2021 BDO RETAIL CFO OUTLOOK SURVEY

BDO

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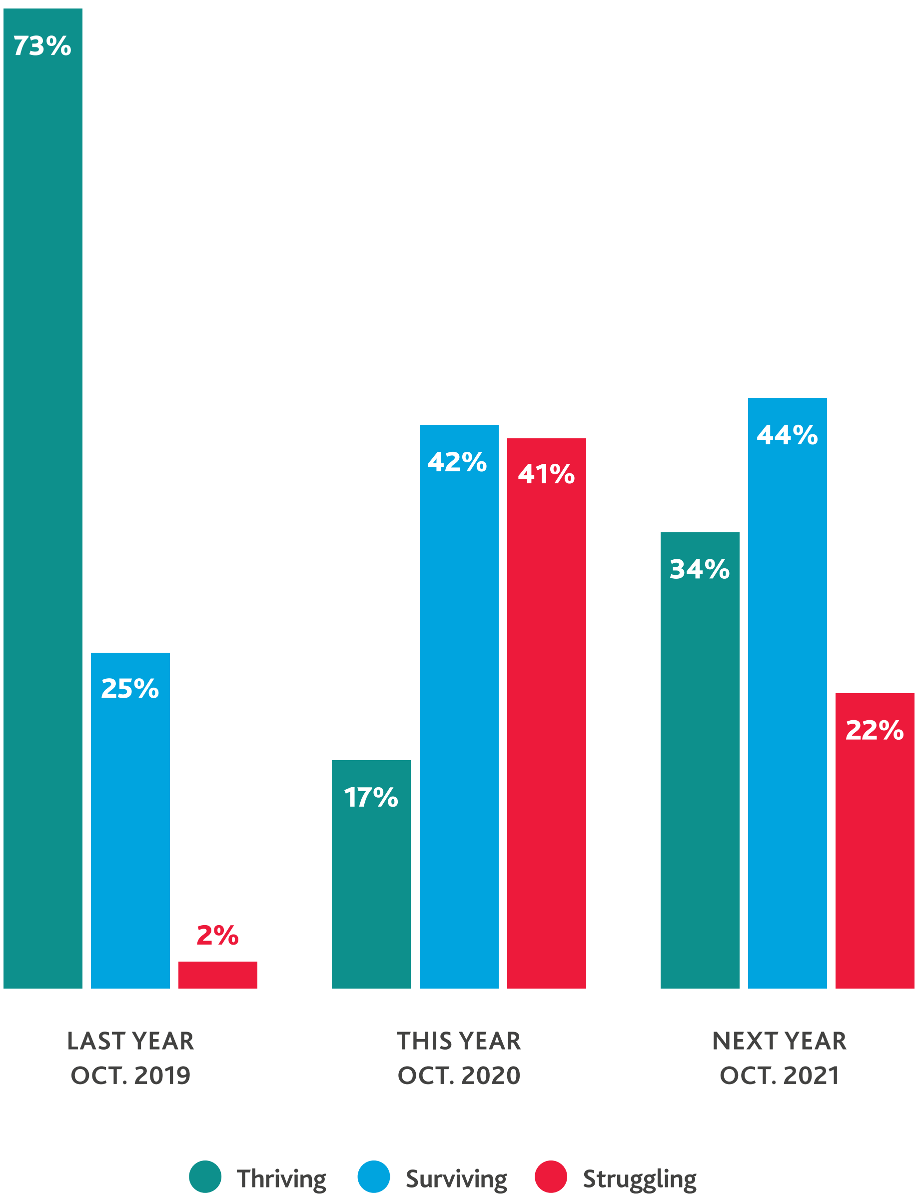
Bold Resilience

Few sectors of the economy were hit harder by the COVID-19 pandemic than retail. Still saddled with the debt they incurred during the last recession, many retailers were already in or on the brink of bankruptcy. Storefronts were shuttering well before the first mandated shutdown. The e-commerce boom of the last decade set a new bar for customer experience that few have been able to emulate. COVID-19 exposed those existing fissures and made them wider. Now even the industry bright spots of the last few years have lost their sheen: Just 17% of CFOs at middle market retail organizations say their business is currently thriving, according to this year's ***2021 BDO Retail CFO Outlook Survey***, down from 73% the previous year.

TURBULENT PERFORMANCE & EXPECTATIONS



However, this isn't a tale of total devastation. Some product segments—including consumer electronics, grocery and home furnishings—experienced surprise surges in demand as consumer behaviors and purchasing patterns changed in unforeseen ways. Who could have predicted home bread-maker sales would increase by 400% during the first couple months of the pandemic? But there is a rhyme and reason to the seemingly random, one that retailers with the right mindset can translate into a lifeline for recovery.

This isn't an ordinary recession, and so the road to recovery won't be either. As players in a low-margin industry, retailers are accustomed to making incremental improvements to their business—for example, opening a pop-up store to test new products or reallocating marketing dollars from one channel to another. But in these extraordinary circumstances, minor pivots and low-stakes pilots won't suffice. The slow, cautious approach of yesteryear must give way to big ideas, bold moves and short timelines.

For middle market retailers, confronting today's challenges calls for drastic yet calculated measures. Whether by rebuilding their infrastructures, transforming their business models or rightsizing their assets, retailers must sharpen their focus and go all in on strategically investing in what matters most.

