

# Retail and consumer



The retail sector has seen a steep sales decline in all sub-sectors (save grocery), as the lives of consumers change – first during lockdown, and now during the gradual return to normal. The biggest challenge for the sector however, is addressing the expectation that once the dust settles, what constitutes normal will be different than it was pre-pandemic.



For that reason, retailers first need to consider how their sector will change, before deciding what actions will best position them for success:

**How long will it take for demand to build back up to normal?**

This will naturally be different in each sub-sector, with hardware and grocery already largely back to normal, but most others – apparel, department stores, food and beverage – will likely take much longer. Most retailers will be considering their usual market demand drivers (seasonality, weather, economic conditions), overlaid with more variable factors like competition, tourism, and social restrictions – to create the best forecasts they can with the information available.

**Will consumer demand (level or preferences) for retail be different in a post-COVID-19 world?**

From the beginning of the pandemic, New Zealand saw some significant changes in consumer demand. Luxury and discretionary retail decreased and 'nesting' increased, increasing demand for homewares, DIY and activities that could be carried out in the home. Apparel demand shifted in line with people dressing to work from home. Household spending normally allocated to international travel, restaurants and entertainment is also likely to be reallocated to other retail sectors for a significant period post-COVID-19.

**Will the way I engage with the consumer also be different?**

Perhaps the largest consumer driven shift in retail has been the surge of e-commerce, within a short timeframe. Given lockdown restrictions, organisations have been forced to shift demand from physical to digital channels – in most cases, far beyond existing capacity. While post-COVID-19 is bringing with it a gradual return to physical stores, this digital shift will remain to some degree. Already in New Zealand, between March and May, the e-commerce consumer demographics have shifted significantly, with the historically lowest adopters now becoming some of the largest adoption groups.

After assessing each of these questions in the context of an individual retailer, there are five major ways an organisation can set themselves up to succeed in a post-COVID-19 New Zealand – particularly over the next 18-24 months. These focus areas are in line with industry trends in New Zealand prior to the pandemic, but have been dramatically accelerated, in many cases becoming critical to maintaining competitive advantage, given changes in consumer demand.

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## Omni-channel experience

Prior to the lockdown period, e-commerce was growing at a rate many times that of physical stores. More and more people are researching retailers online prior to purchasing (up to 90% in some sub-sectors), the average basket size of online orders is increasing, and there is more and more competition between local and foreign online retailers (about 30% of New Zealanders' ecommerce orders are with foreign businesses). As a result, most retailers were already in the midst of growing their web and mobile offerings, streamlining their click and collect service, and differentiate themselves online. Perhaps the biggest change during COVID-19 therefore, is the marked rise in customer expectations for their online experience, adding to these pressures.

The lockdown has exposed a lot of frustrations consumers have with site navigation, customer service, information availability, and product availability – areas that many retailers have considered a lower priority given the historical size of the online channel. No longer able to rely on their bricks and mortar brand strength as much as they could pre-COVID-19, it has raised the level of competition between omni-channel and online-only retailers, both at home and abroad. Retailers with the greatest investment in their online channel – especially when it comes to customer experience, omni-channel consistency, real-time inventory levels, and range extensions like an endless aisle – are the ones most likely to succeed over the next 18-24 months.



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## Distribution optimisation

