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2021 retail industry outlook

The new rules of retail

A year of turmoil shapes priorities for 2021

We just lived through a market-shaping year; roughly 50 retail bankruptcies occurred during a time when others experienced record earnings.[1] Consumer behavior changed overnight as health and safety concerns suddenly became a purchase driver, and we saw technological adaption in a matter of months that would normally have taken years to occur. This was all brought on by COVID-19, but the effects will be with us even when the pandemic subsides. As a result, there are some new rules for retail.

Against this backdrop, we interviewed 50 retail executives and 15 of our retail subject-matter specialists to address what the retail world may look like when COVID-19 is in our rearview mirror and what that means for retailers as they plan for 2021 and beyond. Will consumers return to a reshaped retail environment? If so, when? Will the pandemic's digital adoption be the new baseline? Or will consumers' pent-up demand for interaction and experience drive them to rally around local shops that give them a taste of prepandemic life?

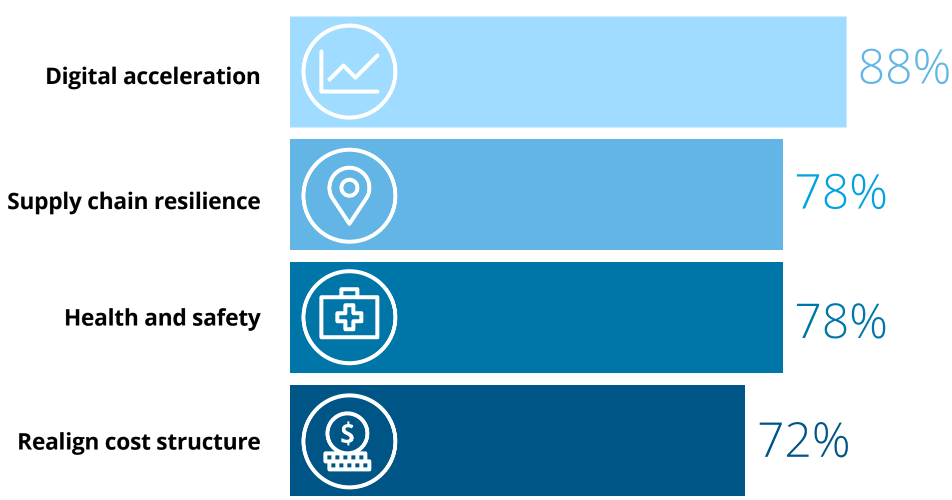
It is abundantly clear in our survey that retail subsectors performed very differently during 2020. Grocers, home improvement, and mass merchants benefited from changes in consumer behavior, along with being categorized as essential services. As such, they are aggressively looking to drive revenue growth in 2021. Others, like apparel and department stores, struggled from the onset of the pandemic and are approaching the upcoming year with a higher priority around cost-cutting. Despite these differences, executives agreed, they aren't going to let this crisis go to waste. It may be a once-in-a-lifetime opportunity for organizations to transform their businesses and rewrite the rules of the industry.

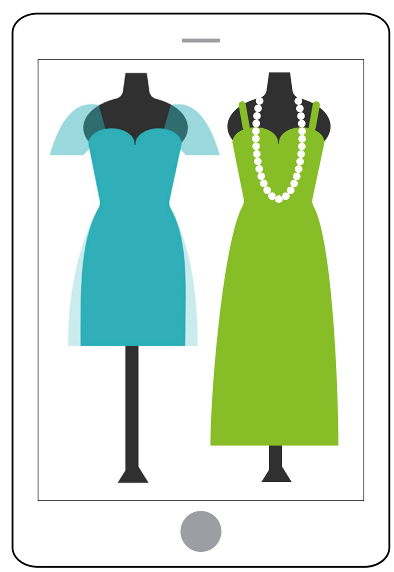
In particular, executives identified four priority areas where the rules will likely be rewritten and key investments will take place:

- **Digital investment should go beyond differentiation**
- **Supply chains, inventory management, and digital user experience can no longer operate in separate silos**
- **Health and safety will remain a top priority as it continues to shape consumer behavior**
- **Cost realignment will need to be coupled with fresh viewpoints on how to address profitability**

The specific actions required to meet these strategic goals are different for each company, but the bifurcation of the retail market will likely only define where a retailer has to act first. Given that much depends on the pace of the pandemic and a still-tenuous economic recovery, we offer suggestions on how retailers can navigate the new rules of retail to maximize their investments in 2021.

