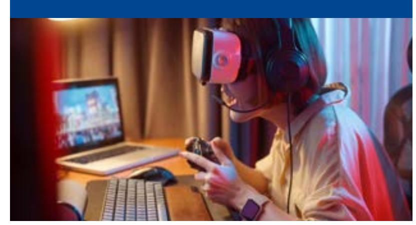
Here today, gone tomorrow?

Six trends impacting the fate of retailers

What's inside







Innovation meets inflation

Despite record-high inflation, tightening labor markets and ongoing uncertainty, retailers cannot afford to hold back on innovation. They must continue to transform, invest, and innovate to remain competitive and create their future or risk falling behind. As buyer behaviors shift, technologies advance, and the world moves beyond the pandemic, winners will have a continuously forward-thinking mindset. They will share a commitment to advancing omnichannel integration, innovating capabilities and infrastructure, and implementing agile operating models to meet changes in behaviors and fluctuations in demand.

Current challenges and opportunities for retailers range from pricing to labor, logistics, technology, and sustainability. To keep moving forward, retailers will need to make strategic and operational adjustments as the economic environment unfolds. Technology will play a supporting role in helping to improve operational efficiencies, manage labor costs, elevate consumer experiences, and seize new opportunities.

Catering to the increase of in-store traffic, retailers will look to innovate in-store shopping experiences, enhance true omnichannel capabilities, explore metaverse potential, and embed more sustainable processes and practices in their organizations. At the same time, retailers continue to grapple with high inflation, supply chain disruption, and labor shortages. They must also contend with changing consumer habits as rising prices are no longer offset by federal stimulus payments. According to a recent KPMG report, 70 percent[1] of consumers are starting to tighten their purse strings, pulling back on discretionary spending to allocate more of their dollars to "needs" above "wants."

After interviewing 100 retail executives on the state of the industry, we've identified six key trends that we believe will continue to drive the industry forward. These include:

1. **Going back to the future.** While the pandemic accelerated online retail to reach new heights, shoppers are returning to stores with great expectations.
2. **Enabling omnichannel with BOPIS.** Retailers are considering restructuring opportunities within physical locations to enable better fulfillment and create a true omnichannel experiences.
3. **Overcoming supply chain struggles.** As supply chain challenges persist, retailers are turning to new, short-to-medium term solutions to overcome bottlenecks.
4. **Managing in a tight labor market.** In response to tight labor markets, retailers are increasing pay and adding benefits and incentives while turning to automation and new technologies.
5. **Experimenting with metaverse opportunities.** The metaverse represents new worlds of possibilities for retailers, allowing them to experiment, innovate and discover new growth potential.
6. **ESG: Embracing progress with purpose.** As sustainability increases in importance, retailers are embedding ESG principles across the enterprise to achieve progress with purpose.

In this paper, we take a deeper dive into each of these trends, providing insights on the evolving world of retail and what executives believe the future has in store.

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[1] KPMG 2022 Consumer Pulse Summer Survey, "Is inflation pushing consumers to the edge?" May 2022.

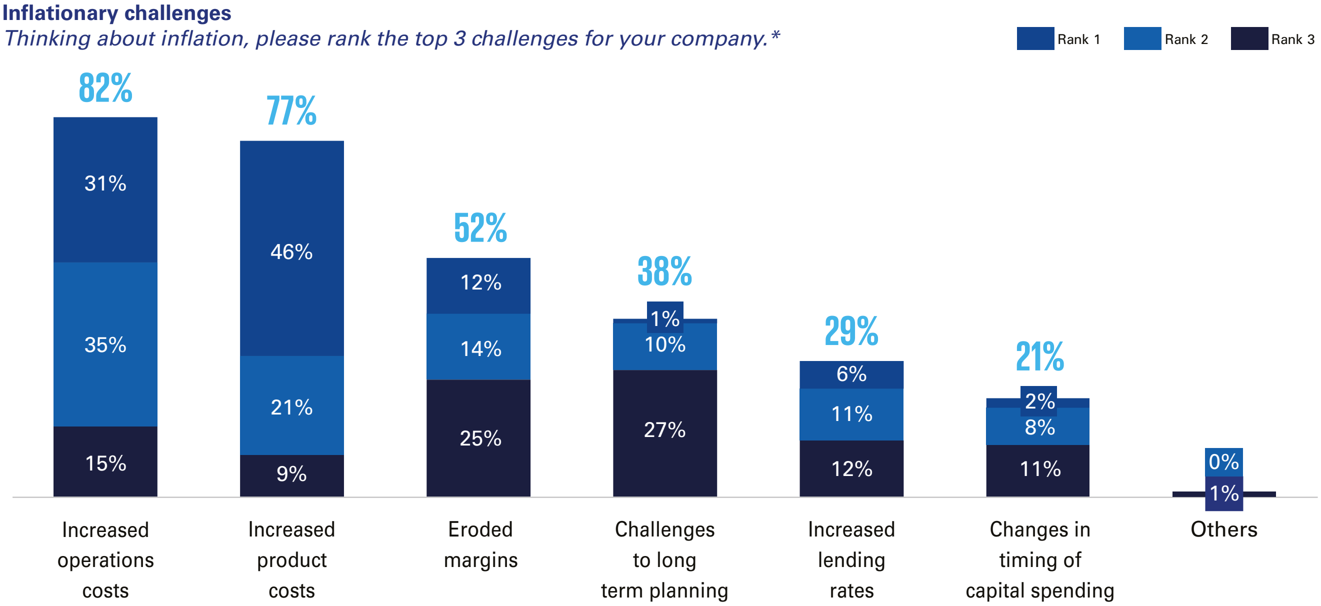
Navigating economic uncertainty

In another wave of change, the retail industry faces a challenging economic backdrop of high inflation that is impacting demand. Many retailers are revising their profit forecasts due to cost pressures. Disappointing earnings reports this year revealed retailers are saddled with excess inventories, which will result in markdowns for some products at a time when consumers are slowing spend amid rising prices and higher interest rates.

Across retail categories, companies are increasing prices to offset costs as high inflation looms. Approximately 50 percent of U.S. retail businesses have used shrinking discounts to increase profitability during rising inflation.[2] Businesses have also used several pricing tactics such as shrinkflation (shrinking package sizes without lowering prices), increased surcharges, and bundling to drive up prices.[3]

Inflationary challenges

Inflationary challenges
*Thinking about inflation, please rank the top 3 challenges for your company.**



*Percentages might not equal 100 due to rounding.

[2] Digital.com, "More than half of retail businesses are using inflation to price gauge," March 28, 2022
[3] Digital.com, "More than half of retail businesses are using inflation to price gauge," March 28, 2022

Consumers are shifting spend back to travel and services and away from the pandemic-high spending on physical goods.

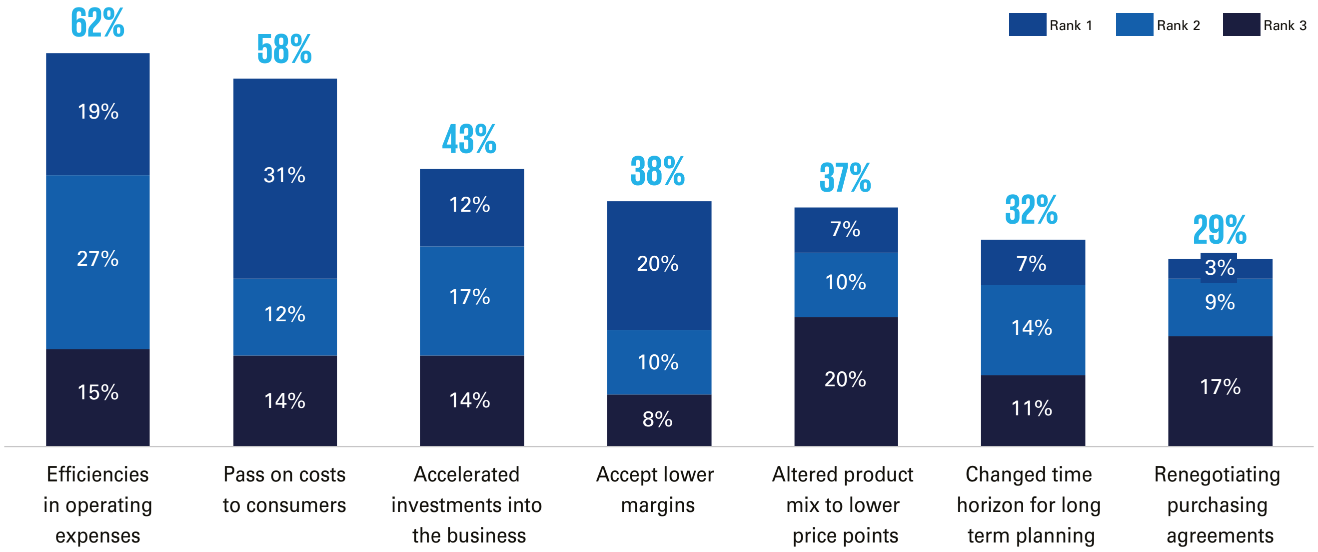
While lower-income consumers are most sensitive to price increases, their choices are limited due to the lack of lower-priced alternatives.

Rising inflation is likely to deter spending at specialty retailers, department stores, and fine dining restaurants as customers opt for lower priced alternatives, if substitutions are available.

Luxury retailers will be challenged to find new customers willing to spend more on premium items in the current climate.

Addressing inflation

Ways to address inflationary challenges
*Please rank the top 3 options in order of importance to your company to addressing inflationary challenges.**



*Percentages might not equal 100 due to rounding.