3 BOLD RETAIL MOVES

Faster Decision-Making

48% are making faster decisions than pre-pandemic

Digital Transformation

46% are accelerating digital transformation plans

Innovation

44% have taken advantage of new opportunities for product/service innovation

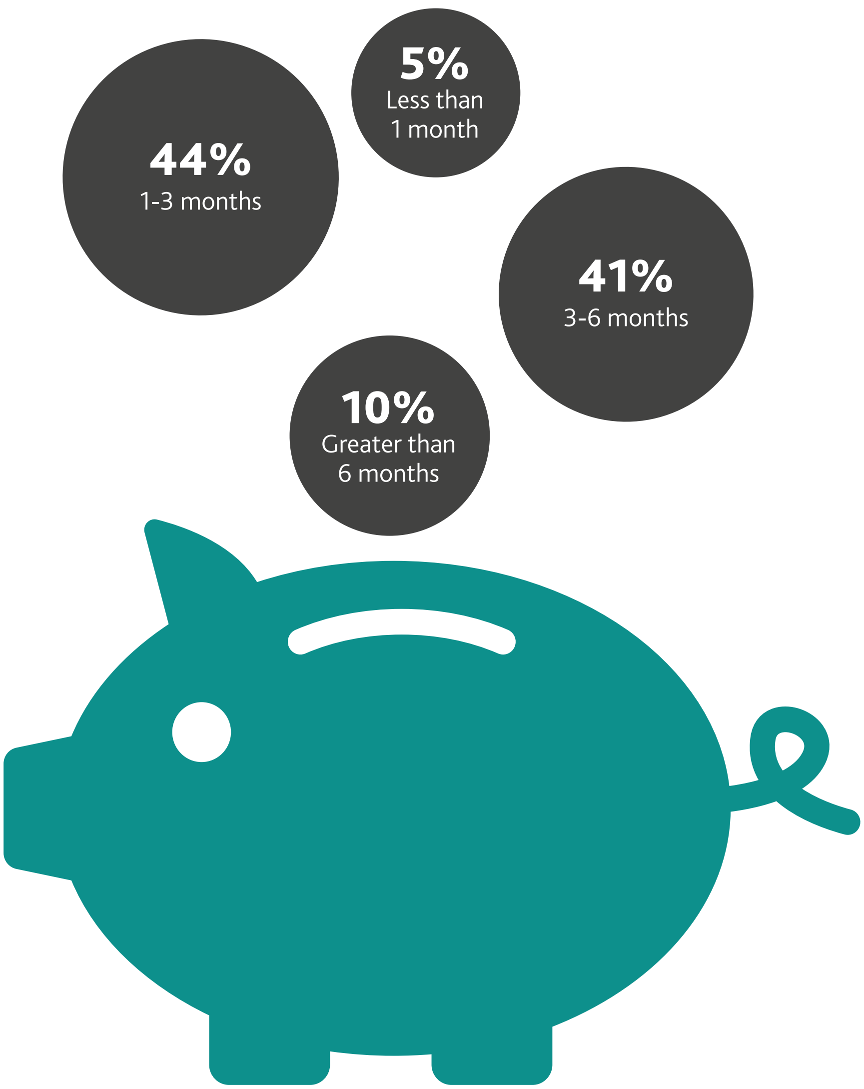
> *The scope and impact of the Coronavirus Recession requires retailers to make bold moves now to weather the challenges that lie ahead. But bold doesn't need to be expensive. With a strategic lens, double down on tactical changes that align your offerings to the market and propel your organization into retail's digital future.*

NATALIE KOTLYAR
Partner and National Leader of BDO's Retail & Consumer Products Practice

Resilience Requires Relief

Survey respondents confirm that across sectors, supply chains, workforces and sales were heavily disrupted by the pandemic, sending even those that were faring relatively well into turmoil. Many of last year's winners are now unprofitable and hemorrhaging money, cash supplies are dried up and credit lines are tapped. Not every retailer is in financial distress, but most are facing some level of financial difficulty that will take a combination of new capital injections and ingenuity to overcome.

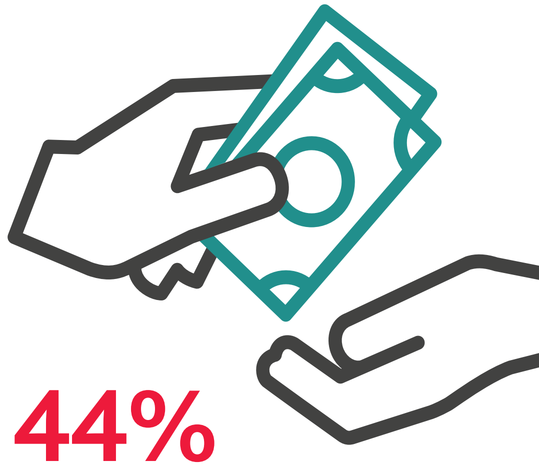
IN THE PIGGYBANK: RETAILERS' CASH ON HAND



While retailers' cash on hand may be limited now, many have received external capital and are seeking more in the near future.

A CHALLENGING FINANCIAL PICTURE

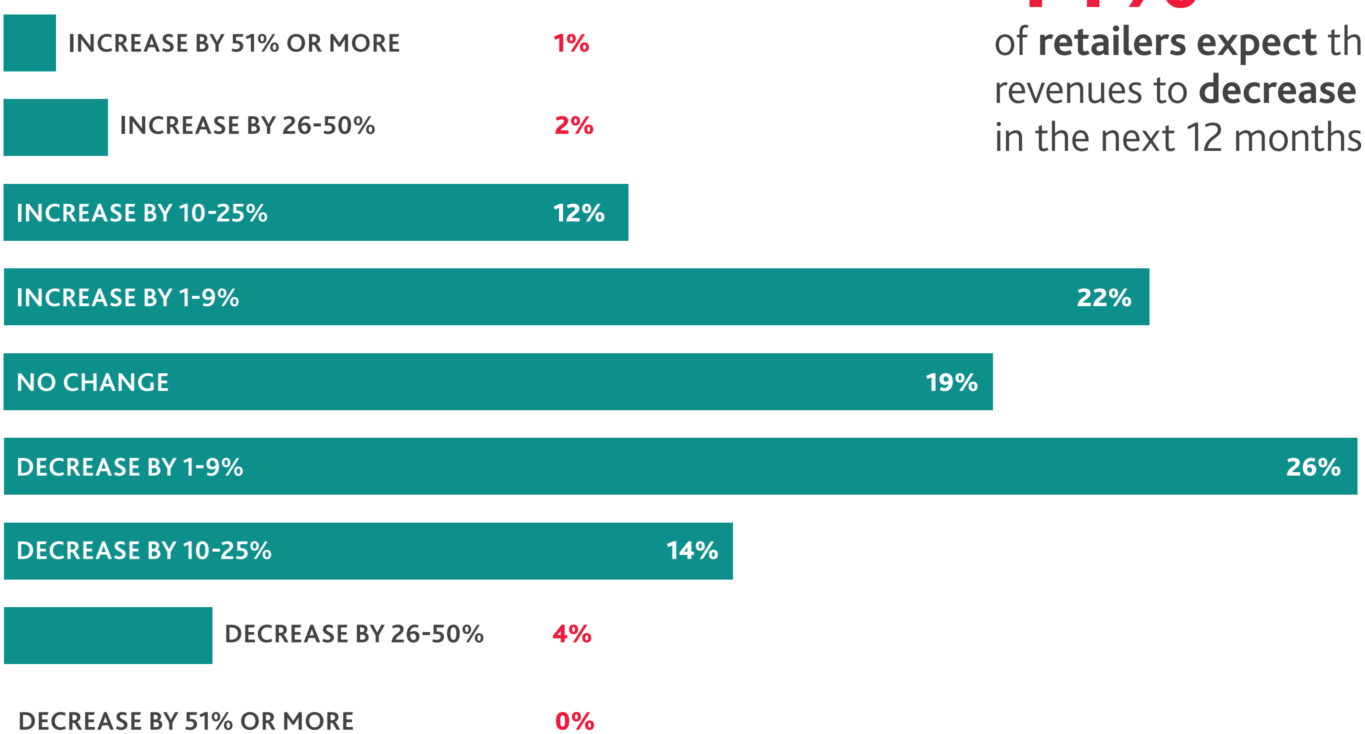
High unemployment rates and uncertainty around a vaccine have retailers preparing for a prolonged period of reduced consumer spending. Just 37% of middle market retailers anticipate an increase in revenue over the next 12 months. By comparison, 83% of respondents anticipated an increase in revenues over the next 12 months in last year's survey. With sales expected to stumble, retailers have little padding—**49% have only enough cash in reserve to cover three months or less of expenses.**