Retail investment priorities for 2021





Moderate to major investments for 2021. Percentage of retail executives.

Source: Deloitte analysis based on interviews with C-suite executives in consumer products industry. Caution: Small sample size.

A murky macroeconomic outlook ahead

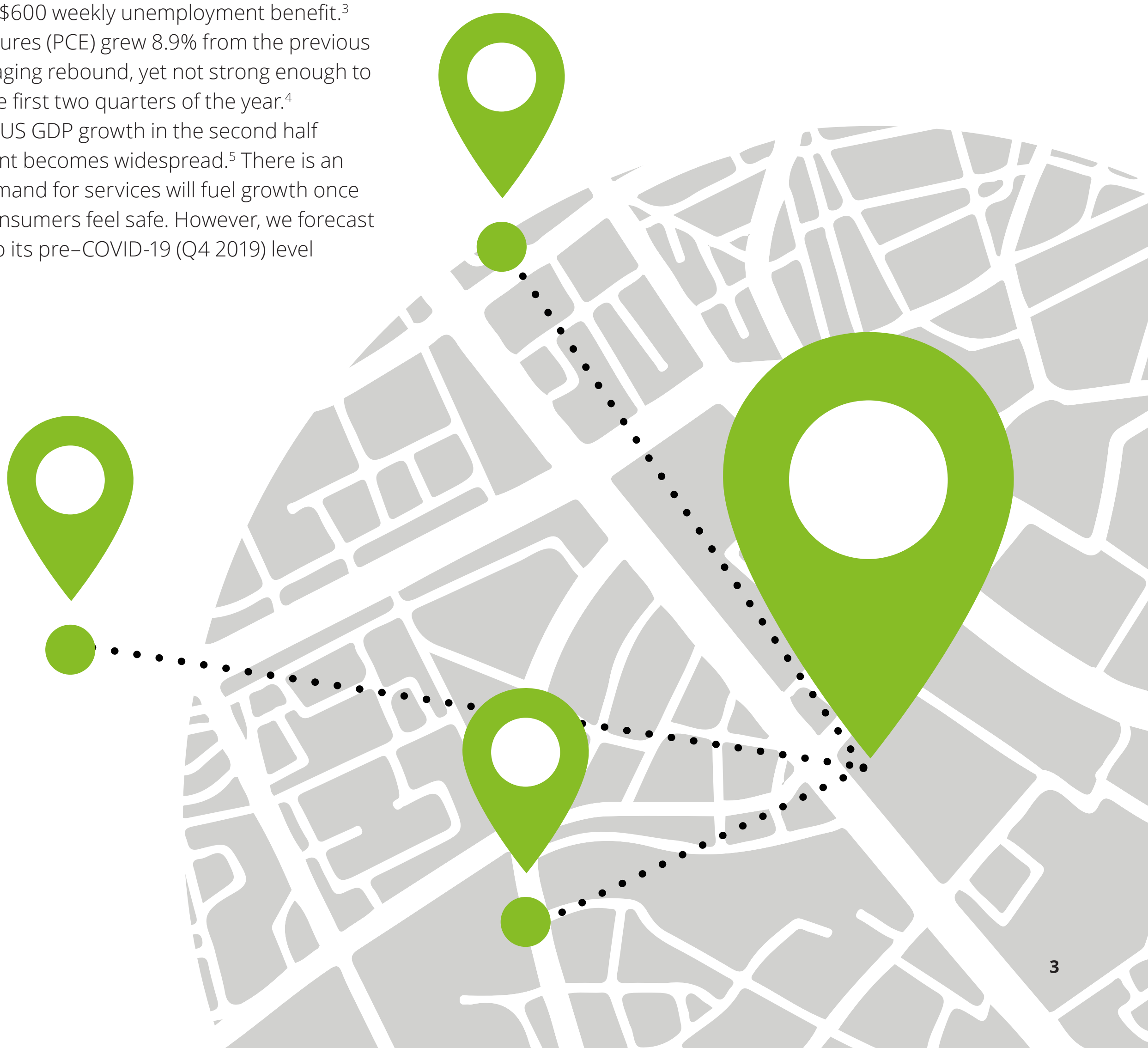
Understanding how political and economic factors may unfold will be instrumental when thinking about future investments and business strategies.