Combatting challenges

In the current climate, all retailers, regardless of scale, are focused on driving efficiency in operations.

62% In fact, 62 percent of retail executives surveyed said they are attempting to offset inflation by driving efficiencies into operating costs.[4]

Meanwhile, 58 percent will pass added costs on to consumers and 43 percent plan to accelerate investments into the business to overcome such challenges.[5]

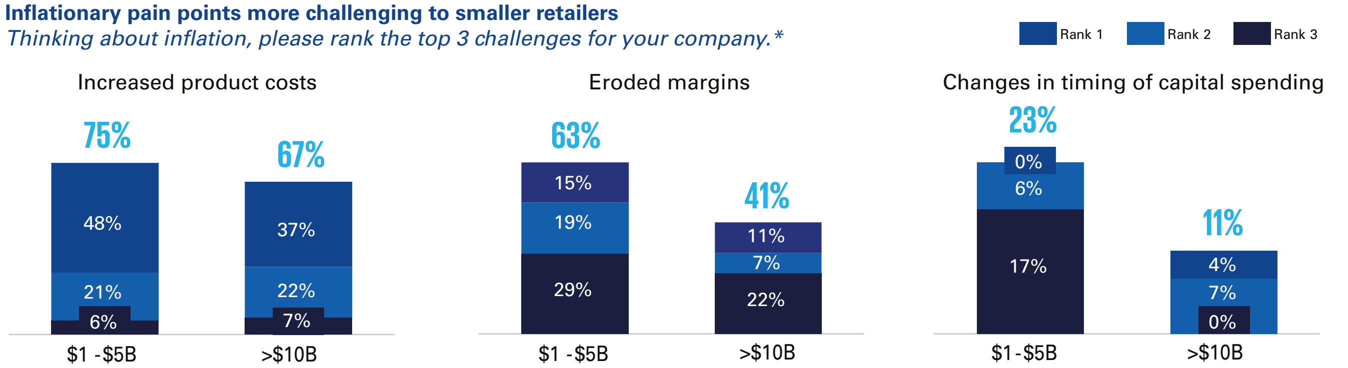
Retailers said they are feeling the greatest pressures from three top areas including increased operating costs (82 percent), higher product costs (77 percent), and eroding margins (52 percent).[6]

Moreover, when breaking down the data between size of the retail organization, larger retailers are most concerned with increased operational costs, higher product costs, and long-term planning challenges. In comparison, smaller retail organizations also cite increased operational costs and higher product costs but also highlight eroded margins within their top three challenges.[7]

Inflationary pain points by size

Inflationary pain points more challenging to smaller retailers

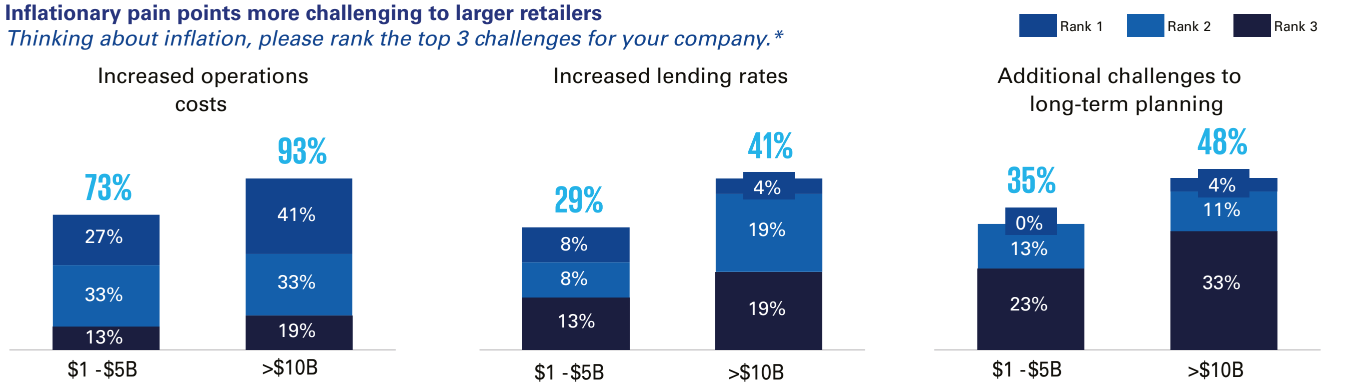
*Thinking about inflation, please rank the top 3 challenges for your company.**



*Percentages might not equal 100 due to rounding.

Inflationary pain points more challenging to larger retailers

*Thinking about inflation, please rank the top 3 challenges for your company.**



*Percentages might not equal 100 due to rounding.

[4] KPMG 2022 Retail Trends Analysis.(Survey fielded May 2022).Slide 16.All additional slide references in this report are from this source unless otherwise noted).
[6] Slide 15
[5] Slide 16
[7] Slide 17

Retail sales flattened in July

Ken Kim
Senior Economist

Consumers are spending less on discretionary items as prices rise. July retail sales were unchanged over June, missing expectations for a +0.1% increase. June retail sales were revised lower to +0.8% from the originally reported increase of +1.0%.

Gas station sales saw the largest drop in July, -1.8% m/m, due to falling gasoline prices. Motor vehicle sales and parts experienced the next largest decline, -1.6%. Given that vehicle purchases represent a big-ticket item for consumers, higher financing costs due to rising interest rates look to be having an impact. According to Kelley Blue Book, the price for a new vehicle is more than $47,000 and the average monthly vehicle payment is more than $650 per month, according to Edmunds, which are sizable amounts.

Spending more, receiving less

Keep in mind that retail sales data is reported on a nominal basis. The higher prices for items can influence the total aggregated figure higher even when volumes are falling, providing a false sense that things may be improving. In other words, retail sales in the current environment might be more reflective of the higher prices that consumers are paying and not necessarily that they are buying more items. Indeed, the latest second quarter financial statements from large retailers showed that consumers are spending more but receiving less. Company earnings reports indicated that dollar sales rose due to higher prices. When adjusted for inflation, retail sales on a real basis have been negative in two of the last three months, exhibiting the corrosive effects of higher inflation.

Clothing store sales declined by 0.6% in July. Industry expectations of higher back-to-school shopping did not materialize in apparel sales last month. Meanwhile, both general merchandise store and department store sales fell for the second straight month, a sign that inflation is discouraging discretionary purchases. Even sales at eating and drinking establishments slumped in July, eking out a 0.1% increase after robust gains in recent months – a sign that social activities are also being impaired by rising inflation.

Some sales increases

However, the July report was not entirely negative. Building material store sales jumped by 1.5% and furniture store sales rose by 0.2%. As my colleague Yelena Maleyev points out, the housing sector is losing ground as interest rates climb. We suspect that big-ticket purchases tied to housing, such as materials, garden equipment and all the goods and furnishings associated with it, will not be sustainable going forward as we saw in July.

Other positive notes in the July report included online sales, +2.7%. And excluding the negative impacts of autos and gas, July retail sales rose by 0.7%.

Bottom Line

The ongoing drawdown in the savings amassed during quarantines, high inflation, rising interest rates and an expected increase in unemployment suggests that consumer spending will be weak moving into 2023. Despite the upward pop in the July jobs report, in which 528,000 new jobs were created, it is unrealistic to suspect this type of strength can be sustained going forward, particularly with both monetary and fiscal policy now being restrictive. Core retail sales rose by 0.8% in July, which is an input into GDP. As a result, third quarter real GDP is tracking at just under a 1% seasonally adjusted annual rate, which isn't a whole lot to cushion the economy from unexpected internal or external shocks.

1 Going back to the future

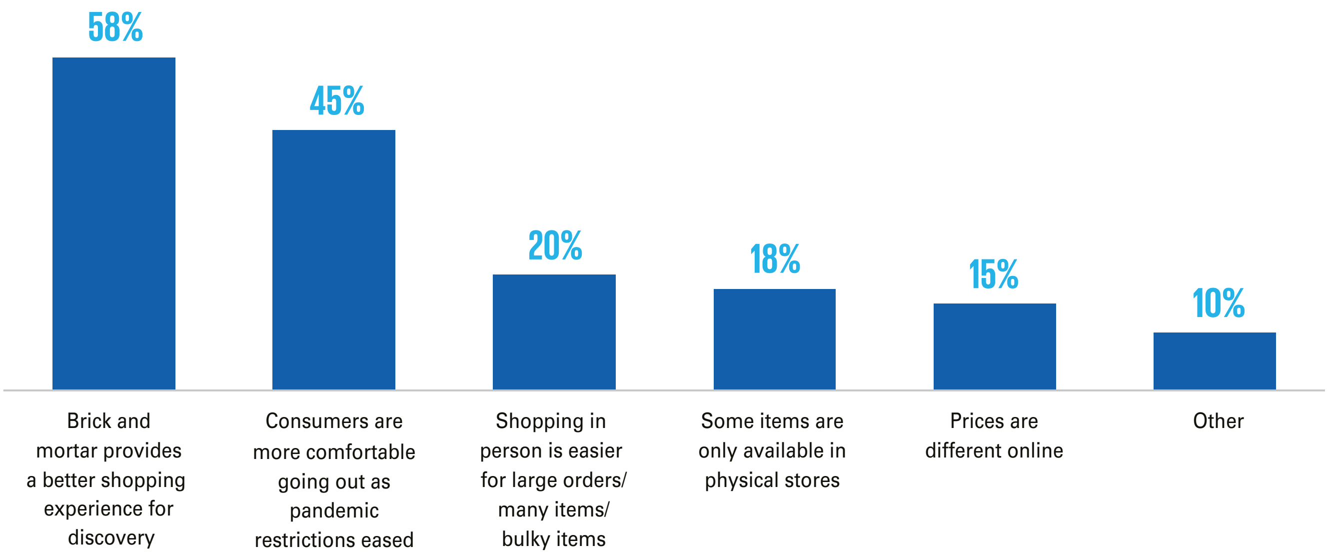
A boomerang shopping shift from physical to digital and now back to physical again is occurring as consumers increasingly enjoy a return to in-store shopping. In fact, when given the option to shop in store or continue making purchase online, most consumers prefer to walk through the doors of physical stores.