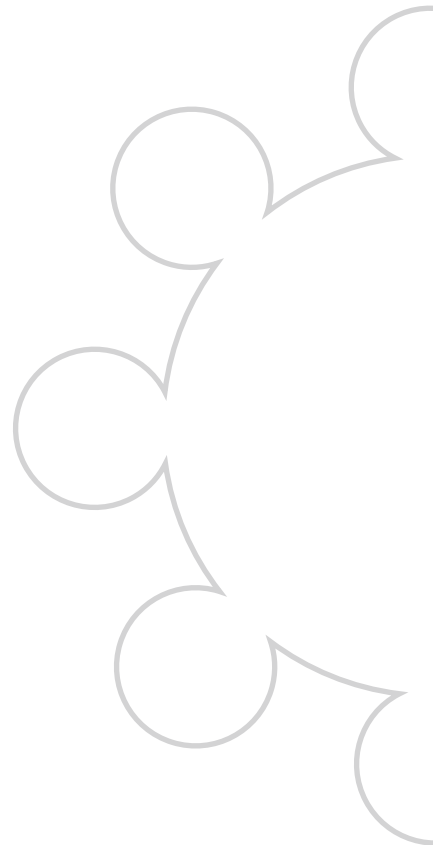
With omni-channel taking up much of the demand-side focus for retailers, a large part of the supply-side challenge is driven by a retailer's physical logistics network configuration. This is in part due to its having to meet the needs of a demand shift – e.g. a jump in volume for online consumer deliveries and click and collect orders. For most local retailers, online typically represents 5% to 20% of total sales, meaning that fulfilment is managed from either individual stores, selected stores, a central DC, or a hybrid of these options. Coping with the immediate rise in online delivery and click and collect during lockdown saw many retailers dedicate some stores to fulfilment only, others simply did anything they could to scale up existing operations to levels needed. Ultimately, as online fulfilment is expected to settle at levels higher than pre-COVID-19, most retailers will be considering shifting these short-term changes to a more sustainable, optimised operating model.

The second distribution challenge is in the location of distribution centres, and transport modes used. Similar to the Kaikoura earthquake, retailers with both a North Island and South Island DC experience less out-of-stocks and are better able to weather demand variability than those with only one Auckland based central storage location.

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## Store rationalisation

Reduced revenue has seen most retailers consider each of their levers of cost reduction and profitability – a major one being physical store footprint. Given decreased demand overall, now is a good time to evaluate store performance, and look to either close or right-size underperforming stores - or those in regions with high costs to serve, high competition, or low growth potential. These are typically stores that were already underperforming prior to the COVID-19 pandemic, but have essentially had their remedying action brought forward given market pressures.



## Agile operations planning

Most retailers run some variation of a classic sales and operations (S&OP) process whereby demand is forecasted, inventory requirements are calculated, and (depending on the value chain) either replenishment orders, manufacturing orders, or overseas allocated buys are made. This system is largely based on accounting for seasonality and trend (i.e. repeating changes to demand, or gradual increases or decreases), and often struggles to adjust to events like a pandemic that need wholesale changes. A major reason for this is that retailers typically possess a large number of SKUs that can't be managed individually, and they operate supply chains with long lead times (especially for overseas buys). This can either be directly (dealing with overseas suppliers) or through a supply chain using local distributors. As a result, most replenishment systems are geared to historical performance (either through reorder point, min/max or similar logic). Managing more than short term demand changes required significant updates to system parameters, or involves using less data science, and more 'gut feeling' in the planning process.

To address this challenge, and to create a process whereby retailers are able to quickly react to a changing market – organisations need to update their planning process. 'Agile operations planning' is a S&OP evolution with a focus on the next 18-24 months, whereby:

- Demand signals from multiple sources are gathered on an ongoing basis to form the best forecast of the future as possible, at a SKU level
- Stockouts and excess stock levels are monitored weekly to identify waste
- Supply constraints, escalation and deferral means are decided upon weekly to maximise on shelf availability, working capital, and overall operational costs each month.

This process is similar to 'classic' S&OP in structure, but focuses on a different time horizon, is more encompassing within the business (i.e. does not just involve sales and supply chain), and most importantly it makes particular use of data-driven and perpetual scenario planning supported by an executive decision making cadence.





## Marketing spend shifts

Marketing spend is currently in the middle of a significant shift from traditional media and promotional channels, to digital and social marketing. With up to 90% of consumers researching products online prior to purchasing, and with individuals in all demographic bands spending more and more time on social media and their mobile phones – spend on digital marketing is growing six times faster than traditional.