Although it is hard to plan around ever-evolving political agendas, it is worth considering how proposed policy changes could affect the retail space. Specifically, policies proposed by the Biden administration on trade, taxes, climate, and minimum wage may have implications for retailers. Strategies and investments may need to be reprioritized based on those potential outcomes.

Vaccine rollout could spur demand for services

In addition to a changing political landscape, the trajectory of the pandemic and vaccine rollout will undoubtedly shape the 2021 economic landscape.[2] After a sharp, pandemic-driven drop in consumer spending in the first half of 2020, spending rebounded in Q3, even with the end of the $600 weekly unemployment benefit.[3] Personal consumer expenditures (PCE) grew 8.9% from the previous quarter. That was an encouraging rebound, yet not strong enough to make up for losses during the first two quarters of the year.[4] Deloitte projects substantial US GDP growth in the second half of 2021 as vaccine deployment becomes widespread.[5] There is an expectation that pent-up demand for services will fuel growth once a vaccine is rolled out and consumers feel safe. However, we forecast that US GDP will not return to its pre–COVID-19 (Q4 2019) level until early 2022.

Retail executives seem to agree that an economic recovery to prepandemic trajectory levels will take time, with six in 10 expecting recovery in the next one to two years, but a quarter see a longer timeline of two to five years. There are still many issues that could shackle retailers. A winter surge of cases could erode confidence and make consumers retreat once again. Retail growth has largely been driven by sales of durable goods, which could reach a saturation point in the upcoming year. In addition, unemployment remains high compared with 2019, at 6.7% in November 2020.[6] Whether those financially affected by COVID-19 will be able to recover, and by when, is very dependent on the pandemic ending soon, the extension of unemployment benefits, and recovery in the services sector.



Digitally differentiate by looking outside the box

It seems one of the most discussed topics coming out of the pandemic is digital acceleration. And although everyone seems to be jumping on the digital bandwagon and hyping the same topics, it doesn't make it any less important. With the pandemic taking the volume of digital interactions to unprecedented levels, the majority of retailers expect a continued increase in demand for digital engagements through 2021. Only three in 10 executives rated themselves as having mature capabilities within digital and, as such, are planning "major" e-commerce, contactless capabilities, and store technology upgrade investments.

"We need to catch up from behind on e-commerce, enable shopping within our mobile app, and figure out last-mile fulfillment."