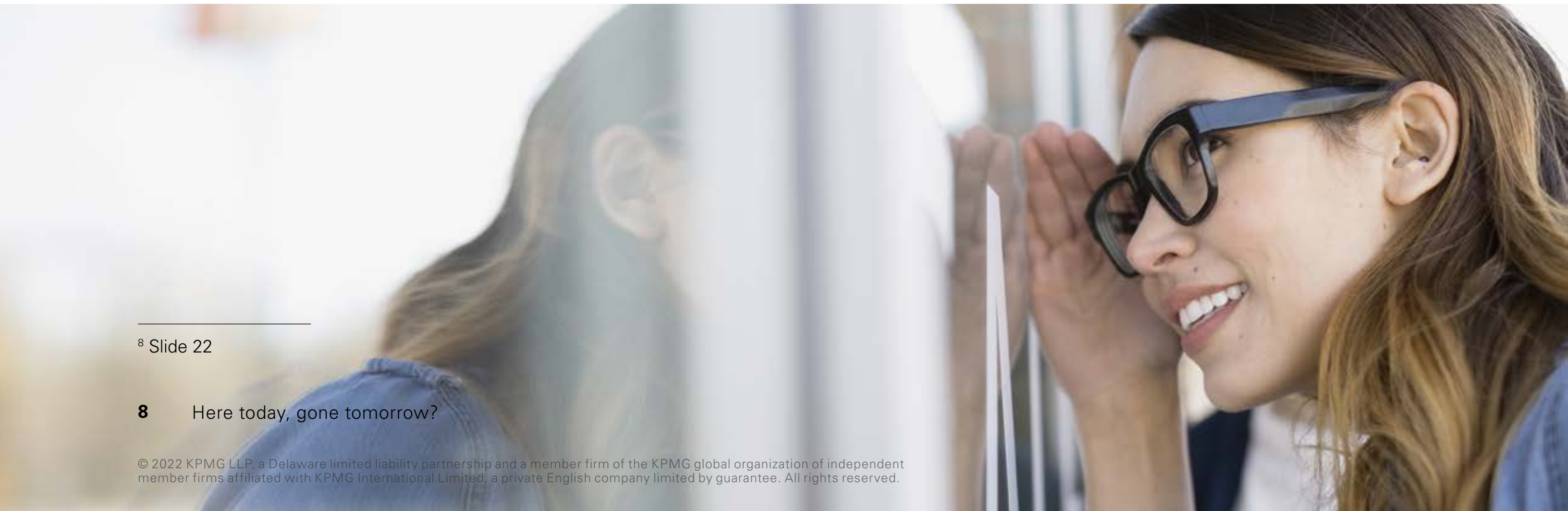
Upon their return, shoppers are bringing higher expectations with them, seeking to match the superior shopping experience they found online now in the store. As a result, retailers have an opportunity to re-create the favored portions of the online shopping journey for the in-store experience to provide consumers with the best of both worlds.

More than half (58 percent) of the retail executives surveyed believe physical store locations provide a better discovery experience for consumers. In addition, 45 percent of executives think in-store foot traffic will increase since pandemic restrictions have eased and consumers are comfortable resuming normal experiences such as going out to shop.[8]

Reasons behind the return

Reasons for foot traffic increase in brick and mortar
Why do you expect brick and mortar foot traffic to increase?





[8] Slide 22

In-store tech improvements

Technology is helping improve in-store experiences. Survey results show that QR codes for seamless checkouts are favored by more than one-third of retailers (39 percent) and consumers (38 percent.) Both groups equally (34 percent) appreciate QR codes for reading reviews. Results also reveal that 34 percent of retailers value virtual customer service technologies compared to 26 percent of consumers.[9]

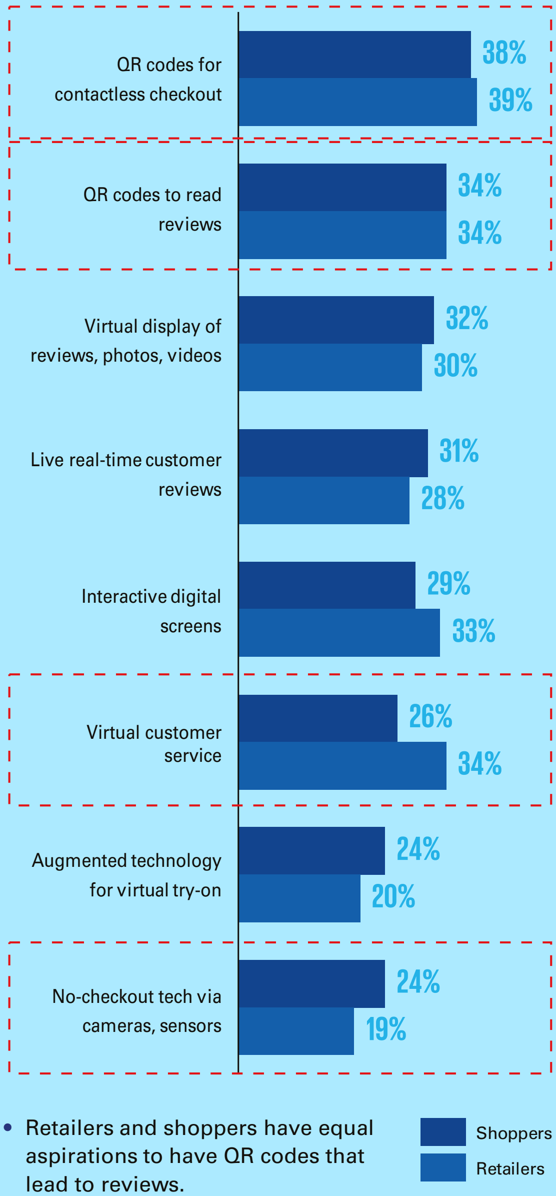
Retailers are also implementing smart carts for frictionless in-store shopping. Smart carts can tally up the total, make recommendations, and allow customers to pay for groceries directly in the cart, eliminating the need for customers to wait in long lines, stand around strangers, or pass off items to a salesclerk.

e-Commerce sees slower growth

As consumers return to physical locations, e-commerce has experienced slower growth and even declines, although its activity remains well above pre-Covid-19 levels. e-Commerce penetration and foot traffic loss and recovery differ based on retailer size and product categories. Online is frequently driven by ease of fulfillment in product categories.

Retail technology applicability by user

Retail technology that appeals to customers and retailers



- Retailers and shoppers have equal aspirations to have QR codes that lead to reviews.
- Virtual customer service is the third highest ranked technology from a retailer perspective, although customers ranked it as the third lowest.

[9] Slide 26

Durable goods have the highest e-commerce penetration rates with electronics and clothing achieving over 50 percent of purchases online.[10] In addition, free return policies are enhancing consumer confidence about buying durable goods online that can be reliably reviewed and returned. Value-added services, like product installation for electronics, also drive positive purchasing behaviors in some sectors.

Consumer expectations for free and quick delivery continue to challenge e-commerce profitability. Overall, retail executives surveyed view digital infrastructure (61 percent), customer experience (58 percent), and talent (57 percent) as the biggest challenges to overcome as they continue to build out digital offerings.[11]

58%

believe physical locations offer better discovery experience for consumers

Major e-commerce challenges

Major e-commerce challenges

*Thinking about e-commerce, please rank the top 3 potential challenges for your organization.**

*Percentages might not equal 100 due to rounding.

[10] Slide 23
[11] Slide 24

Elevating in-store experiences

Scott Rankin
Principal, Strategy Leader, Advisory

If proof is ever needed on the value of physical stores, look no further than digital natives opening up brick-and-mortar locations. Most recently, one online retailer launched its first-ever physical store for men's and women's clothing in Los Angeles. The e-commerce retailer aims to "reimagine in-store shopping" with a technology-driven experience through its app.

Online experiences are good and over the last two years have gotten better. However, for pure discovery and inspiration, the physical store provides a superior experience.

After two years of pandemic restrictions, people miss shopping in stores and being able to see, touch, and compare products. For particular categories there's real value in being able to pick something up and bring it home the same day.

So, it's not surprising that, as our survey data points out, shoppers prefer to shop in store, which is a rising trend. But it's not enough to just get consumers back into stores, the trick is to keep them coming back. To do so, retailers need to make experiences enjoyable by offering unique experiences or events, staffing stores with well-trained employees, and increasing checkout speed and convenience.

Consumers will continue to expect more from shopping in store, expecting brick-and-mortar locations to match the beneficial aspects of online experiences. Therefore, focusing on incorporating advanced technologies into physical stores will elevate offerings and enable seamless personalized experiences integrated with digital touchpoints.

2 Enabling omnichannel with BOPIS

Consumers shop with a brand in mind, not a channel. And they expect a consistent, quality experience regardless of whether they are shopping in store or online. This extends across activities such as access to inventory, product knowledge, and ease of checkout.

For years, many retailers have aspired to achieve true seamless omnichannel capabilities. With the growing popularity (boosted by the pandemic) of fulfillment options like buy online, pickup in store (BOPIS), true omnichannel presence is now becoming more of a reality.