This means more than just a reallocation of spend. In the context of a general cost crunch, it has led to a large number of retailers using data analysis and causal modelling to understand in detail the return of their marketing investment. Beyond surveys and net promoter score data, this statistical method attempts to isolate each element that influences demand (pricing, promotions, competition, weather, economic factors etc.) so that a clearer ROI can be established for each above or below the line investment. This kind of modelling is enabled by the large number of easily accessible internal and external market data sources, and tracking technology that cheaply compiles competition pricing and promotional activity.

Finally, disruption caused by COVID-19 has increased the value of making marketing more targeted, either in seeking out a particular consumer type, providing consumer-specific offers, or in many cases, trying to influence specific consumer actions. In a post-COVID-19 world where competition is higher – there is a significant value in using marketing activity to increase cold and warm customer acquisition, and in-store conversion for example.



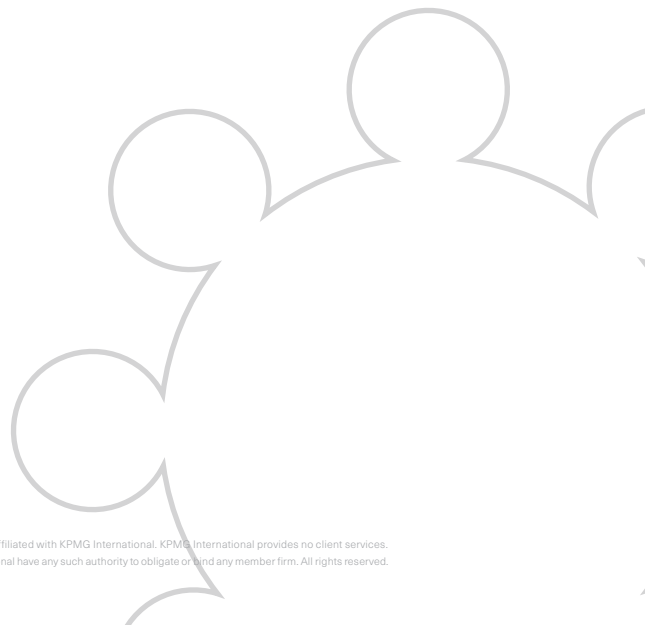
## FADES analysis

### Digital technology in retail

Retailers in New Zealand have typically been strong adopters of customer facing, demand-side digital investment, all be it at levels behind most other developed countries. Online, mobile and digital marketing are all well established for example, but there is less historical adoption when it comes to digital technology within the business. Most major retailers in New Zealand are either finishing, in the middle of, or starting core systems replacement programs, but less invested in merchandise financial planning technology, in-store digital technology (beyond the basics), collaborative planning software, or digital workforce management solutions. All these areas are expected to grow over the short to medium term, especially those where digital investment can be tangibly linked to either customer acquisition, working capital optimisation, or reducing cost to serve.

### Elastic workforce

Many of the initiatives discussed in this retail overview are centred around easing financial pressure – either through operating model change, digital automation, and optimisation etc. Generally, they end up addressing major value drivers - reducing logistics spend, reducing wasted working capital, reducing out of stocks, improving margin, or lastly, reducing labour costs. For most retailers, labour savings sound appealing in general when creating a business case, but are more difficult when it comes to implementation – especially in-store. Retail labour models need flexibility, and given the nature of the retail sector, with a pool of labour spread across full-time, part-time and casual contracts – reducing overall labour costs permanently often poses challenges during seasonal peaks. For this reason, creating an elastic workforce, where head office and store staff can work more flexibly – either through digital collaboration, between multiple locations, or remotely – can provide an solution. This requires an investment in continuity planning, security, and cultural fit.