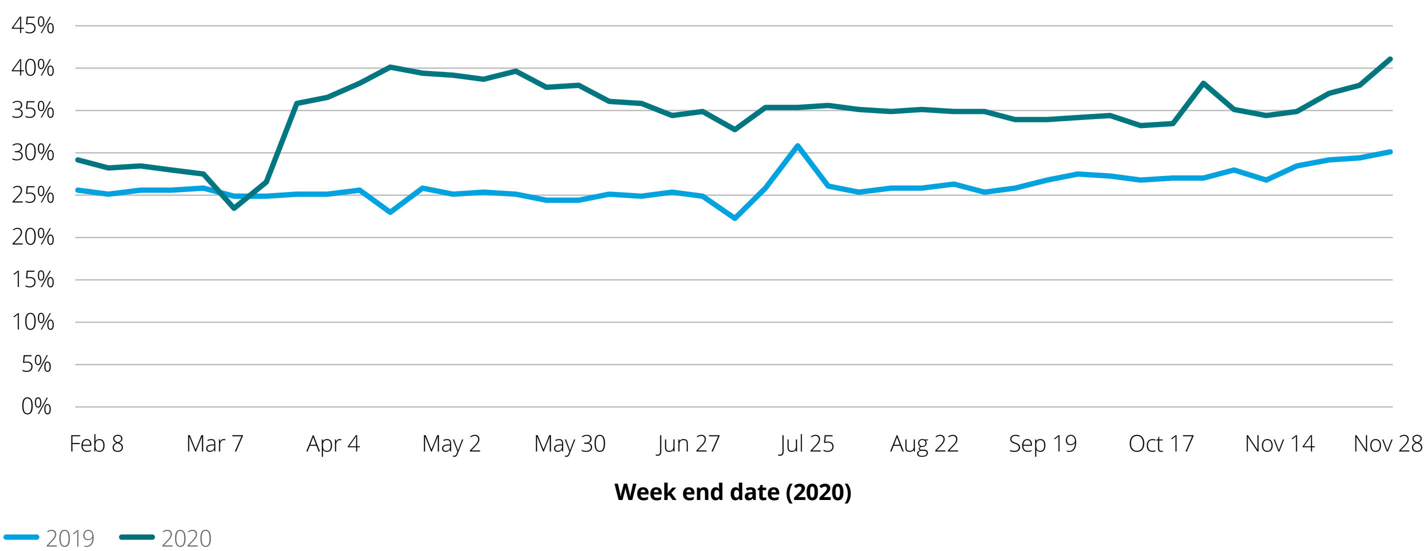
– Retail executive

While having a digital touchpoint might help retailers meet minimum consumer expectations, retailers should differentiate themselves as customer acquisition costs continue to rise. Digitally native retailers, subscription models, and consumer products companies now pose meaningful competition.

And perhaps the bigger juggernaut shaping the space is large tech companies and their access to consumers and their data. In Deloitte's 2020 holiday retail survey, half of consumers said their most preferred starting point for their holiday shopping journey was online search engines or online-only retailers.[7] With tech companies dictating channel preferences, differentiation becomes an even more urgent need.

But what does that mean to digitally differentiate? And if everyone is doing it, do we end up in the same place? With bankruptcies running rampant and mass merchants and online retailers consolidating the market, is the lone-wolf approach the most efficient way to compete?

US retail spending – % of total spend online (Online share of total retail spend by week)



Source: Affinity Solutions spending data, Deloitte InSightIQ analysis

Note: "Retail" = a representative mix of ~500 individual retailers; dates aligned by retail 4/5/4 week structure, beginning week 1 as week end 2/8/2020; unique spikes in July 2019 and October 2020 correspond to Prime Day.

For the long game, the new rule of retail is about looking for new revenue models, like subscriptions or memberships, and forming new partnerships and alliances to create a profitable and digital omnichannel experience. This can allow for new solutions around third-party logistics, data analytics, and customer acquisition. For example, some traditional brick-and-mortar companies are teaming up with digitally native retailers to gain efficiencies.[8] These partnerships may open up cross-channel opportunities for both while also expanding their customer bases.

As retailers plan their digital investments for the upcoming year, they should consider the following points to understand where their capabilities fall short and where it would make sense to consider new alliances.

Create connection and convenience through the right portfolio of digital assets

While concerns over shopping in-store will continue to push consumers online and increase demand for contactless formats, it is not all about pure-play e-commerce. Many shoppers want to mix and match their channel journey based on convenience needs, leading to growing opportunity for new customization expectations and cross-channel avenues, such as reverse logistics.

As digital transforms a once person-to-person, high-touch industry, finding ways to recreate those connections will be important online. One possible next frontier for e-commerce can be seen in Asia, where many consumers are embracing livestreaming platforms. During the events, influencers tout their products' reliability, quality, and other features—thus increasing trust in the brand and creating better engagement. While only a few retailers have tried this in the United States, the pandemic may have opened US consumers' minds to new ways of engagement.