Retailers have succeeded in growing their BOPIS sales by making BOPIS core to their online shopping journey, through premier placement on home pages and persistent information throughout the checkout process. By thoughtfully designing a specific customer journey for BOPIS, retailers can maximize both cost savings, operational efficiencies, and ancillary benefits from customer pickups.

In essence, having an omnichannel presence online helps brands better understand the customer journey and tailor personalized messaging. Consumers that pick up online orders in store can view more products and brand messaging, increasing the likelihood of additional in-store purchases, and increased basket size.

Consider that BOPIS sales grew at an accelerated 54 percent CAGR from 2019 to 2021 and it is expected to grow at a 19 percent CAGR through 2024.[12] With such positive momentum, retailers are investing in changes to their physical locations to enable and enhance BOPIS, including consumer-facing changes like self-pickup lockers or dedicated pickup areas. They are also increasing efficiencies internally by dedicating in-store personnel and converting portions of stores to hold BOPIS orders.

In fact, more than a third (38 percent) of retail executives surveyed want to prioritize changes to physical stores to better serve customers.[13] Some retailers wish to convert some of their stores to combine selling space and warehouse space, enabling faster order fulfillment for consumers.

The push to increase capacity and redesign floor space reflects retailers' belief that the future of delivery is ship from store (SFS). For example, Best Buy has converted many of its stores to be a combination of selling space and warehouse space.[14] DSW plans to turn its stores into a "warehouse reimagined" dedicating extra space for fulfillment[15] and, testing at Walmart is underway dedicating store space into a warehouse for fulfillment purposes.[16] And many other retailers are following suit, redesigning store footprints for a variety of quick omnichannel service options.

[12] Slide 29, Source: Insider Intelligence
[13] Slide 31
[14] Best Buy Press Center, "Best Buy brings new store pilots to Charlotte," Kevin Flanagan, November 22, 2021
[15] PR Newswire, "Designer Brands Debuts 'Warehouse Reimagined' for Enhanced, Immersive Retail Store Experience," May 10, 2022.
[16] Walmart Press Center, "New Era of Fulfillment: Introducing Walmart's Next Generation Fulfillment Centers," David Guggina, June 3, 2022.

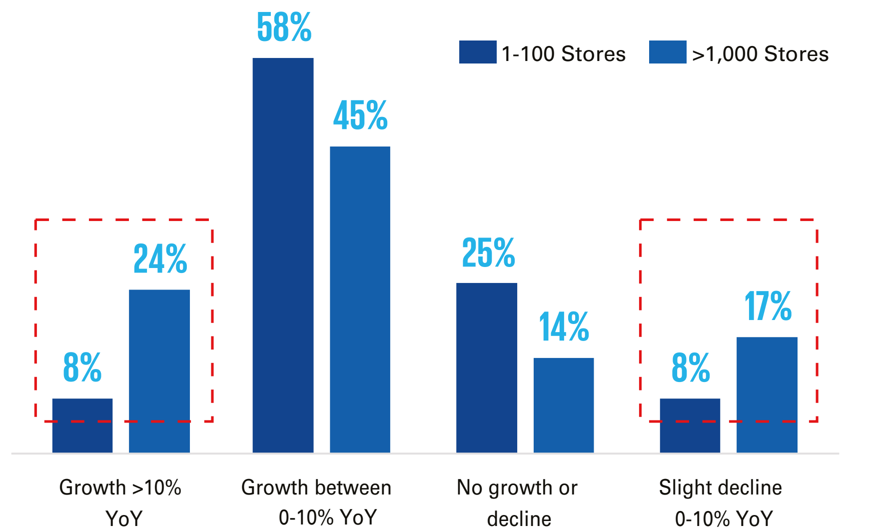
Technology challenges

The technology required to support BOPIS continues to be a challenge for many retailers. This is illustrated by 67 percent of executives of smaller retailers and 48 percent of larger retailer executives that believe the accuracy and visibility of shared inventory (which requires websites to have store-by-store inventory levels), as being a significant BOPIS challenge. This was followed by demand forecasting, which 66 percent of larger retailers and 50 percent of smaller retailers perceived as another substantial challenge.[17]

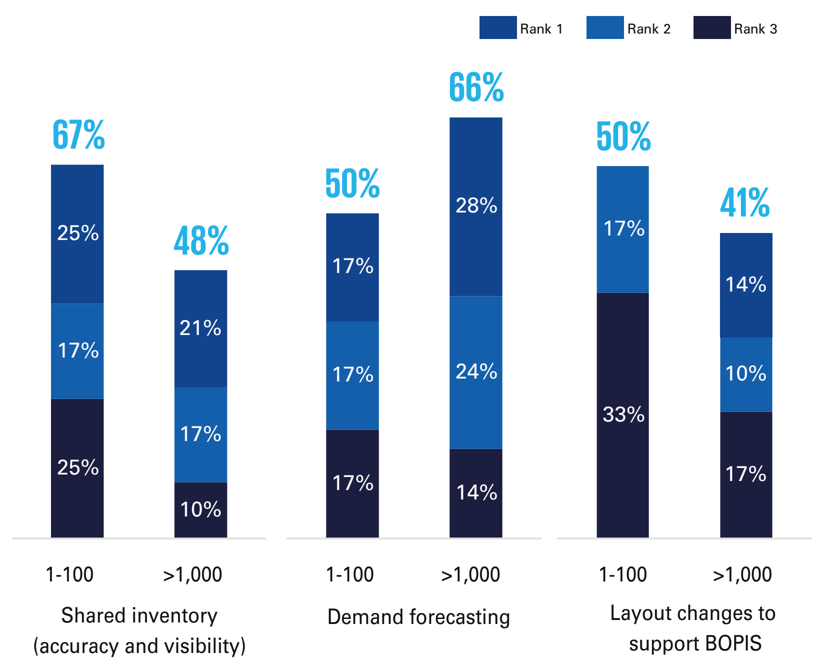
BOPIS forecast growth

BOPIS forecast growth, by number of stores

How do you expect BOPIS penetration at your company to grow in the future?



Challenges of BOPIS by number of stores*



*Percentages might not equal 100 due to rounding.

[17] Slide 32

Improving BOPIS offerings

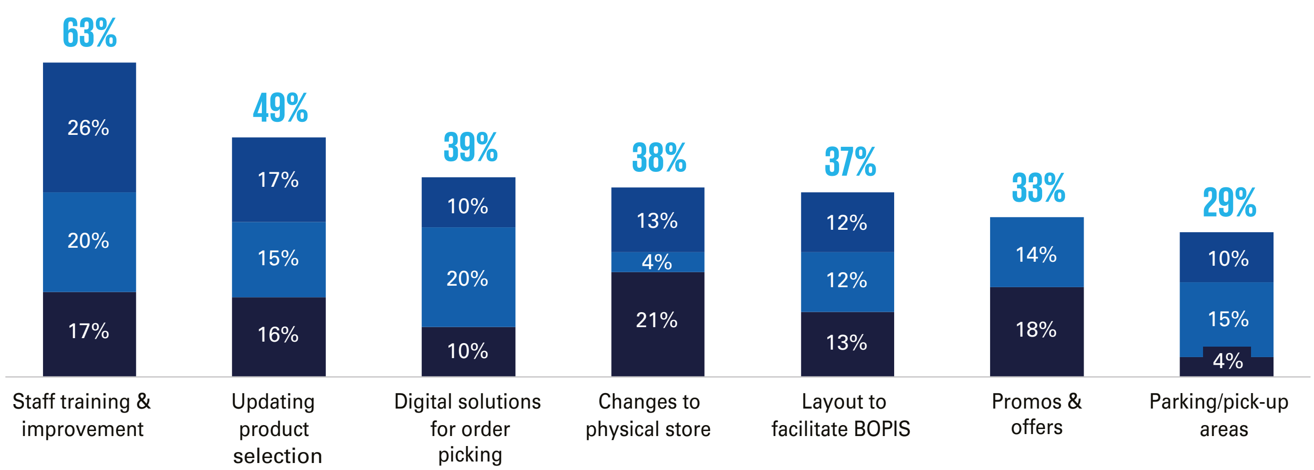
Retailers understand that consumers do not want to pay shipping costs or wait for items. BOPIS enables immediate gratification. To improve BOPIS offerings, 63 percent of retail executives point to staff training and 49 percent view updating product selection as top priority initiatives.[18]

In order to facilitate the continued growth and improve margins of BOPIS options, retailers are increasingly investing in modifications to store locations, making consumer pickup easier by adding amenities like self-pickup lockers, which the buyer can access with limited employee help, or dedicated curbside parking/pickup areas. Some retailers are creating "hub stores" in each major market that facilitate all channels and have the full infrastructure to store more inventory, serve customers in store, and enable delivery via a BOPIS and ship from store (SFS) model.

63%
plan to increase training to improve BOPIS

BOPIS forecast growth

Ways to improve BOPIS offerings
*Please rank the top 3 initiatives in order of importance to your company for improving BOPIS offerings.**



*Percentages might not equal 100 due to rounding.

[18] Slide 32

Putting customers first

Sundar Ramakrishnan
Managing Director, Strategy, Advisory

More retailers are recognizing the opportunity to enable true omnichannel offerings that seamlessly combine online and physical store capabilities to meet customers on their terms.

Buy online, pickup-in-store (BOPIS) services illustrate how retailers are putting customers first by providing a shopping experience that is convenient and also saves time and money. Additional positive experiences are derived when in-store associates go the extra mile to place online orders for consumers that went to the store only to find an empty shelf or associates that accept returns in store from customers who ordered online. Both experiences drive customer satisfaction and brand loyalty.

