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Retail

The Assault on Margins: Five New Rules for Retail CFOs

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Assessing how the pandemic is impacting profit profiles

We all know the world has changed. In just a few short months, we've seen shifts that would normally take years to unfurl, and have rushed to adapt and keep up, finding new ways to work and compete on the fly. This is especially salient in grocery retail, one of the first spaces to be impacted by a sudden and massive change in consumer behavior in March as consumers abandoned weekly or more frequent shopping trips in favor of stockpiling and skipping in-store visits altogether.

Technological shifts that have been underway for years have been put into turbocharge by the recent health crisis and resulting behavioral changes, with shoppers rapidly embracing online ordering for curbside pickup and delivery at astounding rates. To keep pace with this unprecedented change in behavior, retailers are adapting new operating procedures spanning labor to buying, forecasting and merchandising, but this doesn't stop at the store, and the impact is felt at the corporate level and in retailers' bottom lines. We see this reflected in large retailers' earnings reports and no doubt in independent brands' balance sheets, too: fifty years of supply chain management best practices and accepted norms of consumer behavior have been rendered moot, and retail margins have faced an all-out assault in result.

As retailers reflect on the first half of 2020, retail CFOs must quickly adapt to these new rules or face further assault on margins:

Beware New Shopper Habits: Consumers are making fewer, bigger trips to the store and hoarding goods. Of course, they're not just buying their normal shopping lists at two or three times the amount, but are stocking up on paper goods, shelf-stable basics such as canned soup and other necessities. This places uneven strain on these categories, resulting in stockouts and leading to the massive unmet demand for paper products, hand sanitizer and soap in the spring.

Rethink Margins: Every action has a reaction, and these new shopper habits have repercussions on the full supply chain. To avoid stockouts, retailers have to buy more inventory further ahead and carry the cost on their balance sheets for longer. Grocery margins are traditionally built on quick turns, with grocers often selling goods at retail prices before paying their bill to the wholesale supplier. This move to pre-buying is eroding traditional margins, forcing grocers to pay for stock well before it is sold or even delivered, and carry that cost until goods reach the customer's cart potentially months later. These trends are definitely breaking the traditional view of financing the supply chain.

Anticipate Demand Transference: Stockouts also have downstream implications, at times resulting in less-than-satisfied consumers, and potentially further eroding margins and potentially causing customer churn. A lack of their preferred item on the shelf might lead shoppers to buy different brands or more likely will result in them continuing to shop online to find exactly what they are looking for. Running out of Campbell's Soup might lead to an uptick for a competing brand, but still places an overall strain on the canned soup category. If the shopper opts to buy the store brand instead, this can have a mixed impact for the retailer by offering a higher margin while preserving the category strain.

Further, the unmet demand from total category stockouts represents not just a missed opportunity for retailers, but a much bigger loss: shoppers who find empty aisles may turn elsewhere not just for out-of-stock items but for their full carts, depleting a broader swath of potential revenue. Worse, once burned, these customers may never return, resulting in incalculable lost future revenues.

Understand the True Cost of BOPIS: The rise of buy online, pickup in-store (BOPIS), curbside shopping and home delivery has meant more than investing in enabling technology and accompanying consumer marketing for retailers—indeed, it has also necessitated changes in how retailers deploy workers. Without shoppers coming in-store to walk the aisles and place items in their carts, retailers have had to bring more workers in-store to collect items for online orders. Given grocery's typical open-warehouse format with limited backroom supplies and self-service collection, tasking workers with picking items from shelves means additive labor, and thus, additive costs for retailers. While delivery and convenience fees for online orders may help offset this, the true cost of an expanded workforce is difficult to calculate.

Work With Promotional Disruption: Even before the mass disruption of 2020, the industry began to see margins change at the hand of grocery newcomers. Big box retailers that are expanding into grocery have rewritten the rules of the game with cross-category promotions. These retailers are offering promotions based on total spend (for example, $10 off $100), mixing the grocery bag with high margin, center of the store items such as apparel. This is a new paradigm for a grocer that is used to limiting discounts to given SKUs in a circular as a promotion strategy.

While basket A may contain $100 in paper goods, basket B might carry $100 in items from multiple categories, and the margins earned on these baskets can be drastically different, meaning the impact of that $10 discount on each basket can look very different on the retailer's gross margin.

This shift from managing promotions purely "bottom-up" at the UPC- and item-level to also having to understand the "top-down" impact of the promotion needs to be understood, and new orchestration is now required between the merchants and the CFO to protect profitability. This trend will absolutely require that grocers' margin and sales forecasts are attached at some level to the overall promotion planning in grocery going forward. This is a subtle, yet big change with far reaching systems implications for the grocer's foundation data and its use by finance, merchandising and supply chain teams.

Retail will continue to change both throughout the current health crisis and beyond, and CFOs must find ways to work with this disruption before them. To protect their balance sheets, they must understand the macroeconomic forces and behavioral shifts in play, partner with store merchants to find ways to entice customers, and find ways to balance added labor and inventory costs with demand. With the right inventory visibility and analytics and bearing these new rules in mind, CFOs can optimize their stock and drive equal sales with less inventory. As any financier will tell you, a penny saved can be as good as a penny earned—and at retail scale, these savings can add up.

A retailer's brand promise relies on delivering goods to the customer at a given level of service, and this responsibility now falls on CFOs more than ever before. While the task may seem daunting, the answer may lie in the inventory itself and finding ways to make it work harder.

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