Derive the full potential of your data to predict and react quickly

To deliver true value, retailers will likely have to do a better job anticipating demand and fulfilling customer expectations. The panic-buying spree of spring 2020 and the resultant whiplash effect on supply chains exposed several weaknesses in retailers' data analytics capabilities. Some household categories, like mattresses, experienced skyrocketing demand that they could have never predicted using their old models based on GDP growth. Taking those events as a learning experience, retailers should rebuild their analytics strategies. Artificial intelligence (AI) could play a critical role in this, helping to customize consumer engagements, but it will require more outside-in data. Nearly half of executives said they plan to use better analytics in 2021 to improve decision-making.

> "AI investment is particularly important right now because of margin compression. By investing more in AI, it could create efficiencies while reacting to customers' needs more quickly."
>
> **– Deloitte principal with more than 15 years of retail experience**

Meet shoppers' privacy concerns with clarity and transparency

Online security is a wellspring for retailers seeking to cultivate trust. In a recent Deloitte survey, only 5% of consumers ranked the retail industry as a top-three industry for data privacy, compared with 63% for banks.[9] These issues have come to the forefront again as pandemic-driven contract tracing and the gathering of health data by employers have brought attention to data privacy. To safeguard shoppers, retailers should be transparent about their data strategy and able to rapidly resolve problems.

Seek out digital-savvy talent

To a larger extent, traditional retailers were caught off guard by pandemic-driven lockdowns, leaving business continuity in tatters. As the industry regains momentum, retailers should look beyond on-premises talent plans, which are mostly suited for stores and warehouses, and recognize the talent needs of digital formats. More investments and incentives will likely be needed to attract digitally savvy, versatile talent, especially as competition for digital skills is already intense.

Supply chain resiliency requires end-to-end integration

Disruptions during the past six months exposed inefficiencies in the supply chain, making some retailers realize how ill-equipped they are to anticipate and meet consumer demands and disruptions in unprecedented times. And shoppers are well aware that supply chains aren't keeping up. In Deloitte's pre-Thanksgiving pulse survey, 56% of shoppers said they planned to shop earlier to avoid stockouts, versus 42% last year.[10]

We were curious how retailers were addressing this, and while half said that they believe retail is past the point of no return with globalization, a quarter are looking to repatriate some of their supplier production to avoid the risk of stockouts and delays. However, three-quarters had previously diversified outside of China and didn't plan to make additional changes. Others, however, were making changes in-house, such as actively using the pandemic as an opportunity to centralize control over inventory. For example, retailers could switch from the old model of having many buyers purchasing for separate regions and channels and drop down to a consolidated few buying for all channels.

Retailers understand the importance of being able to react more quickly to consumers' needs and realize they should be more resilient and agile. It's no surprise, then, that eight of 10 expect moderate to major supply chain investment in 2021. Order fulfillment (e.g., last-mile delivery, curbside pickup) will see the heaviest investments, followed by warehouse management and procurement, according to our research. Given the disruption consumers felt during the pandemic, it will be important for retailers to build back confidence by considering focusing on these four areas:

Winning at the last mile means moving beyond the doorstep

As COVID-19 cases will likely continue through a large portion of 2021, consumers will push for more contactless formats and stress last-mile delivery solutions for immediate needs and even for stockpiling. In the early stages of the pandemic, contactless formats were primarily being driven by safety concerns. Increasingly, it's because consumers perceive that it's faster and cheaper than delivery, indicating that the trend is here to stay.[11] New rules of retail would say these contactless formats have become table stakes, and retailers should do more to build loyalty for their platforms. For example, very few retailers are offering reverse contactless logistics such as porch pick-up and curbside returns.

Fortify every link in your supply chain

To be a trusted destination, retailers should have clear visibility into their supply chain networks—spanning multiple vendors, suppliers, distributors, warehouse operators, store workforce, and delivery partners. Incorporating much-needed transparency into the supply chain is viewed as important by slightly more than half of US retail executives. But it requires the organization to be committed and accountable for its partners and workforce. In such an accountable network, every stakeholder will have incentives for identifying issues early on and responding promptly. Of course, if in-store and digital inventory systems are blended, this will require better digital platforms and technology. Ultimately, the ideal inventory system is integrated end-to-end from production to last-mile delivery.