Moreover, such actions continue to close the gap between these two channels, helping give retailers a competitive edge. By reassessing customer journeys and optimizing digital experiences, retailers are revising their approaches to enable BOPIS and add value to consumer experiences.

Many stores are also reconfiguring physical locations to provide more beneficial layouts, and focusing on delivering more personalized, convenient shopping experiences.

In addition to investing in automation and digital marketing, store associates will need training to optimize advanced technologies, offer new services, and seek to be retrained to offer services that differentiate the store as an enhanced destination.

3 Overcoming supply chain struggles

While global supply chain disruption is nothing new, the recent shift in consumer buying behaviors due to skyrocketing inflation compounds existing issues. From stockouts to excess inventory to logistics nightmares, retailers face increasingly intense pressures. This is especially true in the areas of inventory management and demand planning.

Retailers have responded to such challenges by increasing inventory thresholds and planning longer lead times, giving them more leeway to overcome delays or shortages but further increasing storage costs. Since intermodal transfers have become a key bottleneck, retailers have implemented solutions like using ports during off-peak times.

To help limit their exposure to supply chain issues, combat increasing freight costs, and enhance delivery times, retailers are updating internal processes. Many are investing in additional space and emerging technologies to streamline their supply chain and better serve customers. In the short term, retailers are considering alternative shipping methods and ports.

A matter of logistics

Increasing consumer demand for faster delivery times adds pressure to meet expectations and update logistics networks—from quality control to inventory levels to shipping and cost reduction. There’s a definite need to increase predictability, flexibility, and speed into supply chain operations.

As such, major retailers are piloting emerging technologies to completely eliminate human intervention in the last-mile delivery process, including wheeled and aerial drones. And new tracking technologies are being used to locate items in transit and identify bottlenecks to deploy targeted solutions.

In addition, previously unthinkable modes of transport, like air freight, have become increasingly common as the cost comparison became more palatable and timing needs outweighed incremental costs. However, while longer lead times are needed, using different modes of transport, such as air-freight, is not a practical long-term solution.

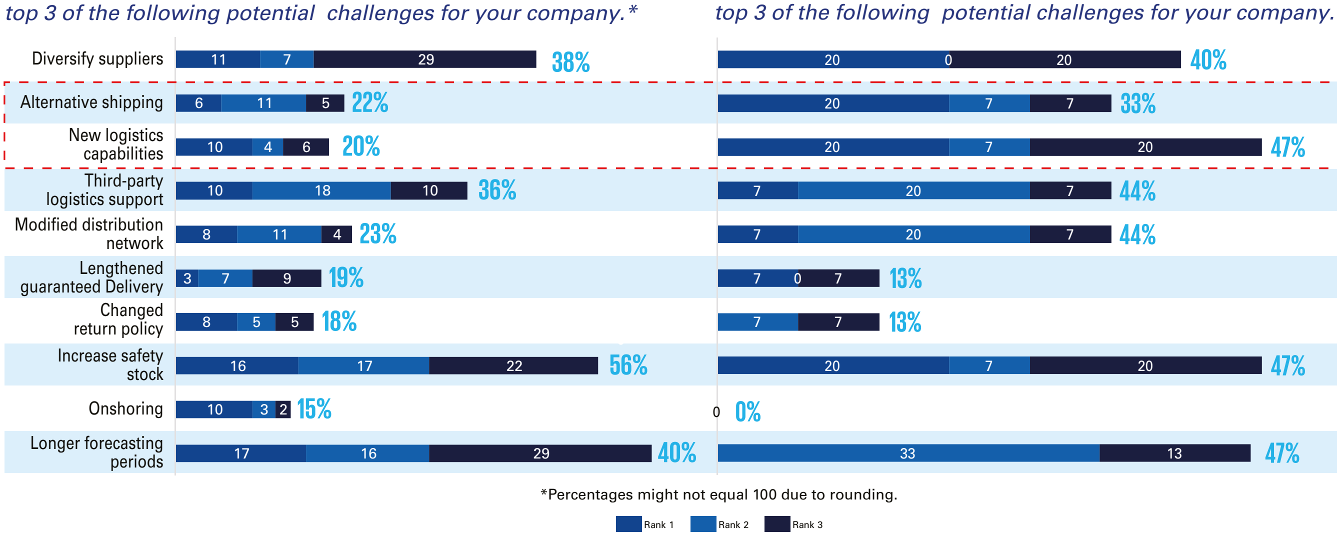
Different supply chain perspectives

Major supply chain/logistics challenges for companies for all executives

*Thinking about supply chain and logistics, please rank the top 3 of the following potential challenges for your company.**

Major supply chain/logistics challenges for companies for supply chain executives

*Thinking about supply chain and logistics, please rank the top 3 of the following potential challenges for your company.**



*Percentages might not equal 100 due to rounding.

Varied viewpoints

Interestingly, retail supply chain executives have different perceptions than their c-suite peers on top supply chain and logistics challenges. For example, 47 percent of supply chain executives cite the importance of new logistics capabilities compared to 20 percent of their executive counterparts.[19] Moreover, one-third (33 percent) of supply chain executives view alternate shipping as a priority compared to 22 percent of their executive peers.[20]

In the current climate, retail executives are seeking to solve such challenges with short- and medium-term solutions. More than half (56 percent) of the retail executives surveyed are increasing safety stock, 47 percent are diversifying suppliers, and 40 percent are implementing longer forecasting periods[21].

To remain competitive, retailers are updating their logistics networks to accommodate faster, affordable shipping by partnering with third-party delivery providers (e.g., Instacart), or building upon in-house solutions by investing in additional fulfillment centers and delivery resources.

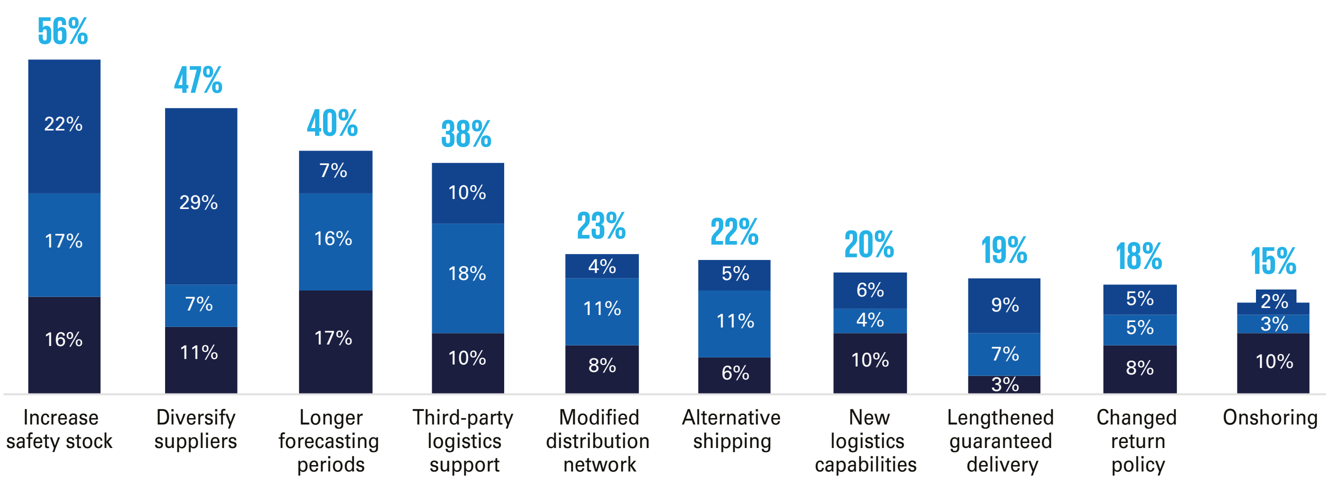
Retailers are also investing in forecasting tools with AI capabilities to improve inventory management. There are transitory challenges that are required to help with immediate logistics headaches and there are medium term strategic initiatives, like improved forecasting and supplier rationalization, that can be implemented. Longer-term solutions, like onshoring of suppliers, are not yet being considered as companies focus on the immediate pain points but should be reviewed in the future.

Data and analytics are also helping retailers overcome challenges in stocking the digital shelf versus the physical shelf. Previously, retailers could look at historical demand to forecast future demand, but this method has changed to accommodate omnichannel shopping. Leading retailers are using advanced data analytics to help with forecasting, which include things like product search volume. They are also realizing the value of pick and pack automation, which can lead to significant time and cost savings.

Different supply chain perspectives

Initiatives to overcome supply chain challenges

*Please rank the top 3 initiatives in order of importance to your company for overcoming supply chain challenges.**



*Percentages might not equal 100 due to rounding.

[19] Slide 40 [20] Slide 40 [21] Slide 38

Leveraging the power of analytics

Ken Spigarelli
Managing Director, Supply Chain, Advisory

Rising fuel costs. Port congestion. Stockouts. Labor shortages. Shifting consumer behaviors. Geopolitical uncertainty. There's certainly no shortage of retail supply chain challenges.

To help overcome such issues, retailers will benefit from investing in tools and technologies to enhance capabilities in demand planning, inventory management, visibility, logistics and transportation networks. Leveraging analytics to better inform what is happening across the supply chain will enable smarter, faster, and more efficient decision-making.

After all, it's hard to manage what you can't see. Getting better visibility across the supply chain starts with data and gaining critical insights from analytics. Such insights can expose inefficiencies within partner strategies, supply route strategies, diversity of supply and more. This is especially important as more retailers are looking to take cost out of the supply chain in order to combat rising prices.