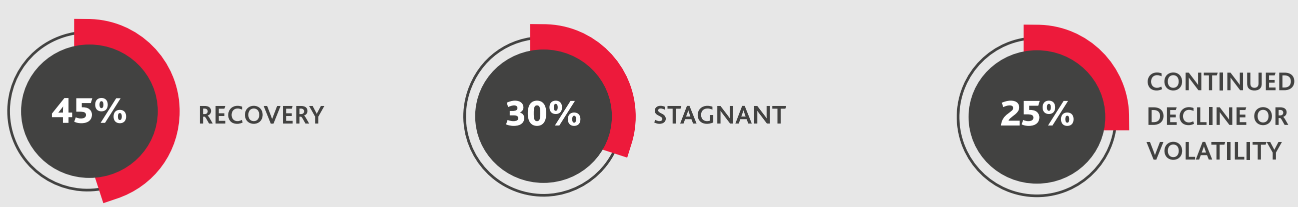
44%

of **retailers expect** their revenues to **decrease** in the next 12 months

12-MONTH REVENUE FORECASTS



2021 Economic Outlook



THE GOVERNMENT CLOSES THE GAP

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) relief package was a financial lifeline for retailers during the worst of the pandemic. Virtually the entire retail middle market applied for a loan, and the vast majority of applicants received assistance. Among those that secured government assistance, half received a loan from the Paycheck Protection Program (PPP), which offers forgivable loans of up to $10 million to cover payroll costs. The initial program closed to new applicants in August, but a new relief package has passed that includes additional funding for the PPP, and more retailers are likely to take advantage.

91% **applied for government assistance** in response to the pandemic*

*As of September 2020

84% **secured government** assistance*

*As of September 2020

GOVERNMENT PROGRAMS RETAILERS UTILIZED*

Paycheck Protection Program	50%
Primary Market or Secondary Market Corporate Credit Facilities	45%
Economic Injury Disaster Loan	42%
Term Asset-Backed Securities Loan Facility	40%
Main Street Lending Program	32%

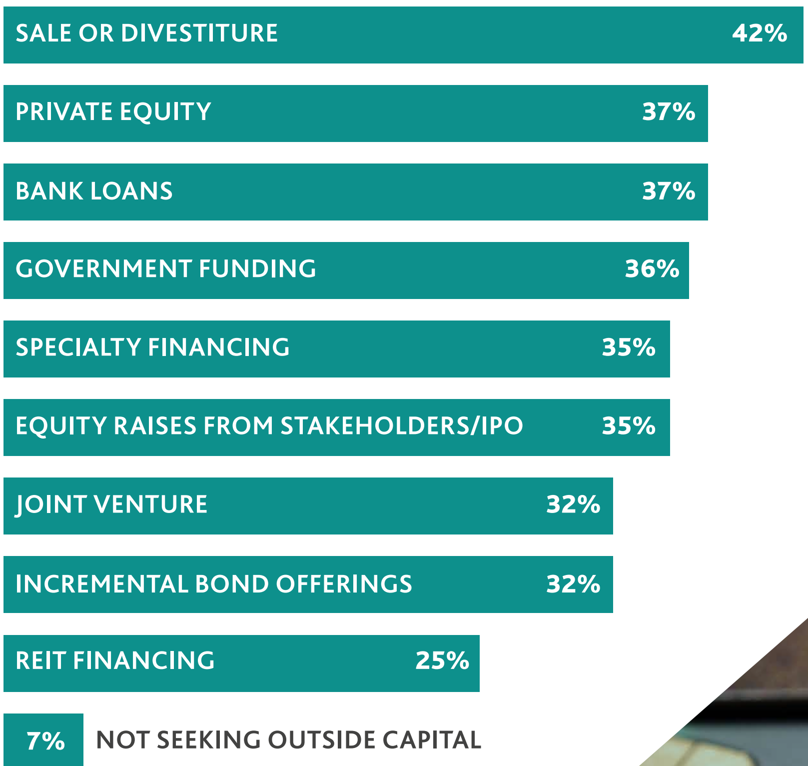
*As of September 2020

CALLS FOR CASH

For many, the need for external financing is a direct result of the pandemic. When asked at the end of 2019 about their plans for tapping outside assistance in 2020, 65% of middle market retail CFOs anticipated doing so. However, in the last six months, 94% of retailers ended up securing outside capital—a significantly higher percentage than expected. Ninety-three percent say they plan to secure additional outside funding in the next six months, with proceeds from a sale or divestment topping the list of likely sources. Joint ventures are also picking up steam as retailers explore creative collaborations with pooled resources and shared risk.

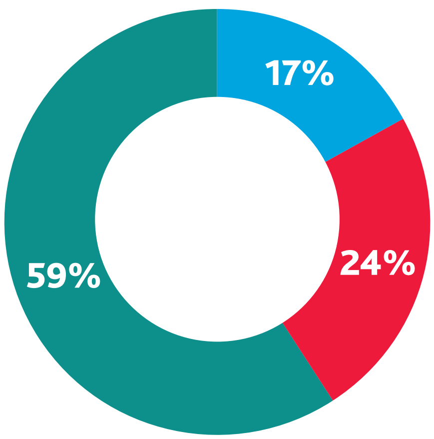
Choosing the best path for growth will depend on the matchup of priorities between buyer and seller, or company and investor. There is particular interest in sectors that have new potential or a stake in COVID-19 recovery, including tech, life sciences, and healthcare. But across the board, the success of deals will be dependent on strong governance, including a thorough and accurate view of a company's risk profile and future opportunity.

PLANNED OUTSIDE CAPITAL SOURCES – NEXT SIX MONTHS

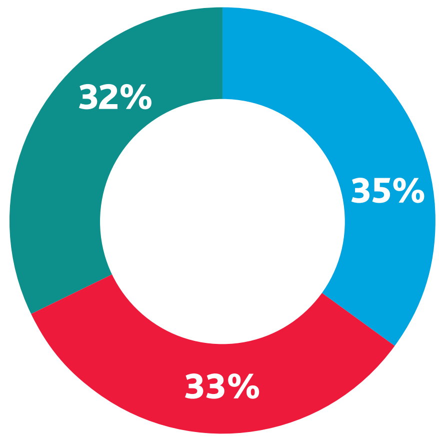


While specific uses of outside assistance vary based on the individual retailer and their circumstances, the majority of retailers are using external sources of capital to prevent or mitigate financial distress, with the percentage of respondents planning to use it to execute a turnaround strategy doubling year-over-year. However, savvy retailers can still spot strategic opportunities in times of economic turbulence: Just under a third are leveraging external funding to capitalize on growth. Others are looking inward, deploying creative cost optimization strategies to reduce fixed costs.

PRIMARY REASON FOR SECURING OUTSIDE CAPITAL IN 2020



PRIMARY REASON FOR SECURING OUTSIDE CAPITAL IN 2021



Drive a Turnaround Strategy · Remain Stable · Capitalize on Growth

BOLD COST OPTIMIZATION STRATEGIES

Reducing product variety
43%

Eliminating or consolidating floor space
36%

Outsourcing logistics to a 3PL provider
31%

Outsourcing labor to a low-cost center
22%

The depth of the damage caused by the pandemic has made it exceptionally challenging for retailers, especially those already saddled with significant debt. The availability of outside capital is uncertain, but it's critical that retailers try to use some of the new capital to reinvest in what's next rather than what they've always done. It's natural to take a conservative approach during crisis and focus exclusively on cutting costs, but true resilience is more likely for those focused on reallocating costs to revenue-generating activities and strategic investments.