> "An end-to-end supply chain is what needs to happen—companies should be looking at manufacturing all the way to the final mile. COOs are going to have to drive this change."
>
> **– Deloitte partner with 20+ years of supply chain experience**

Drive decisions through the consumer lens

Many digital channels still struggle to demonstrate profitability because they are often bolted onto systems still dominated by human analysis and reaction. If deployed correctly, AI could create the efficiencies throughout the business promised by digital channels. The shift could be dramatic: No longer would the merchandising team make ordering decisions with a product-first focus; they could focus on what the consumer is telling them—online and elsewhere. Everything could emanate from the customer, precisely because AI makes such personalization possible by achieving economies of complexity (handling personalization at the lowest possible cost) rather than economies of scale (handling production at the lowest possible cost). For example, some beauty companies have successfully used AI to assist in providing personalized recommendations and realistic try-on via mobile devices, potentially helping with better sell-through, inventory management, and demand forecasting.[12]

Resiliency measurements required

Based on lessons from recent disruptions, retailers should measure how these investments drive supply chain resilience. Eight in 10 US retailers view measuring resiliency as increasingly important. Without such measurement, retailers' supply chains may be vulnerable to future disruptions, rendering current investments obsolete.

Build trust through health and safety strategies

Winter has brought a spike in COVID-19 cases and, along with it, rising anxiety. In Deloitte's pre-Thanksgiving pulse survey, 56% of consumers were anxious about shopping in stores, revealing the need to invest in additional health and safety measures in the upcoming year.[13] Executives were aware of the concern, stating that "health and safety" and "trust" would be among the top purchase drivers in 2021 for US consumers. Retailers should go beyond the status quo and use health and safety investments to differentiate, create loyalty, and build trust.

Trust is in short supply everywhere, but retail is in a worse position compared with other industries that have also been hit hard by the pandemic and concerns around safety. According to a recent Deloitte study, only 23% of consumers ranked the retail industry as trustworthy, versus 33% for travel and hospitality.[14] This indicates there is an opportunity for retailers to use their health and safety investments to also build trust with the consumer.

The majority of executives we surveyed plan 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. It may be important to consider the following strategies to make the most from investments:

Infuse health and safety throughout operations

Despite expectation for a vaccine, only a quarter of executives believe health and safety concerns will decrease in 2021. Therefore, it becomes critical for retailers to go beyond standard sanitation practices to make their 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 (BOPIS) purchases in order to have fewer people in the aisles. Many executives said rearranging stores and checkouts to create more space was also on the wish list for 2021. Retailers that are embracing new strategies should repurpose their communications for consistent messaging to make consumers understand that safety remains a top priority.

> "We need to separate the online ordering workforce from the everyday in-store shopper. One of the biggest issues today for our shoppers is the space being taken up from the online shopping team while on the sales floor."
>
> **– Grocery executive**

Embrace technology and redesign the retail journey

For some, investments may need to be a stopgap approach. Others, however, see the long game that contactless shopping will likely remain an important purchase driver and should use their investments to differentiate, improving store safety "by design." External window displays, 3D virtual showrooms, mobile and express returns, carts that act as checkout, and cashierless stores may seem futuristic, but could be the key to standing out from competition in the long run.

Opportunity for cost realignment not going to waste

Heading into 2020, the retail industry was already in a depleted position, with heavy debt burdens, slow asset turnover, increasing SG&A, compressed margins, and increased competition. In fact, our analysis found EBIT for the retail industry as a whole had been in decline for the past several years.[15] COVID-19 has compounded problems, with margins becoming even more compressed as consumers shift online. Does this shakeup of the industry create an opportunity to regain profitability?