Analytics can help improve forecasting and increase efficiencies. By improving the ability to anticipate demand, inventory modifications can be made that can save costs and accelerate delivery times. But achieving end-to-end supply chain visibility requires integrating platforms at each stage of the process, from procurement through production to distribution.

To help address current challenges, consider the following:

- Get closer to the consumer experience and gain a better understanding of behaviors and shifts in demand.
- Acquire tools and capabilities to gain visibility across the supply chain and analyze the data to make fact-based decisions of what actions to take, while having insight into the impact of those decisions (such as impact on revenue, margin, cost, customer satisfaction, fill rates, etc.)
- Implement an effective planning and execution model for transparency so stakeholders can be unified on the organizational plan and how to best execute that plan together.

4 Managing in a tight labor market

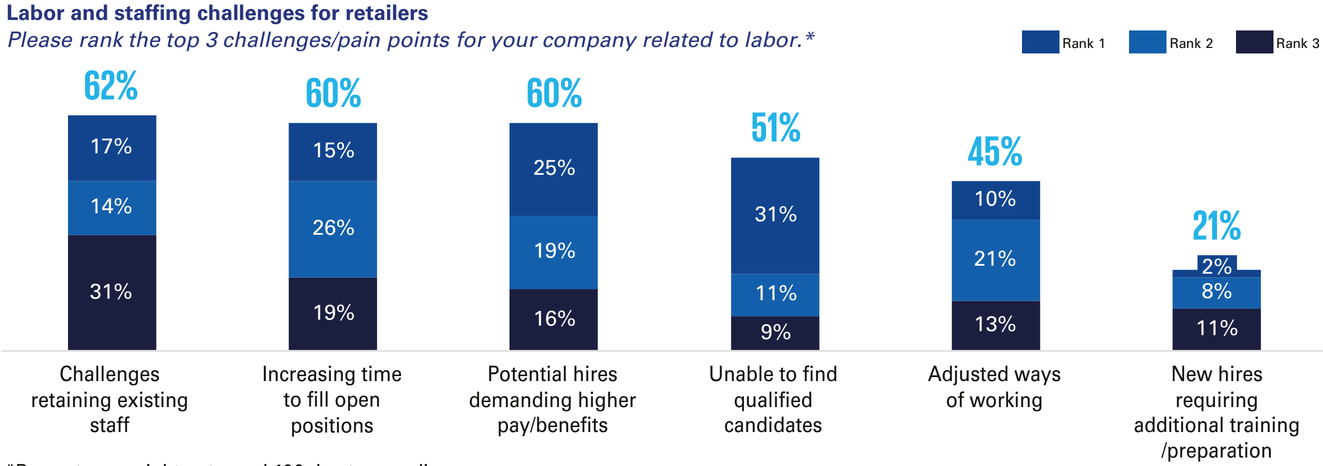
Retailers face a much more challenging labor market than in recent years and have reacted by increasing cash and non-cash compensation and turning to automated solutions. Most retailers have raised worker starting salaries, improved health and wellness benefits, and increased upskilling and educational opportunities for their workers.

According to the retail executives surveyed, the top strategies used to attract workers include higher wages (57 percent), and signing bonuses (51 percent.) Meanwhile, increased location flexibility (37 percent) and career advancements (29 percent) are seen as lower-cost solutions for retailers to retain talent without placing as much burden on profitability.[22]

Managing staffing challenges

Labor and staffing challenges for retailers

*Please rank the top 3 challenges/pain points for your company related to labor.**



*Percentages might not equal 100 due to rounding.

Alleviating labor challenges

Initiatives to overcome labor challenges

*Please rank the top 3 initiatives for your company to alleviate labor and staffing challenges.**

*Percentages might not equal 100 due to rounding.

[22] Slide 49

While overall U.S. GDP has increased over 10 percent above its pre-COVID peak, workforce participation remains below pre-COVID, driving a tight labor market, increasing competition for talent, and advancing employee leverage.

Automation on the rise

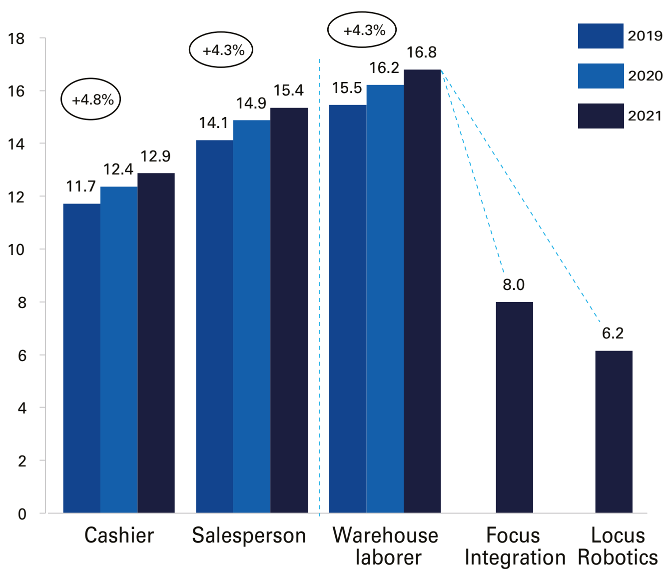
Facing a broad-based labor challenge, 62 percent of retail executives acknowledge struggling to retain existing staff and 60 percent cite an inability to replace lost employees with qualified candidates.[23]

As a result, retailers are relying more on automation to help alleviate the demand for in-store labor. As hiring and employment costs increase, automation can create a counterbalance following the initial investment.

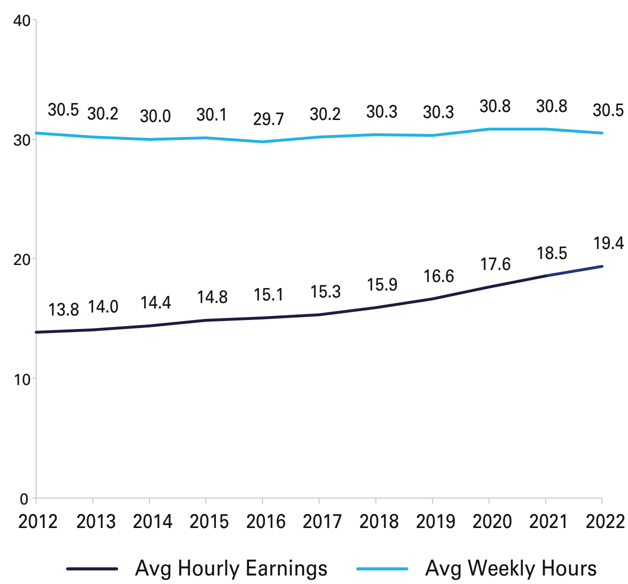
In fact, over 70 percent of retailers surveyed said they are already using, or plan to, introduce new technology to reduce their reliance on labor, especially in areas like e-commerce, order picking, self-checkout, and automated customer service.[24] For example, grocery and mass retailers are piloting all self-checkout stores while fast food and quick serve restaurants have rolled out kiosks for taking orders. Specialty robotics can achieve cost efficiencies as they can be as much as 33-50 percent cheaper than human workers on an hourly basis.[25]

Impact of automation

Hourly cost of automated solutions and average earnings by occupation, 2021 (1,2)



Retail store employees average hourly earnings v. average weekly hours, 2012–2022 (2)



23 Slide 48
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25 Slide 46

Proactively managing labor shortages

Robin Rasmussen
Principal, Human Capital, Advisory

Retail labor shortages in stores and distribution centers continue to challenge the industry. Proactive retailers can take key steps to retain, grow, and attract talent. Consider the following:

Elevating experience. In addition to wage increases, retailers need to care about employee experience. It's top-of-the-spear important. This is especially true for a younger workforce, providing them with support to alleviate stress and seeking to make the job easier and enjoyable to create a positive experience.

Retaining talent. Retaining retail talent is becoming more important than recruiting new workers. Retailers investing and upskilling existing talent can drive cost efficiencies saving in onboarding and training of new hires and developing existing talent into more advanced roles.

Adding benefits. Higher pay is important but so is health and wellness, tuition assistance and many other benefits. Such programs often focused on professional personnel but its time to offer them to non-exempt workers to provide support and enhance their health and wellbeing. Following pandemic-induced stress and worries, caring about an employee's mental health needs to be a top priority.

Accelerating payroll. Enabling employees to get more immediate access to their wages can be a strategic advantage for retailers. Many are exploring the potential of earned wage access and other options to enable workers to get their pay faster, which can prove extremely beneficial when dealing with high inflation.

Improving workforce management. Retailers are investing in software and analytics that will enable smart, dynamic scheduling of employees to improve work quality and drive job satisfaction. It also achieves operational efficiencies by enabling better management of labor cost.

5 Experimenting with metaverse opportunities

While the metaverse is in its early stages, excitement and enthusiasm surrounding the possibilities abound. An evolving virtual universe, the metaverse brings people together to share interactive, immersive, and social experiences by way of digital avatars and identities. It blends consumers' physical and virtual worlds together through shopping, socializing, gaming, fitness, education, working, training, and entertainment or just hanging out with friends. Simply put, the metaverse is about bringing people together in new and previously unimaginable ways.

