A&M

THE PERFECT STORM: INFLATIONARY PRESSURES CAST A DARK CLOUD OVER RETAIL

ALVAREZ & MARSAL

LEADERSHIP. ACTION. RESULTS.

After two long years of intermittent lockdowns due to the Covid-19 pandemic, the retail sector in Southeast Asia (SEA) and Australia appears to be bustling with life again. Indeed, the retail sector is said to be one of the recovery plays as we transition out of the pandemic phase of Covid-19.

However, retailers are faced with a new challenge—sweeping inflation. While the official inflation rate is hovering around three percent, domestic food prices in developing Asia have increased about 10 percent, and oil prices have seen increases of up to 40 percent over the course of the year. A consumer study by Alvarez and Marsal's Consumer and Retail Group in October 2022 revealed that 60 percent of consumers have cited price as their No. 1 barrier to spend today, a measure that is up 20 percent from the same time last year. As consumers become more value conscious, trading down, particularly within price-sensitive categories, will become increasingly commonplace.

In this year, retailers will have much to grapple with as they work through the inflationary pressures that cloud the industry. Hence, it stands to reason that many are questioning whether momentum in retail is sustainable going forward. Can consumers continue to spend as usual with the growing threat of price increases or will they spend more prudently?

The Impact on Retailers

Retailers are already seeing the impact of this cost-conscious consumer behavior, with both topline and bottomline challenged as sales growth slows and margins get further compressed. In 2022 an APAC lifestyle furniture retailer, which witnessed a 30 percent boom in sales during the peak of Covid-19, reported a severe sales downtrend and margin compression, leaving it with less than 2 weeks of cash runway.

Retailers across formats are finding themselves in a serious predicament. For one, retailers are still sitting on too much Covid-driven inventory, a dilemma sparked by irrational exuberance of over-ordering after years of pandemic and supply-chain driven product availability challenges. For example, a leading SEA pharmaceutical retailer found themselves with over 200 days of sales inventory (DSI) of Covid-related products that needed to be liquidated at a 90 percent markdown. Secondly, lower customer demand is creating significant challenges in developing effective promotional strategies to drive traffic, with a range of questions around optimal markdown timing and depth. Finally, retailers have sunk costs in marketing and hiring campaigns that will have negative impacts on the bottom line.

To top off this incredibly complex problem, there is an “elephant in the room”—the hybrid working model—that has reduced the effectiveness of cross-functional decision making that is arguably one of the most important elements in reacting to a crisis such as inflation. Retailers must now reckon with the new realities of record inflation and develop solutions to sustain their business, retain customers and ensure long-term growth.

Keys to Surviving an Economic Downturn

Retailers can catalyze these challenges into opportunities if they make bold, deliberate decisions. While there is no silver bullet, retailers can take a number of transformative actions to address inflation and drive a step-change in performance for the years ahead. Those that adopt a comprehensive approach will be able to combat inflationary pressures and preserve their profitability. To that end, A&M has identified five focus areas for retailers in the near term:

01

Proactively plan a structural reset

Do not wait to tweak day-to-day ways of doing business. In today's environment, consumers are becoming less loyal to brands and turning to private labels to cope with inflation. Strategic adjustments to product mix, promotional cadences, inventory management and operational expenditures will have meaningful implications tomorrow.

02

Aggressively target cost of goods sold (COGS)

Impacting selling, general and administrative expenses (SG&A) alone is no longer sufficient to achieve financial goals. The core of all companies' spend resides in their COGS, and no matter how efficient an organization believes its existing sourcing capabilities are, there is more to get. An organization needs to proactively challenge specifications of what it buys to ensure the products it is sourcing matches the wants of the consumer and their willingness to pay.