DAVID BERLINER
Partner and Leader of BDO's Business Restructuring & Turnaround Services Practice

Rebuilding the Foundation

Now is the time for retailers to actualize their transformation strategies—10-year plans should become 2-year plans to prove value and relevance in the shortened window to do so. For many, bold change means an overhaul of their business' foundations, from the ground up: from digital capabilities and business models, to capital structure and financial models, to organizational architecture and processes.

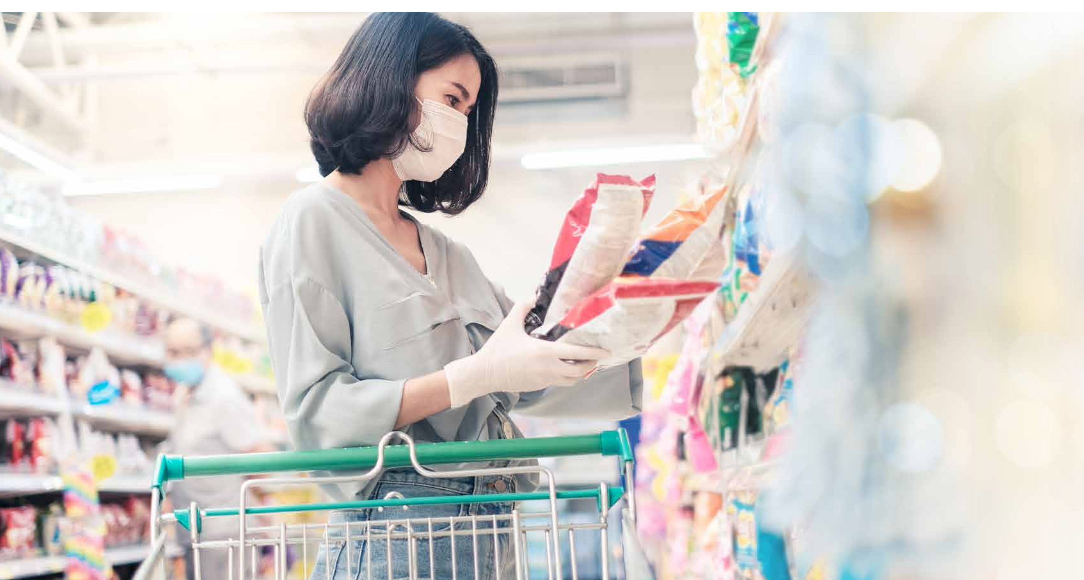
DIGITAL WITH DISCIPLINE

Retailers have historically been slow technology adopters, but the crisis settled any lingering doubts that the future of retail is digital. COVID-19 accelerated the Amazon Effect, and whether the pandemic ends tomorrow or in 2022, there is no going back. Now, the industry must rely on digital to keep the lights on.

The digital imperative is why, despite ongoing liquidity and cash flow challenges, investing in technology tops the list of retailers' business priorities for 2021. Savvy retailers recognize that a cost-cutting agenda alone won't save them. Instead, they are focused on building digital capabilities that enable them to get closer to the customer and ensure they are delivering a first-rate customer experience. That said, aggressive cost management will remain a priority in order to make these investments.

WHICH OF THE FOLLOWING WILL BE YOUR TOP 2021 BUSINESS PRIORITY?

24%	INVESTING IN TECHNOLOGY OR INFRASTRUCTURE
22%	MANAGING THROUGH ECONOMIC DOWNTURN
16%	CUTTING COSTS
12%	OUTSOURCING ROLES OR FUNCTIONS
10%	M&A INTEGRATION
10%	RECRUITING/RETAINING TOP TALENT
6%	DATA PRIVACY



Although retailers' top three priorities are the same as they were heading into 2020, according to our 2020 Retail CFO Outlook Survey, it's clear plans to navigate an anticipated downturn didn't—and couldn't have— prepared them for the effects of the pandemic:

1. **Investing in technology or infrastructure: 28%**
2. **Preparing for an economic downturn: 15%**
3. **Cutting costs: 13%**

RETAILERS' DIGITAL TRANSFORMATION PLANS

48%

are pursuing digital transformation in 2021

48%

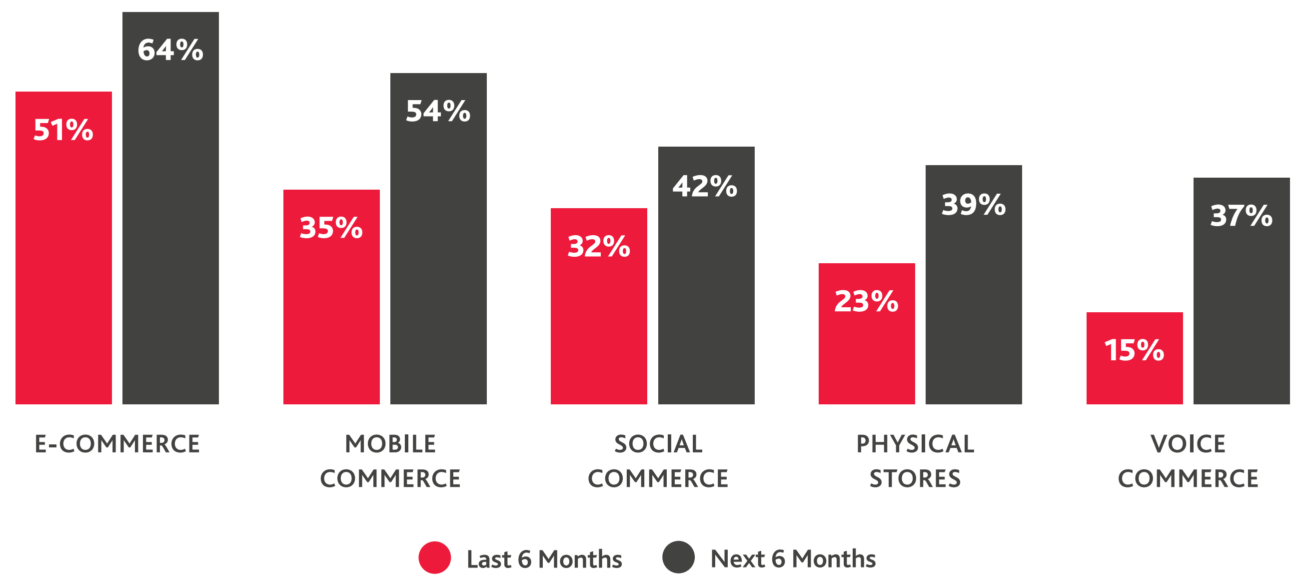
are increasing their IT investments right now; 71% plan to next year

37%

plan to automate manual labor in the next year

The Coronavirus Recession has favored retail players with a strong digital presence as government-mandated store closures pushed even brick-and-mortar purists to shift their shopping online. Retailers without digitally-enabled revenue streams will be left behind. Most have taken note and are increasing investments in their customers' most-used channels.