Profitability may require new business models and alliances

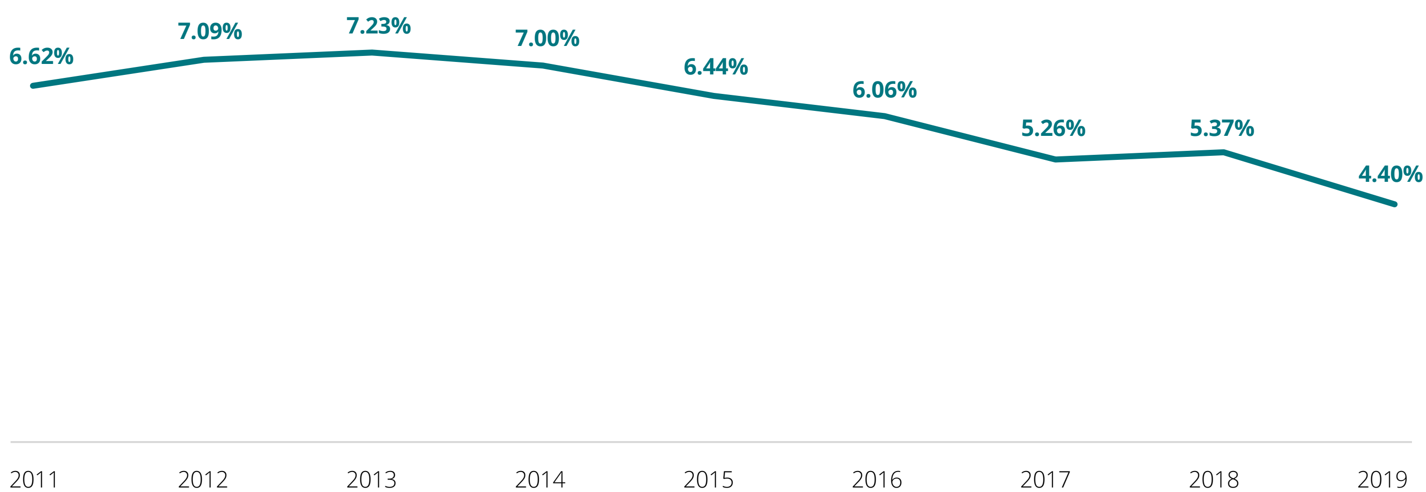
By now, retailers have been able to regroup and analyze how COVID-19 has reshaped their business, leaving a clearer picture of what they should keep and what they can live without. This may be a once-in-an-career opportunity to rebalance cost structure—and it's a fundamental requirement for retailers who were battered by lockdowns and the economic effects of the pandemic. Long-contemplated cost reductions, such as rationalizing store footprints and reducing business travel, can now be pursued in the name of responding to COVID-19.

While these cost reductions are a good start, they don't represent a transformation from the old retail model. 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. Developing alliances for store-in-store models could serve dual purposes by hedging against being "nonessential" while also expanding the customer base. Even talent models can be redesigned: For example, work-from-home platforms can allow retailers to rethink how they attract, retain, and elevate top talent. This opens the doors to a more diverse set of leaders that may more accurately reflect the geographical, ethnic, racial, and other differences of our society as a whole, leading to increased profitability.[16]

For retail executives, slightly more than half said realigning cost structure was of high importance and expect it to be a key area of investment for them. For others, cost-cutting was done early in the pandemic, and their view is that 2021 is about getting back to growth.

> "Our focus is to grow revenue through superior services."
>
> **– Retail executive**

EBIT margin (adjusted) – Median value



Source: Deloitte analysis of 120 US retailers

Closing thoughts

As we look at the responses from our executive survey, we have found that, with the exception of cost reduction, all macro-level actions for retailers are largely the same, regardless of their perfomance in 2020. Similar investment strategies and areas of focus may make it difficult for an individual retailer to "win" in the new retail marketplace. The old playbook and rules will have to be thrown out, and bold, differentiated action will be required to stand out from the competition. Retailers in 2021 are faced with more consequential decisions than at any time in the recent past. Our hope is that it will be a year in which the promise of coopetition can finally come to fruition as retailers rapidly adapt to the new retail environment.

Endnotes

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