According to a recent KPMG survey of more than 1,000 consumers, two out of three respondents say they are already aware of the metaverse—and that awareness increases for younger generations, with 86 percent of Gen Z and 81 percent of millennials reporting familiarity.[26]

Yet, familiarity with the metaverse is low among retail executives, of which 41 percent report being "somewhat familiar/ somewhat understand" and 10 percent "had not heard of it." Meanwhile, 42 percent of executives view the importance of the metaverse for retail companies as "somewhat important." Nearly as much (40 percent) view it as "not very important."[27]

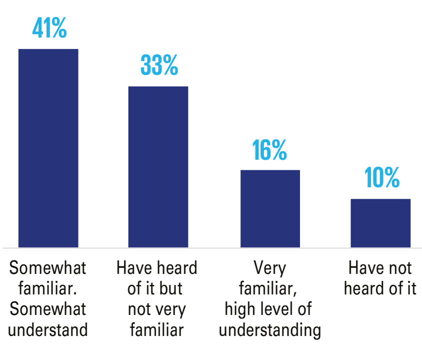
Retail in the metaverse

Almost half (47 percent) of retail executives admit they have not yet begun to develop a metaverse strategy, while 35 percent said they do not have a strategy and have no plans to do so.[28]

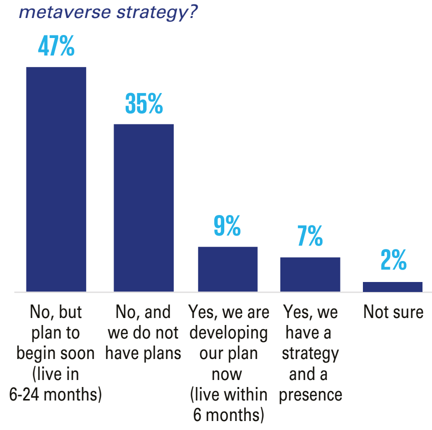
When developing a metaverse strategy, retailers should focus on deepening connections between the brand and consumers within an open and immersive virtual community space.

Exploring the metaverse

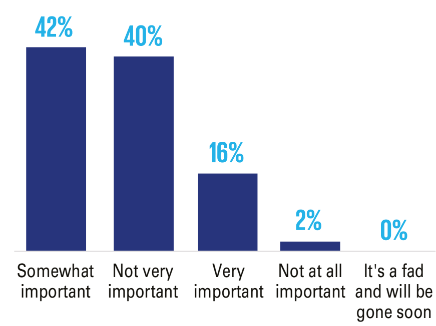
Famliarity with Metaverse for retail executives
How familiar are you with the metavesrse?



Metaverse strategy intentions and maturity
Does your company have an articulated metaverse strategy?



Importance of metaverse for retail companies
How important do you think the metaverse will become for retail companies?

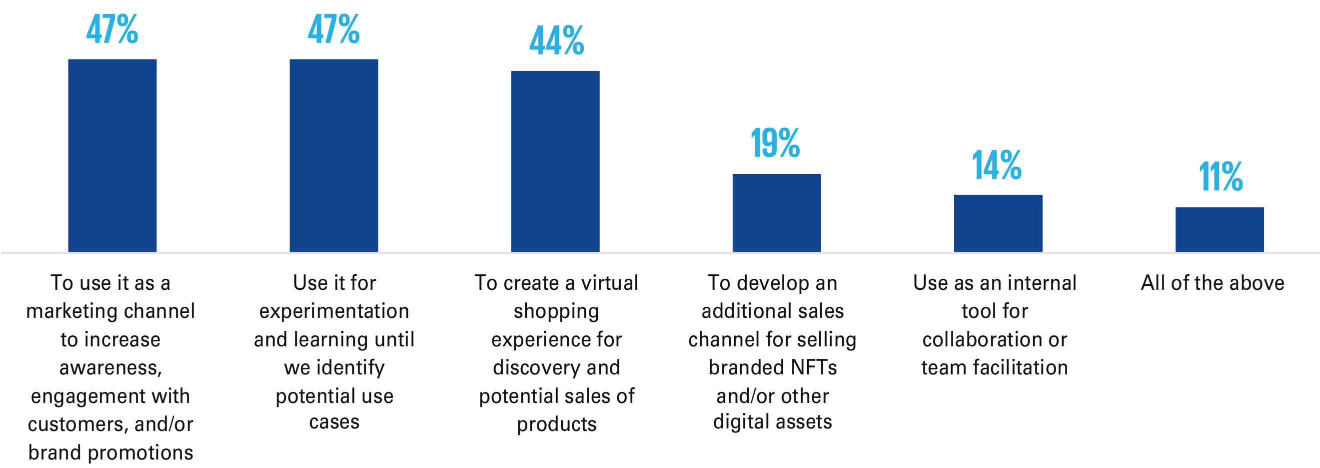


[26] KPMG report, "Go boldly, not blindly, into the metaverse," March 2022.
[27] Slide 57
[28] Slide 57

Leveraging metaverse opportunities

Ways to leverage metaverse for retail companies

How does your company plan to leverage opportunities in the metaverse?



Doing so will create meaningful experiences, where relationships develop, loyalty grows, and time and money are spent.

Of the retail executives surveyed, 47 percent currently see the metaverse as a marketing channel to increase brand awareness and consumer engagement. The same amount (47 percent) plan to use it to experiment and team with others to identify potential use cases.[29] In the longer term, a wide variety of use cases may become standard, ranging from sales of digital items like nonfungible tokens (NFTs) or physical items through a metaverse storefront or sponsoring live performances hosted in the metaverse.

Some retailers are already exploring this vast new world of new opportunity, acknowledging its potential as a future growth channel to drive new revenue streams, build brand awareness, and expand consumer reach.

For instance, NIke and Nikeland, a virtual space built on the Roblox metaverse platform where users create 3D avatars to play mini games, try on Nike gear in the showroom, and experience a new blend of sports, games, and fashion. Considering that Roblox users spent about 4.2 billion hours on the game in 2021 and nearly 55 million daily users logged into the gaming platform in January 2022, Nike's presence on the platform enables it to greatly expand its reach to new and existing customers.[30]

Many luxury retailers have already made their mark in the metaverse. For example, luxury retailers such as Dolce,Gucci, LVMH, Fred Segal, Gucci, and LVMH have opened NFT stores or held events to create a dynamic retail experience.[31]

Overall, metaverse business opportunities are growing rapidly. According to Bloomberg analysis, the metaverse market may reach $783.3 billion in 2024 compared to $478.7 billion in 2020, which represents a compound annual growth rate of 13.1 percent.[32]

[29] Slide 58

[30] Roblox Corp. Press Release, "Roblox reports fourth quarter and full-year financial results," Februaru 15, 2022.

[31] Slide 30, "Marketwatch.com, Luxury in the metaverse: Morgan Stanley says it could be $500 billion market,: November 16, 2021.

[32] Bloomberg Intelligence, "Metaverse may be $800 billion market, next tech platform," December 1, 2021.

On the cusp of a consumer revolution

Sam Ganga
National Consulting Leader, Consumer & Retail

With the metaverse capturing more and more headlines, retailers may be eager (or not) to have some type of metaverse presence. However, at this early stage, actions taken often amount to little more than a check-the-box exercise. Most retailers are doing this out of fear of missing out on the next big thing. They worry that the metaverse could be the next mobile revolution, and they don't want to be left behind.

Truth be told, many retailers still need to focus on overcoming fundamental technology challenges across their front, middle, and back offices. They are updating antiquated systems in a 2D omnichannel world, and not yet ready for the 3D metaverse.

When the metaverse does take off, it's going to drive tremendous change because of its multidimensional nature. It will be much different than previous internet waves, due to the fact that the very premise of Web3 (the next generation of the internet) is decentralization. So, unlike other adoption curves, it will likely be much more radical.

Why? Because the power of the web and its data will belong to the individual, not companies. This will be a dramatic shift for retailers, as consumers will drive change and shape the metaverse in what will amount to a massive consumer revolution.

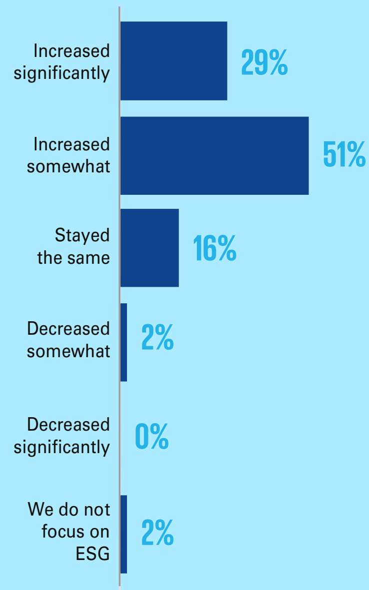
The connectedness of the metaverse will be enabled by individual adoption that no one can control. The technology will evolve but it will depend on people to make it happen.

Although retailers are challenged by inflation and economic uncertainty, it's worth it for them to take some time to explore the vast potential of the metaverse and develop a strategy before their fear of missing out comes true.

6 ESG: Embracing progress with purpose

Environmental, social, and governance (ESG) programs continue to grow in importance for retail organizations. This is evidenced by more than 80 percent of executives stating the role of ESG has increased within their company over the last two years, including 29 percent characterizing such increases as "significant", while 51 percent view them as growing "somewhat."[33]

Importance of ESG over past two years



ESG encourages corporations to act in an ethical and responsible manner reinforced by a set of criteria focused on factors relating to the environment, social justice, and effective governance. Key stakeholders including consumers, employees, investors, regulators, and boards are advocating a sustainable future and pressuring retail organizations to do the same by reexamining how they operate, exploring alternative methods, and being more mindful of consumption.

Consider the following ways retailers are embracing ESG.