CHANNELS OF INCREASED INVESTMENT



The post-pandemic omnichannel experience will go beyond the changes that were made to address consumers' needs in the midst of it. Convenient, touchless offerings like buy online, pick up in store (BOPIS) and self-checkouts will be the baseline. The next level will include emerging technologies—from AI, to augmented and virtual reality, to voice-enabled commerce—that deliver an ultra-personalized, highly engaging and noticeably seamless customer experience.

ROBERT BROWN
Managing Director and Client Executive, BDO Digital

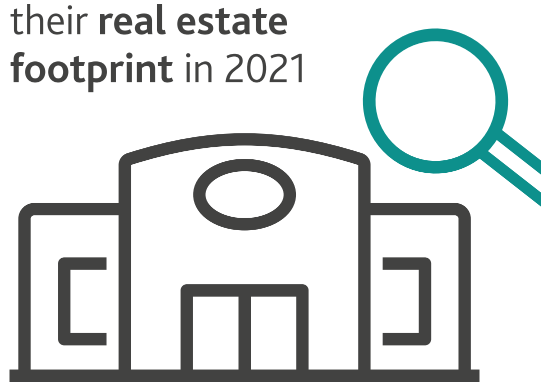
REAL ESTATE FOOTPRINT

Shelter-in-place orders, social distancing measures and upticks in e-commerce sent brick-and-mortar sales plummeting during the pandemic. The temporary rent relief granted by many landlords fueled a “kicking the can down the road” effect, and ultimately retailers across the board took a hit from the significant fixed costs of an extensive brick-and-mortar footprint. A bolder and more sustainable solution than seeking rent relief is a portfolio restructuring, a strategy many retailers were eyeing pre-COVID. In fact, a real estate reset is due as the U.S. remains over-stored, with an average of 24 square feet per person compared to Western Europe’s 4 square feet per person.

Not only will a rebalancing result in retailers shedding their underperforming store locations, but it may also mean converting or rebuilding new warehouse and fulfillment spaces to support an enhanced e-commerce strategy. Without adequate warehouse space to hold inventory, order fulfillment processes lack efficiency and without the right number and location of distribution centers, retailers are limited in their abilities to offer fast delivery. At the same time, malls have become less attractive locations for retailers and customers alike. Closings of anchor and other mall stores makes visits to them less appealing, depressing mall traffic overall unless landlords are able to quickly fill vacancies with compelling alternatives. Some retailers and mall operators may transform vacant or underperforming stores into mixed-use space that supports last-mile delivery.

Still, retailers can't neglect their stores altogether. Investments are necessary to ensure customer safety and convenient, hygiene-centric offerings. While hand sanitizer stations and floor decals may no longer be mandated post-pandemic, consumers will still be more cognizant of germ-related risks than they were before. Crowded aisles, communal product samples and cash exchanges are likely to be shopping realities of the past, and retailers should plan to make permanent adjustments accordingly. Store layouts, ventilation systems, payment methods and dressing rooms should all be designed for a newly hygiene-conscious consumer.

40% of **retail CFOs** say they are reevaluating their **real estate footprint** in 2021



PLANS FOR PHYSICAL STORE FOOTPRINTS

Increase investments in physical stores	39%
Reduce mall-based stores	31%

NEAR-TERM CHANGES RETAILERS ARE MAKING TO THEIR PHYSICAL STORE SPACES

56%

Requiring masks

47%

Revamping layout to encourage social distancing

45%

Implementing contactless payment options

43%

Limiting capacity regardless of guidance

41%

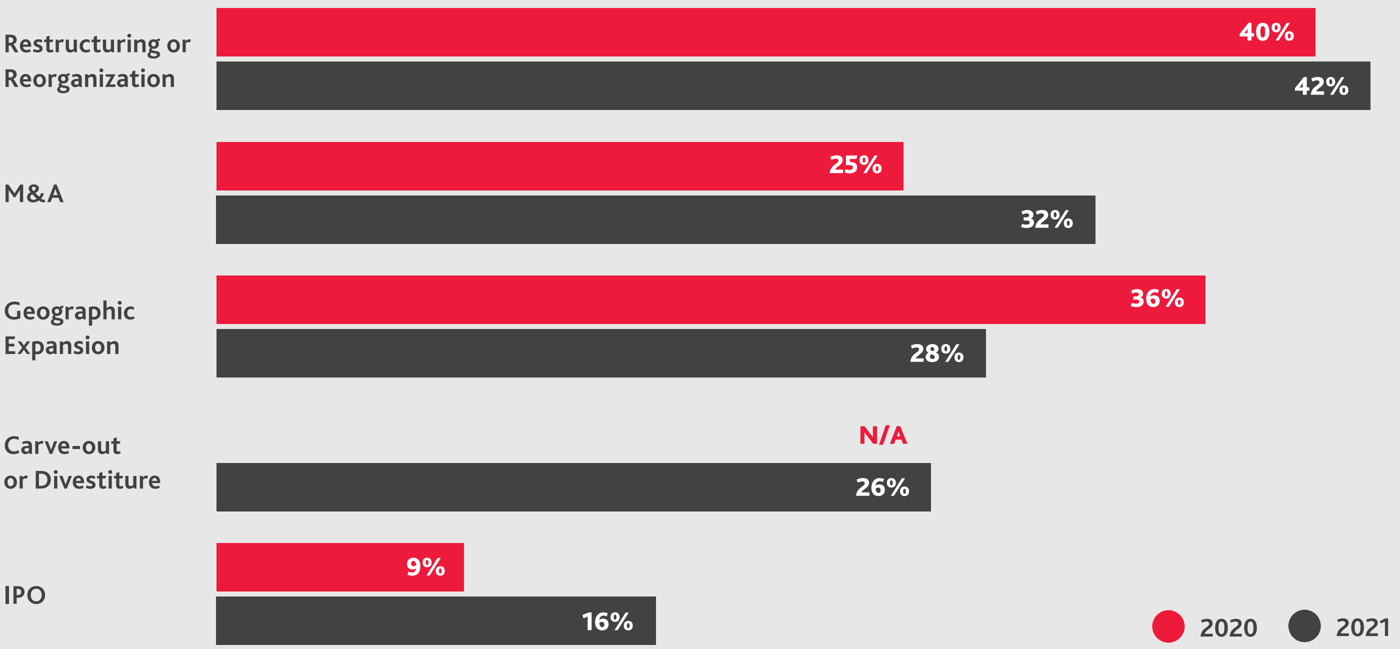
Offering BOPIS (buy online, pick up in store):

STRUCTURAL REVAMP

2020 is on track to set the record for the highest number of retail bankruptcies and store closings in a single year—a signal of the pandemic's impact on the landscape overall.

Retailers are responding to the upheaval by reimagining their entire structures, which are taking different shapes based on company performance. Those with underperforming business units are shedding assets and reorganizing to focus on core capabilities and strengthen the balance sheet, while others are taking the opportunity to make strategic acquisitions at bargain prices.

