Recipe for Successful Retailer Transformation

By Antony Karabus and Farla Efros, HRC Advisory - 11/18/2020

Farla Efros and Antony Karabus

The retail sector continues to experience turmoil with numerous retailers filing for Chapter 11, liquidating or restructuring out of court. But there is a silver lining for the winners, with significant and profitable opportunities for retailers that successfully re-tool their operating models and customer experience.

In 2020, with the onset of the pandemic, the pace of the retail sector disruption has accelerated and the sheer number of Chapter 11 creditor protection and out-of-court restructuring announcements have grown exponentially, including such well-known names as Tailored Brands, Pier 1, New York & Company, Ascena Retail Group, Forever 21, Century 21, Stein Mart, Sur La Table, Stage Stores, Modell's, Tuesday Morning, J.C. Penney and Neiman Marcus

The pandemic is not the underlying cause for most retailer restructurings. Instead, it has been the accelerator. The debt previously added to retailers' balance sheets from leveraged buy-out debt and earlier failed transformations has prevented those retailers from making the necessary investments to their business models to re-tool their store fleets, operational capabilities, technology and processes to more effectively and profitably compete in the digital environment.

Primarily due to the debt service commitments, many retailers didn't have access to the liquidity to fund the new business models and operational capabilities that were necessary to meet the expanding and changing customer demands and expectations. These include the operational capabilities for frictionless omnichannel capabilities.

Since 2010, the retail market has grown at 2% or less most years, which has resulted in numerous retailers' market capitalization declining meaningfully. And this has occurred at a time when Amazon's market capitalization increased 28-fold due to the company's rapid growth rates and steady increase in market share.

Billions of Dollars of Market Value Available From Downsized, Bankrupt Retailers

Massive amounts of market share — or billions of dollars of market value — is available from retailers that have gone out of business or have closed stores. While much of this market share has been won by Amazon, Wayfair, Walmart, Target and other discounters and the home improvement chains, we believe there is plenty available for other retailers that transform their operating model with a customer focus.

While people are still shopping, spending behaviour has changed. Enclosed mall traffic is considerably down and continuing its multi-year decline. But stores whose entrances are open to the outside are holding their own and online traffic is growing.

In addition, retailers have received a windfall amounting to as much as tens of billions of additional market share in 2020 and hopefully into 2021 due to typical household spending being curtailed as a result of restrictions imposed by the pandemic.

More than ever, strategic capital allocation has become a competitive advantage as every dollar matters.

Retail Results are Uneven

Winners include retailers in categories such as home categories, mattresses/bedding, home improvement and appliances, grocery, beauty, pet, pool, and active/outdoor. Numerous specialty apparel retailers (especially those selling work and tailored clothing) and department store sectors are experiencing double-digit negative comparable sales.

Winning requires significant investment in brand differentiation, exceptional and seamless integration between channels, investment in omnichannel and digital capacity as well as a customer experience model that meets the needs and expectations of their target consumer. A flexible cost structure will allow successful retailers to continuously transform to meet customer needs in an ever-changing macro environment.

Success requires meeting ever-changing customer expectations. Retail leaders must invest in the right operational capabilities that are valued by their target consumer, including digital, omnichannel and flexible fulfilment. More than ever before, strategic capital allocation has become a competitive advantage as every dollar matters.

An additional complication is that, for most retailers, digital growth is coming at the expense of in-store sales, which means most of it is cannibalization. And the fact is that digital sales are costlier to fulfil than traditional in-store sales as a result of the increased variable costs due to shipping, fulfillment, digital marketing, talent, returns and other expenses. The increased variable costs can be mitigated by fulfilling and returning digital orders in physical stores.

Three Steps for Successful Transformation

After working with well over 100 retail chains, we have determined three important priorities for retailers to successfully and profitably compete in these complex times. They are outlined below.

* Capitalize on the most important strategic weapon to more profitably compete the store fleet.

* Build and strengthen omnichannel capabilities to meet customer expectations and win against on-line only competitors.

* Build a customer experience model seamlessly and without friction across channels and become a true destination in the eyes of your target consumer.

Antony Karabus and Farla Efros are CEO and president of [HRC Advisory] respectively, a leading retail consulting firm that has worked with more than 100 national retail chains to adapt their economic operating model and key processes in order to compete more profitably during the past 30 years.