— **Environmental**: Retailers are incorporating green economy into business models by setting aggressive environmental targets to generate shared value such as adopting a circular economy, reducing greenhouse gases, conserving natural resources, sustainable sourcing of raw materials, and recyclable packaging. Efforts will likely be accelerated by the U.S. Securities Exchange Commission's (SEC) climate disclosure rules proposed in March. If enacted, the rules include requirements that will likely push the "E" to the forefront for companies for at least the next two to three years.

— **Social**: Companies find social sustainability a proactive way of managing and identifying business impacts on employees, workers in the value chain, consumers, and local communities. This includes analyzing a diversity mix by department and level, and creating metrics to increase diverse hiring, promote diversity, equity, and inclusion, enforce fair and safe labor standards, focus on developing and upskilling employees, and empower communities.

— **Governance**: As shareholders seek transparent and accurate reporting of business practices, companies are making changes to their governance structures to align commercial and sustainability goals, while keeping an eye on long-term value creation. They are doing so by managing the security, protection, and privacy of data, increasing the inclusiveness of board composition, adhering to ESG frameworks, expanding the role of chief sustainability officers (CSOs), and engaging in active partnerships across their business, including local communities.

Cost concerns

Costs to implement and manage ESG remains a top challenge, according to nearly 84 percent of retail executives, who ranked it among their top three ESG challenges, followed by a lack of ESG experience (57 percent) and the need for management attention and dedicated ESG support (50 percent).[34] Investing in executive roles and established processes are the best way to implement positive change and alleviate ESG challenges.

[33] Slide 74
[34] Slide 68

Major ESG challenges for companies

Initiatives to overcome labor challenges

*Please rank the top 3 initiatives for your company to alleviate labor and staffing challenges.**

*Percentages might not equal 100 due to rounding.

Of course, retailers cannot sacrifice corporate performance or shareholder return. Rather, they must create value in a way that benefits the business now and in the future. As such, many leading retail brands are taking steps to strategically embed ESG principles into core business activities, prioritizing areas with the greatest impact on the company's long-term outlook.

But ESG success depends largely on organizational commitment, emphasizing the need for a dedicated ESG role or team to lead ESG efforts, including managing risks, stakeholder expectations and compliance regulations. As a result, the role of CSOs is becoming more commonplace, with seven of the top 20 retailers implementing this role. CSO responsibilities continue to evolve, moving up the value chain, expanding from sustainability initiatives that align commercial and sustainability goals, to working with competitor brands, to establish eco-friendly best practices, to being involved in product development, manufacturing, and marketing.

A quarter of all U.S. companies have some sort of executive compensation incentives tied to ESG goals, representing a 6 percent increase since 2019.[35] Typical ESG criteria included in compensation incentives are those that can be measured relatively easily, such as carbon emissions, worker safety, or number of minorities on the board.

Fast fashion challenges sustainability

With cost efficiencies top of mind for retailers, fast fashion may further challenge sustainable processes. Considered a low-cost way to mass-produce clothing, fast fashion is brought to market very quickly. However, production is linked to environmental and labor concerns coupled with a disposal mindset that adds to pollution.

In a recent KPMG survey, more than half (54 percent) of the 1,000 consumers said they are willing to pay a premium for products from brands or businesses with sustainable practices.[36] Will this hold true if inflation lingers? Many consumers, especially younger generations, favor sustainability and will look to the fashion industry to uphold ESG principles. Retailers will be challenged to strike the right balance between managing costs and maintaining ESG standards to meet consumer demands.

[35] Slide 74
[36] KPMG research, January 2022.

Maintaining ESG momentum

Julia Wilson
Managing Director, Strategy, Advisory

As the old adage goes, Rome wasn't built in a day. Neither is a corporate ESG program.

Companies are increasingly realizing ESG is an enterprise issue that touches all aspects of business and organizational challenges will take time to overcome. However, within the last two years, many retailers have made rapid progress in establishing a solid foundation to implement and build upon their ESG strategy.

For instance, more retailers have leaned into ESG and completed initial assessments to determine ESG topics most relevant to their business and where they can make the most difference.

To date, retailers have had more success with social and governance efforts than environmental, due primarily to the complexity of reducing environmental impact and the need to work with outside partners.

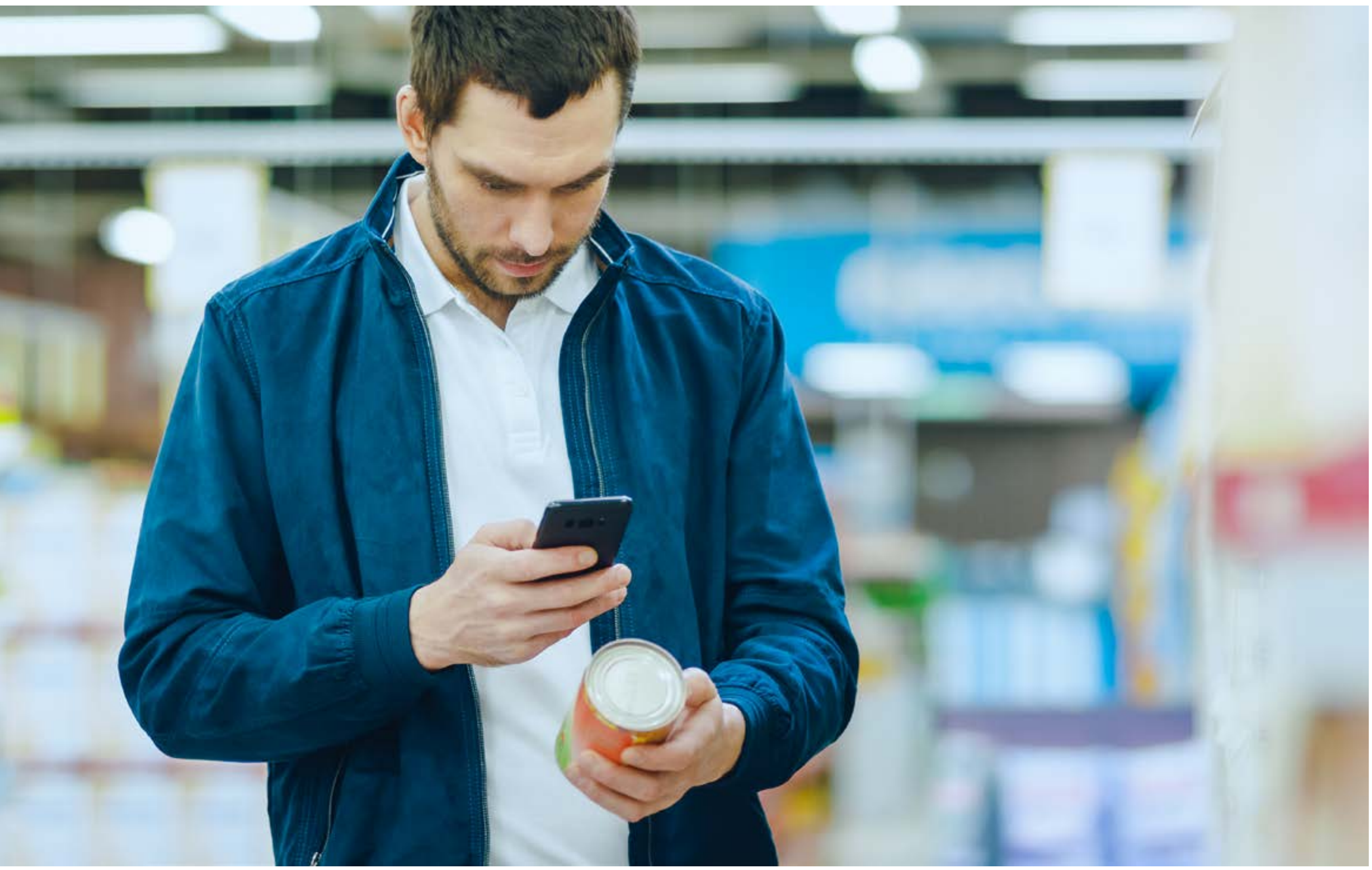
Cost, competition, and value creation all come into play. Facing intense inflationary pressures, retailers are now prioritizing ESG based on what they can do now and why. And they are being transparent about it.

However, if looking only through a narrow lens of cost, an organization can lose sight of the greater value achieved over time. Viewing ESG through a broader lens of a comprehensive business case, other things become apparent. Like how a retailer can reduce risk, increase network resilience, increase employee engagement and retention, enhance brand reputation, grow customer base, and reduce capital costs from tax incentives, and more.

While rising costs and labor shortages may impact strategic decisions in the near term and certain tradeoffs may need to be made, it's likely a temporary detour. Why? Because retailers are passionate about accelerating ESG progress. It's beneficial to their business and their key stakeholders—consumers, employees, shareholders, boards, etc.—will continue to demand it from them.

Seizing new opportunities

Despite challenging market conditions, retailers must continue to move forward and seize opportunities to transform for the future or risk falling behind. Winners in the future will invest, innovate, and implement modern approaches, strategies, and capabilities to maintain a presence and gain competitive advantage in an environment of continuous change. By acting now to enhance the return to in-store shopping, enable true omnichannel experiences, improve the supply chain, employ new labor strategies, explore new metaverse potential, and embrace ESG, retailers are seizing opportunities to drive future success—and survival—in a rapidly evolving and innovating marketplace.



About KPMG Consumer & Retail practice

KPMG is a leading provider of professional services to the consumer and retail industry, with 4,500 U.S. based C&R partners and professionals and 21,000 globally. We provide professional services to 78 percent of top 100 consumer and retail companies within the Fortune 1000. Our experience includes knowledge of all major international markets. This strongly positions us to assist our clients in seizing opportunities in response to industry, marketplace, and regulatory changes.

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