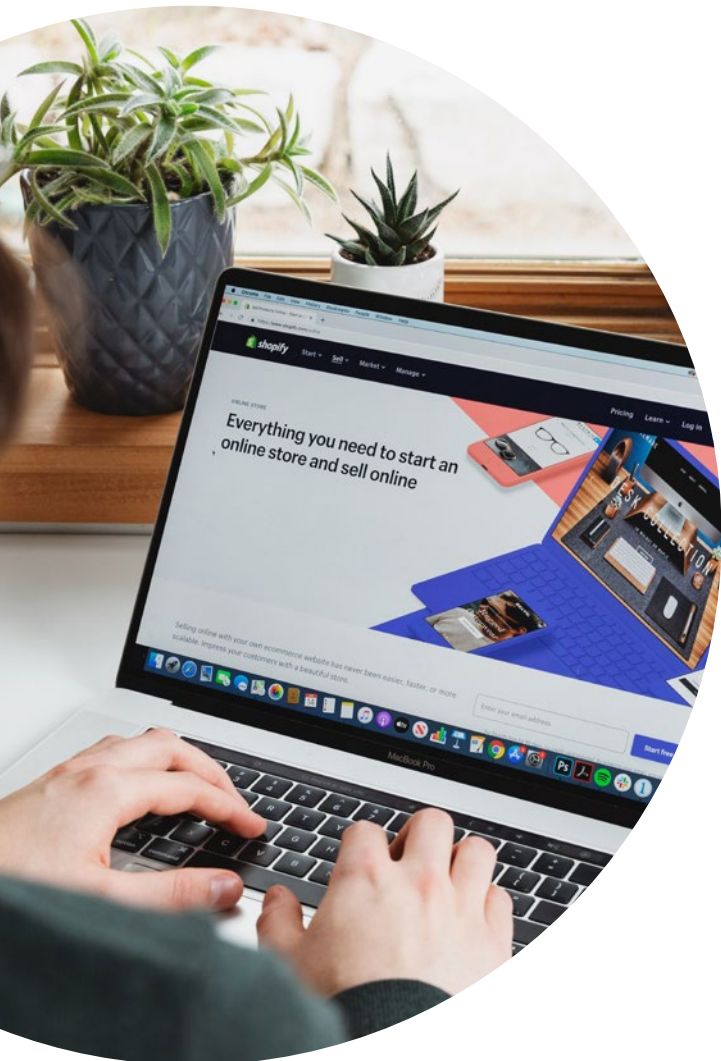




## Strategy and operating model

Coming up with a retail strategy for your business in a developed market is often difficult. Markets like New Zealand are generally mature, customer loyalty is low, and competition (both locally, from new foreign entrants, and from overseas e-commerce retailers) is very high. In other sectors with these same challenges there has been a rise in disruptive strategies, and agile-focused operating models – but somewhat less so in retail. Agile is typically perceived as being a software development toolkit, now finding its way into telecommunications and financial services within New Zealand – but there is no reason to think it can't work for retail as well. And it has overseas.

At the end of the day, agile is about capitalising on scale, acting quickly, becoming customer centric, employee centric, and innovative – exactly what successful retail businesses need. For a retailer this would mean a shift to cross-functional teams, full time alignment to workgroups, rather than functions, and a focus on action rather than process. It also changes the way leadership engages with the business – which is perhaps why retailers, with more traditional career growth models, are more resistant than other sectors. Agile retail operating models can be a great way to align to a post-COVID-19 world.



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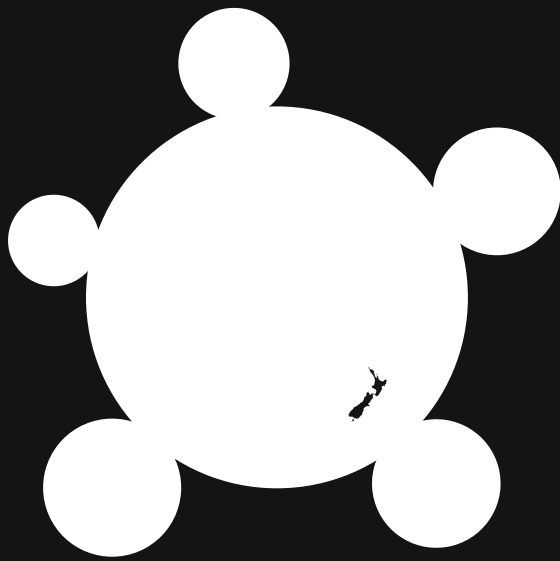
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