Five Actions to Protect Your Business and Position It For Success Post-Pandemic

By Antony Karabus and Farla Efros, HRC - 05/05/2020

[Retailers are reopening their doors on a landscape that will be changed forever. There will be a greater gulf between the winners and losers. Retail strategy firm HRC suggests five steps retailers should take to best position themselves for success.]

Antony Karabus and Farla Efros

Malls and stores are slowly starting to reopen as governments remove COVID-19 shelter-in-place measures. We're already witnessing a cautious reopening take shape in a number of states and Canadian provinces.

However, the environment in which stores are reopening will be far from business as usual.
While we expect customers to start shopping again, it is going to be a very slow and gradual re-building of consumer demand. With governments permitting only "essential" retailers to remain open the past few months, we've witnessed the inevitable shift of market share from "non-essential" retailers to "essential" ones, and to online-only retailers such as Amazon.

In response, total consumer demand for "non-essential" items will likely be reduced as much as 50% for the next quarter and as much as 20% to 30% in the crucial holiday quarter. We also anticipate that some retailers with highly- levered balance sheets will file for creditor protection and either liquidate or close a significant percentage of their stores. Their market share will now be available for the taking.

Keep in mind that, well before the pandemic forced the store closures, numerous retailers were facing significant headwinds. Profitability had been in gradual decline due to the shift of store sales to their digital channels and the ongoing transfer of market share to online-only retailers such as Amazon.

Many have seen their earnings decline year after year and many are now struggling to earn enough to service their debt and fund capital improvements for their stores and technological capabilities, let alone return capital to shareholders. Many of these retailers will not survive in their current form - or at all.

HRC predicts the following:

- Consumer demand for discretionary goods will decline by as much as 50% in the next quarter, recovering to a decline of 20-30% in the holiday quarter versus 2019. We expect sales to slowly recover in 2021 and make a moderate recovery by 2022.

- Digital channel sales penetration will increase and will likely be at or above 30% of total sales for many retailers and as much as 40% for retailers serving digitally-enabled demographics.

- The weakest and most heavily indebted retailers will file for bankruptcy and either liquidate or restructure, while closing a significant number of stores.

- Operating costs will rise significantly to serve customers in a "safe" environment.

We've developed a five-step rapid response program for retailers to safeguard their businesses and position them to be winners in this unprecedented environment. HRC recommends retailers urgently take the following five actions NOW.

> *"Total consumer demand for "non-essential" items will likely be reduced as much as 50% for the next quarter and as much as 20% to 30% in the crucial holiday quarter."*

1. **Reinforce and strengthen liquidity position:** The single most important factor in allowing retailers the time to transform their businesses is the availability of liquidity to fund operations.

Immediately enact robust 13-week rolling cash flows to determine and take action on reducing the "cash burn" until consumer demand recovers. Initiate a disciplined capital allocation committee of the board of directors.

Cancel or defer all non-essential uses of capital that do not produce, at most, a two- or three-year payback. Cancel share buy-backs and dividends. Defer non-essential store remodels. Negotiate with all vendors to develop deferred payment terms on all outstanding payables. Communicate well and regularly with asset-based and other secured lenders to reduce liquidity risk. Explore alternative lease mitigation strategies to conserve cash.

2. **Assess inventory position and develop effective disposition strategy:** Virtually all retailers have stores with too much seasonal inventory that is unsaleable without major markdowns. Determine inventory composition and ensure a strong omnichannel capability (including BOPIS and ship-from-store) that will allow stranded in-store inventory to fulfil digital orders.

Determine how much inventory can be packed away for sale in spring and summer 2021 and what inventory needs to be cleared to make room for fall. To create cash now, consider the possibility of using a liquidator to run clearance sales in non go-forward stores.

Develop disciplined product life-cycle management processes to minimize margin erosion improve inventory profitability as inventory is sold.

For retailers who are funding their inventory through asset-based secured lenders, HRC predicts that in many instances, the inventory value will be re-appraised downwards, increasing risk of covenant breach. This will strengthen the case for more effective life-cycle management to minimize margin erosion and may require additional cash infusions.

3. **Realistically forecast customer demand and build digital capability:** Establish realistic consumer demand forecasts by quarter, from now to 2022 to guide merchandise buyers in planning for holiday 2020, 2021 cash flow (see No. 1 above).

Based on the likely shift digital, this will help direct investments to the right capabilities to allow demand to be effectively serviced.

4. **Right-size the store fleet:** Use the customer demand forecast (see No. 3 above) to create a bottom-up store-level four-wall profit contribution analysis to determine store viability. Based on lease expiry, consider having those stores serve a dual purpose as a mini digital and omnichannel fulfilment center.

Consider withholding or delaying rent payment on weaker and possibly all stores to conserve cash and strengthen the negotiating position. However, real estate mitigation strategies come with a risk of landlords placing tenants in default. Many landlords cannot afford to lose their tenants' income, as they too have substantial debt obligations.

It's advisable to retain a lease mitigation professional to explore viable strategies and negotiate on your behalf with the landlord to terminate non-core stores and reduce lease costs or to move to a percentage-only rent where possible. It typically takes a dispassionate expert to get the best result.

5. **Right-size the business model and cost infrastructure:** Based on the consumer demand forecasts, re-cast the P&L and determine the cash burn and profitability gap by quarter to determine the cost efficiency take-out requirement. Simply slashing store labor, marketing and other costs are not viable solutions; they're just quick fixes that cause more harm in the longer-term.

Assess all costs and determine the necessity of each investment in enabling important digital and other capabilities. Cancel all open positions unless they are essential. Defer discretionary expenses without clear payback.

Balance sheet restructuring is not enough for survival. Without transforming the operational business model, a retailer is only buying time without long-term sustainability.

Antony Karabus is CEO and Farla Efros is president, of retail strategy firm HRC Advisory, which has a reputation for agility, speed and working with a sense of urgency. Karabus and Efros have worked extensively with numerous retailers to help improve their profitability and liquidity. Their experience working with over 100 retail chains in all stages of the economic cycle, from highly profitable to struggling, has provided them with invaluable insight into the retail economic operating model, key levers of profitability as well as margin, cost and working capital needs.

FINANCE INSIGHTS

YOU MAY ALSO LIKE

REAL ESTATE
Kirkland's reduces corporate, DC headcount; negotiating with landlords

OPERATIONS
Ulta Beauty, At Home in additional measures to reduce costs; CEOs forgo salaries

YOU MAY ALSO LIKE

TECHNOLOGY
Deloitte: Six steps to ensure retail success in 2020

TECHNOLOGY
McKinsey: Five trends shaping U.S. grocery

RELATED TOPICS

FINANCE INSIGHTS