RETAILERS' 2021 STRATEGIES TO BRING MORE CONSOLIDATION THAN EXPANSION



In addition to general industry consolidation that comes in times of mass disruption, it's likely that much of the M&A activity this year will be aimed at arming retailers with new or improved digital capabilities and channels. Acquiring established technologies that improve fulfillment or pricing decisions, for instance, could allow retailers to see results more quickly than if they were to build similar capabilities themselves.

Though speed is key, structural changes of this magnitude also require a clear vision, established and specific success metrics and thorough communication. Without them, the savings and advantages of these transformative pursuits will be outweighed by the costs of disruption to the organization.

This risk is particularly high for the more than 40% of retailers undergoing a restructuring or reorganization in the next year. Restructurings tend to fail when the focus is on the symptoms of an issue rather than the root of it. For instance, a handful of retailers filed for Chapter 22 bankruptcies in 2019 after restructuring following previous filings. These retailers went into their earlier bankruptcy filings with plans to close some stores and restructure debt. They were able to exit bankruptcy quickly only to find themselves back in shortly thereafter, illustrating that debt reduction alone is not a cure-all if the underlying problems are not addressed.

Although the pandemic may be seen as the sole source of retailers' challenges—with lower demand and lost revenue as symptoms—a restructuring or reorg will be more effective long-term if they're approached with the goal of improving customer value at the core. In reality, the pandemic is accelerating trends already underway and therefore making organization's existing issues of meeting consumers' needs more pronounced rather than introducing an entirely new set of obstacles.

Responding to Demand Shifts

Throughout the course of the pandemic, some retail segments have experienced short-term demand spikes, while others have suffered from demand droughts. Many have faced a mix of both, with some product lines in high demand and some losing their luster. At the same time, customer demographics played a role in retailers' performance. As affluent shoppers splurge online and lower-income consumers spend at budget-friendly stores, it's players in the middle—including department stores and specialty retailers—that are struggling most.

The go-forward challenge for retailers is sorting out the short-term effects of the pandemic from the long-term shifts in shopping behaviors and demand patterns.

The category in which a retailer operates plays a large role in how they have been and will continue to be affected by the pandemic, but so too does their agility: How fast can they respond to disruption and pivot?