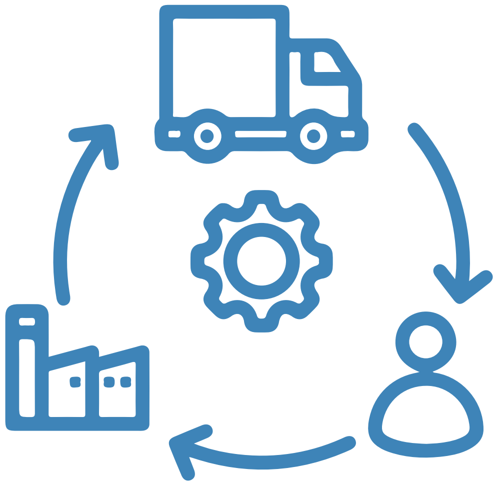
03

Critically evaluate store operations to optimize productivity

To counter the effects of labor cost inflation, retailers need to critically re-evaluate their in-store processes and seek opportunities to reset the store operating model. This can be through tactical deployment of technology and analytics or resetting labor allocation and scheduling. Retailers may also invest in frontline employee experience to reduce costly turnover by leveraging recruitment and talent analytics and rethinking capability building.

04

Managing working capital through robust planning, inventory management and supplier engagement



With inventory at suffocating levels, retailers have no choice but to get creative in how they manage products in order to sustain a healthy working capital ratio. All cards need to be on the table, beginning with a deliberate discussion on how to effectively manage existing inventory. Some of the key questions retail leaders need to ask themselves are: What items can be kept and sold later? Which items will be pushed to the store? Which store will take what products? What should be the appropriate markdown to drive sales?

Additionally, retailers need to critically evaluate how they can collaborate with suppliers to manage working capital and optimise cash. Be it to limit overstock or extend payment terms, retailers should leverage their position as a marquee customer to negotiate the best possible outcome with suppliers.

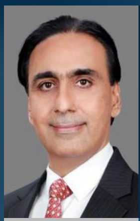
05

Keep customers at the center of your strategy

It can be easy to get distracted with all the noise that comes with inflation. Short- to medium-term adjustments to an organization's business model should not supersede long-term initiatives to delight and retain your customers. Having a dedicated team in place to right the ship in the short-term will allow leaders to keep focus on the long-term health of the business.

Prioritize Speed Over Perfection

The environment for retailers is likely to remain challenging for some time, but the situation also presents an opportunity for those that move decisively and quickly to develop a response. Don't wait to get everything designed perfectly to delay action. Executing a partially right answer fast will ultimately give an organization better cushioning than following a traditional approach of multiple iterations. In this rapidly changing environment, a test-and-learn and adapt-and-execute approach will be critical. Use external help and experts if it helps you get there faster.



PANKAJ SALUJA
Managing Director, Singapore,
Performance Improvement
psaluja@alvarezandmarsal.com

TIMO SCHMID
Managing Director,
ANZ Private Equity
tschmid@alvarezandmarsal.com

HEMANT KALBAG
Managing Director, New York,
Consumer and Retail Group
hkalbag@alvarezandmarsal.com

DAVID RITTER
Managing Director, Houston,
Consumer and Retail Group
dritter@alvarezandmarsal.com

The authors wish to thank Nicole Tham for her contributions to this article.

ABOUT ALVAREZ & MARSAL

Companies, investors and government entities around the world turn to Alvarez & Marsal (A&M) for leadership, action and results. Privately held since its founding in 1983, A&M is a leading global professional services firm that provides advisory, business performance improvement and turnaround management services. When conventional approaches are not enough to create transformation and drive change, clients seek our deep expertise and ability to deliver practical solutions to their unique problems.

With over 7,500 people across five continents, we deliver tangible results for corporates, boards, private equity firms, law firms and government agencies facing complex challenges. Our senior leaders, and their teams, leverage A&M's restructuring heritage to help companies act decisively, catapult growth and accelerate results. We are experienced operators, world-class consultants, former regulators and industry authorities with a shared commitment to telling clients what's really needed for turning change into a strategic business asset, managing risk and unlocking value at every stage of growth.

To learn more, visit: AlvarezandMarsal.com

Follow A&M on:

ALVAREZ & MARSAL
LEADERSHIP. ACTION. RESULTS.℠