TOP BUSINESS RISK FOR THE NEXT 12 MONTHS

Declining product demand

Keeping up with increased product demand

Liquidity and access to capital

Supply chain disruption

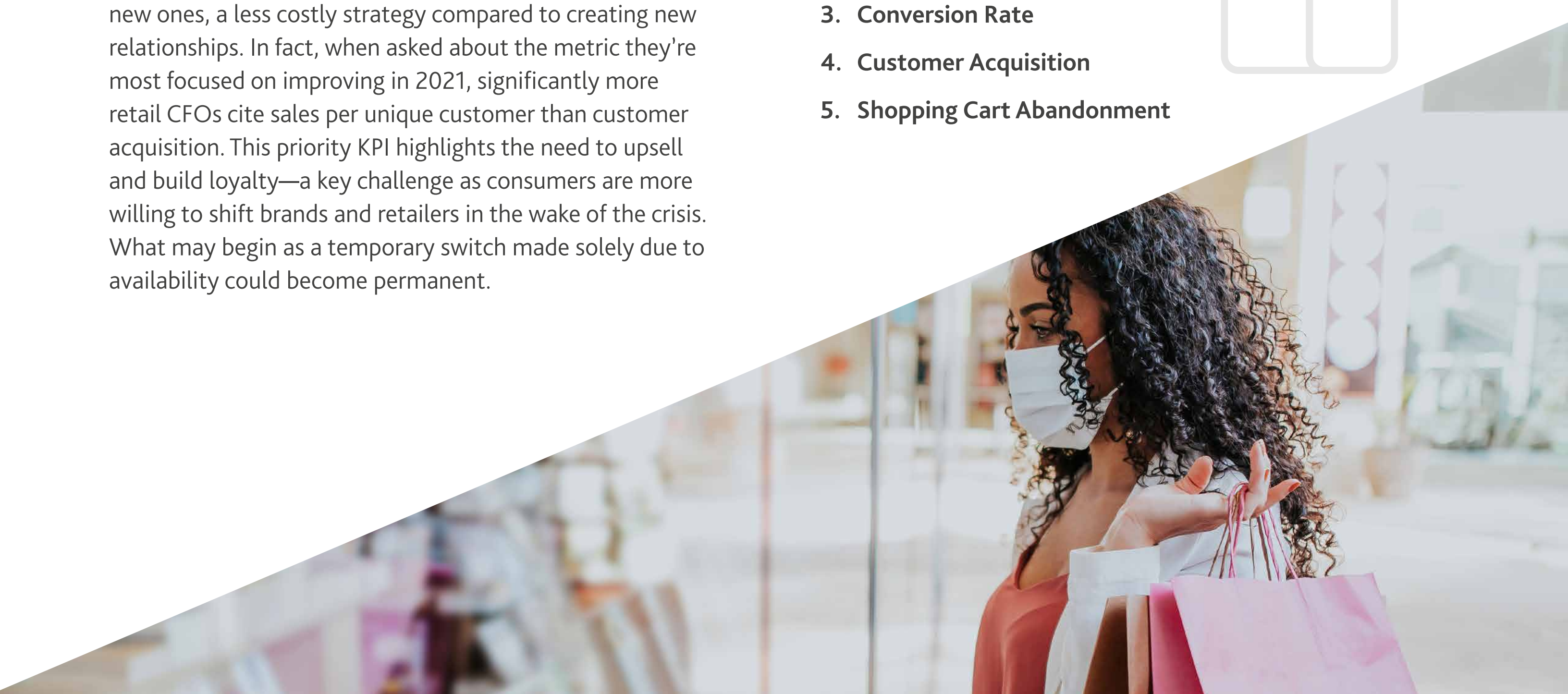
Workplace safety

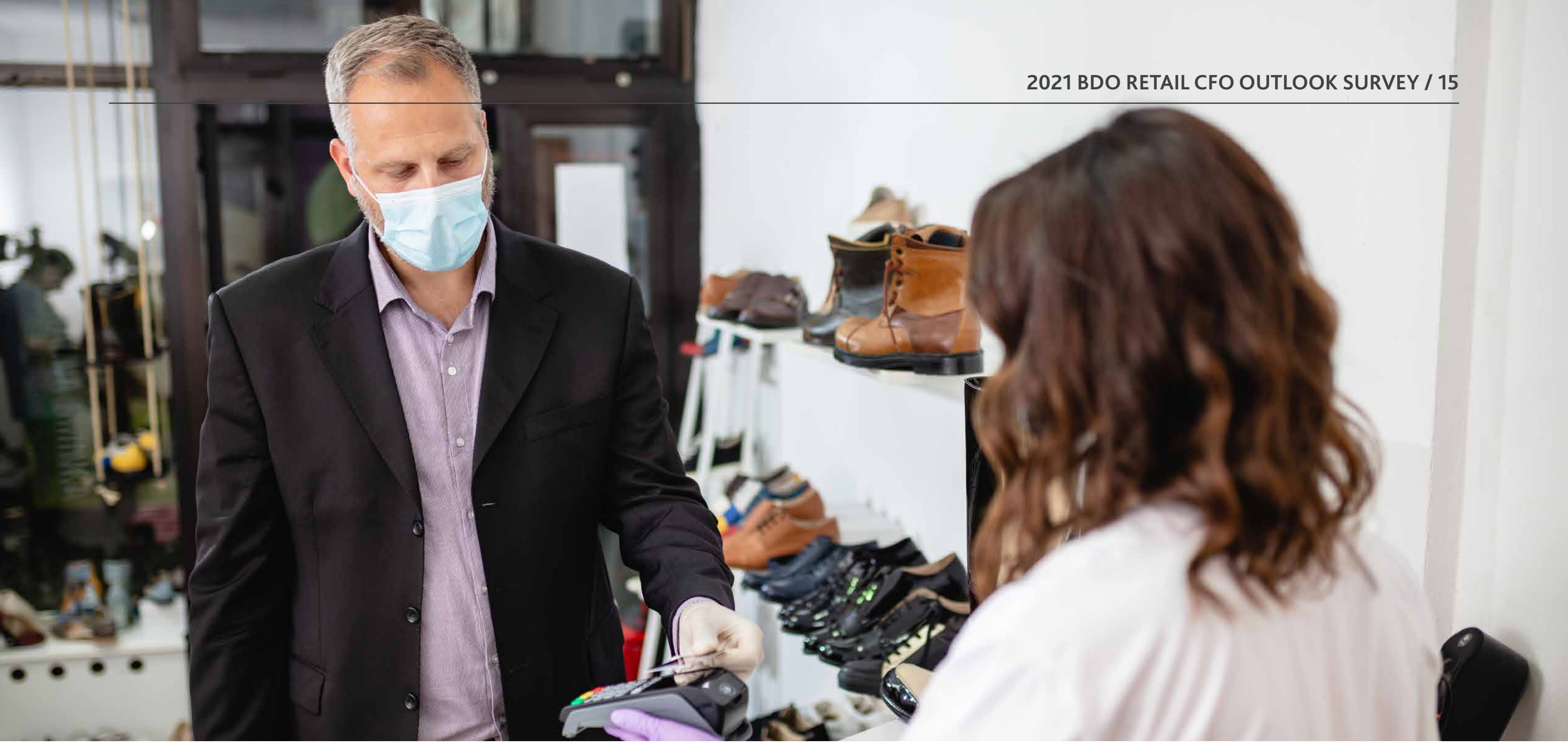
CAPTURING THE CUSTOMER

Whether demand is surging or falling, retailers have their eyes on profitability to navigate the downturn, and are more focused on growing sales with existing customers than winning new ones, a less costly strategy compared to creating new relationships. In fact, when asked about the metric they're most focused on improving in 2021, significantly more retail CFOs cite sales per unique customer than customer acquisition. This priority KPI highlights the need to upsell and build loyalty—a key challenge as consumers are more willing to shift brands and retailers in the wake of the crisis. What may begin as a temporary switch made solely due to availability could become permanent.

TOP 5 TARGET KPIs FOR IMPROVEMENT IN 2021

1. **Sales per Unique Customer**
2. **Average Order Value**
3. **Conversion Rate**
4. **Customer Acquisition**
5. **Shopping Cart Abandonment**





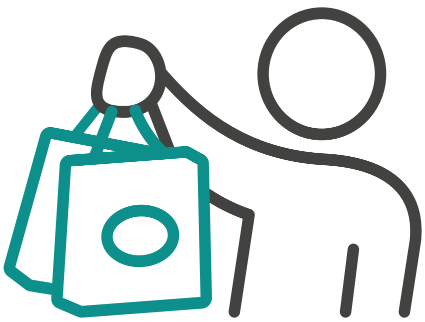
Weakened brand loyalty overall can also be an advantage for retailers that provide the right balance of value, convenience and hygiene. To capitalize on customers' new priorities, retailers should focus on products that are considered essential, or at least revamp existing offerings to ensure continued relevance.

However, revamping shouldn't equate to greater variety, as retailers have a tendency to over-SKU—a consequence of poor demand forecasting and inventory management that leads to supply chain issues. More variety means more complexity and more cost. If demand for any given variant in your product or service mix isn't sufficient to offset the higher costs, it needs to be shelved.

Leveraging the 80/20 principle can help retailers assess the most profitable parts of the business. Formally known as the Pareto Principle, the 80/20 rule is simple: 80% of outcomes result from 20% of efforts. It suggests, for example, that:

- **80%** of sales come from **20%** of customers
- **80%** of sales come from **20%** of products/services
- **80%** of customer complaints come from **20%** of products/services

Once you've identified the business segments driving the most value, realign your organization around those strategic focus areas, setting clear financial targets for profitability.



48% are **expanding** product or service offerings

> *The reality is that if everything is a priority, then nothing is. Luckily consumers have made clear what their priorities are during this crisis. They have helped define what goods, channels and attributes are considered essential. It's on retailers to sync their offerings with these preferences, and then be prepared to do it all over again when current definitions inevitably get rewritten.*

JENNIFER VALDIVIA
Assurance Partner in BDO's Retail & Consumer Products Practice

SUPPLY CHAIN PANDEMONIUM

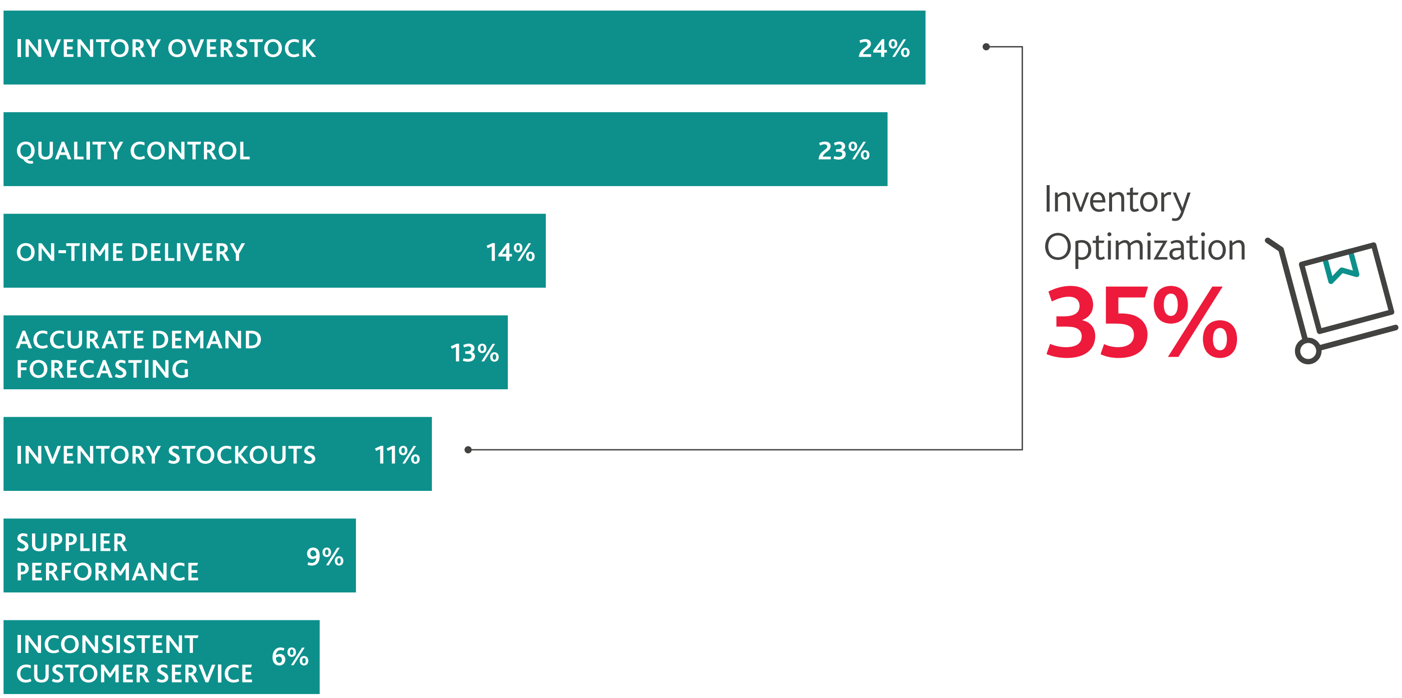
From movement restrictions and shuttered production sites to demand surges to slumps, the coronavirus has wrought havoc on global supply chains. Between stockouts and unpredictable delivery delays, same-day shipping feels like a distant dream. Even Amazon's behemoth supply chain network was overwhelmed by orders during the pandemic, forcing it to temporarily suspend its two-day Prime shipping guarantee and pause shipments for non-essential items.

The biggest supply chain challenge for the retail industry is getting inventory levels right, cited by more than a third (35%) of middle market retail CFOs. Unpredictable shifts in consumer purchasing behavior and demand patterns have rendered most pre-COVID demand forecasts obsolete. Retailers without demand-sensing capabilities will continue to struggle to optimize inventory balances, and inventory service levels may need to be recalibrated.

70%

of mid-market retailers experienced **high or moderate** levels of **disruption** to **supply chain** operations because of the pandemic

TOP SUPPLY CHAIN CHALLENGE



To minimize future disruptions and improve supply chain responsiveness to demand shifts, nearly half of retailers are investing in supply chain technology. Other commonly cited strategies to shore up supply chains in response to pandemic-related disruption include diversifying the supplier base and simplification.

RETAILERS' 2021 SUPPLY CHAIN ACTION PLANS

- **46%** INVESTING IN SUPPLY CHAIN TECHNOLOGY
- **45%** IDENTIFYING ALTERNATIVE/BACKUP SUPPLIERS
- **43%** REDUCING PRODUCT VARIETY
- **39%** ADJUSTING DELIVERY WINDOWS

Finding Your Bold Fit

The timeframe to reach the post-pandemic retail era remains uncertain, and once we get there, the environment could be unrecognizable. But one thing is clear: Retailers that take a slow and steady approach to change will be trounced by those taking bold measures. What constitutes "bold" looks different for every organization, but now is the time for retailers to define what it means for them and put their weight behind it.

Our research goes beyond retail & consumer products.

View the survey results from 600 CFOs across industries in our 2021 BDO Middle Market CFO Outlook Survey.

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60-SECOND RETAIL

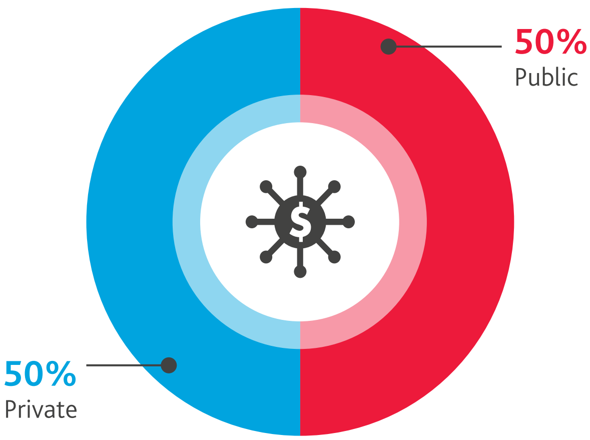
A BDO Podcast Series

Respondent Profile

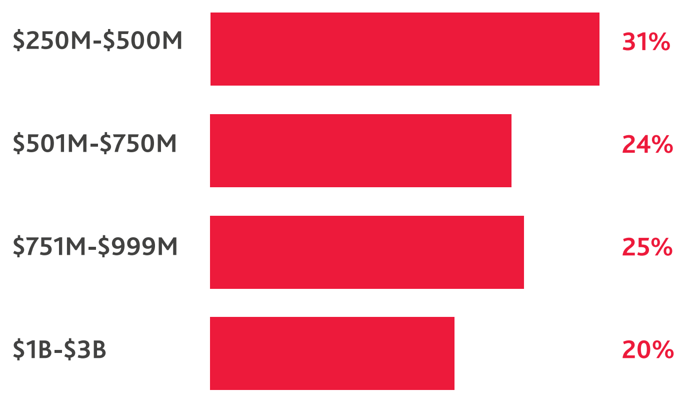
The ***2021 BDO Retail CFO Outlook Survey*** polled 100 retail industry CFOs with revenues ranging from $250 million to $3 billion in September 2020. The survey was conducted by Rabin Research Company, an independent marketing research firm, using Op4G's panel of executives.

Average tenure in current CFO role: 5 years

COMPANY TYPE



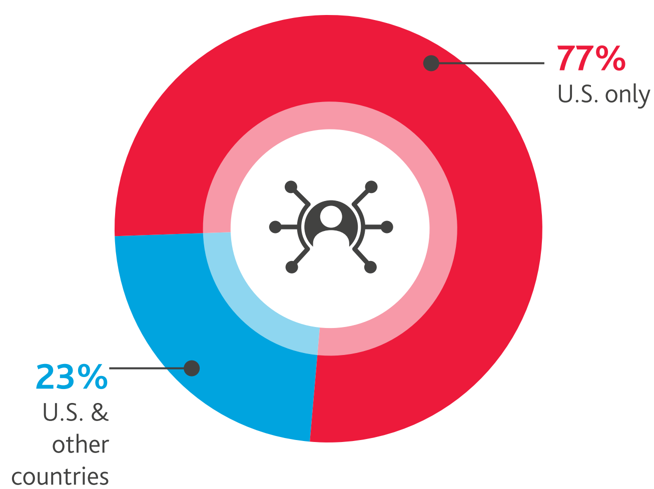
ANNUAL REVENUE



RETAIL SEGMENT

Consumer Electronics & Appliances	30%
Department Store	18%
Apparel & Footwear	17%
General Merchandise	16%
Grocery	7%
Furniture	5%
Sporting Goods	5%
Health & Beauty	2%

REGION OF OPERATIONS



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BDO has been a valued business advisor to retail and consumer products companies for more than 100 years. The firm works with a wide variety of clients across the traditional retail, consumer product and e-commerce sectors, ranging from multinational Fortune 500 corporations to emerging businesses, on myriad accounting, tax and advisory issues.

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