How to make the most of a downturn

Consumer and retail

Consumer and retail (C&R) companies were among the first to get hit by the impact of the sudden jump in inflation and rising expectations of an economic slowdown. With spiking gas and food prices taking thousands of dollars out of household budgets, consumers have been pulling back and switching to lower-cost options for six months. In our recent Consumer Pulse Survey: Holiday 2022 Report, 85 percent of respondents said they were at least somewhat concerned about inflation.[1] As the critical fourth quarter gets under way, many consumer and retail businesses have more inventory than they need to fill weakening demand. This could create additional challenges for the C&R sector if, as we anticipate, the U.S. economy tips into a real recession in 2023.

Important steps from KPMG specialists

01 **Attack costs/cut selectively.**

02 **Rethink automation.**

03 **Keep innovating.**

04 **Revamp supply chain.**

05 **Improve customer experience.**

06 **Use M&A for offense and defense.**

What to prepare for

In previous recessions, some businesses have managed to prosper, at least in relative terms. They prepared for the downturn and attacked costs and adjusted inventory positions before demand fell. They protected and even expanded EBITDA margins and found new sources of growth. They planned strategies to make the most of the post-recession recovery.

So, what kind of recession should C&R leaders prepare for this time? The chances of a "soft landing" as the Federal Reserve raises interest rates to tame inflation are diminishing.[2] So are consumer expectations. "Most consumers are losing economic ground, even though they are still employed," says KPMG U.S. Chief Economist Diane Swonk. "Inflation is eroding all that most were able to gain in wage increases—and then some."[3]

While opinions vary on how deep and long the recession might be, C&R executives remain bullish about the long-term prospects. Having weathered the pandemic, C&R companies were looking forward to a strong 2022. In our latest Consumer & Retail CEO Outlook Pulse Survey, a significant majority responded that they are confident in the longer-term growth prospects for consumer and retail businesses globally (92 percent) and their own companies specifically (90 percent).[4]

In the near term, however, C&R companies must prepare for a challenging 2023. Inflation remains the most pressing

[1] Source: "Consumer Pulse Survey: Holiday 2022 Report," KPMG, Oct. 2022

[2] Source: "Powell Abandons Soft Landing Goal as He Seeks Growth Recession," Bloomberg.com, Aug. 31, 2022

[3] Source: "If it walks like a duck and quacks like a duck," KPMG, Aug. 2022

[4] Source: "2021 Consumer & Retail CEO Outlook Pulse Survey," KPMG, April 2021

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concern for C&R—food costs in particular.[5] The World Bank now predicts that prices of food commodities will remain at "historically high levels" through the end of 2024.[6] So, spending on food could continue to crowd out other kinds of spending—on meals out, travel, apparel, and home electronics.

In 2022, many C&R companies have been able to pass on cost increases to consumers (in its Q2'22 earnings report, Kraft Heinz, for example, said it had raised prices 12.4 percent over the prior year). But high prices are changing shopping habits and consumers are trading down to lower-cost brands and private-label products. Supermarket chain Kroger said sales of its private label products surged 10.2 percent in the second quarter.[7] And shoppers expect to look for lower-priced goods when they hit the stores this holiday season. In our new holiday survey, 73 percent of shoppers indicated that they are likely or extremely likely to shop at mass market retailers and 56 percent at discount stores this year; only 18 percent say they are likely or highly likely to shop at luxury stores.[8]

How companies are getting ahead of the downturn

The key takeaway from the recessions of 2001 and 2009 is that C&R companies that cut costs early emerged better positioned for growth. More than two-thirds of consumer and retail executives polled by KPMG over the summer said they are renegotiating contracts with suppliers to control costs, and half said they would defer capital investments during the downturn. Three quarters of the executives surveyed also said they are increasing promotions and discounts to boost sagging sales. In addition, more than half of consumer executives said they are reducing marketing spend.

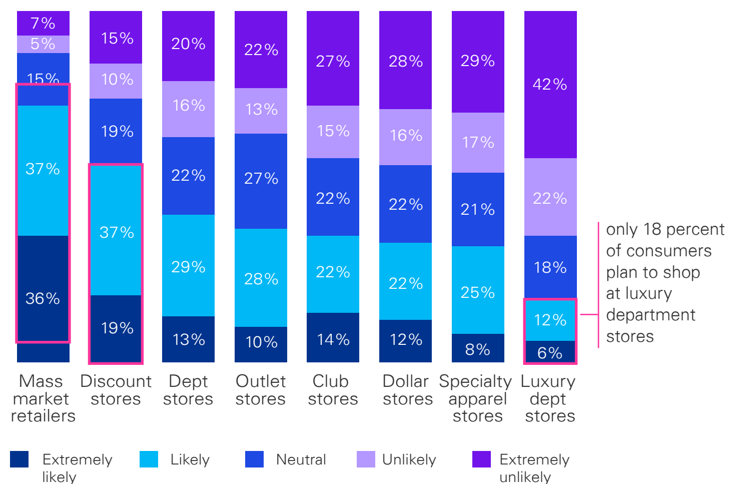
But only a third of respondents said they were likely to reduce investments in technology and digital capabilities. This is a positive sign: leaders understand that they need to continue to innovate and transform their businesses to improve efficiency and deliver a seamless online/in-store shopping experience. A continuing focus of investment—both in technology and training—is in improving self check-out and the buy online/pickup in store (BOPIS) experience.

Case study: Target takes a hit now to soften future blows

Many C&R companies are struggling with major inventory issues as sell-through rates have not met expectations. In the first half of the year, retailers that finally were able to get the merchandise they wanted after the pandemic had snarled supply chains, found that demand was no longer there for home electronics and other discretionary items. Walmart and Home Depot both reported inventory issues in the first half.[9] Unlike Walmart and Home Depot, however, Target decided to take aggressive action to clear out inventory and restock appropriately for a softer economy, including emphasizing more "high frequency" items such as food. The result: a 90 percent drop in Q2'22 profits. "If we hadn't dealt with our excess inventory head on, we could have avoided some short-term pain on the profit line, but that would have hampered our longer-term potential," Target's CFO, Michael Fiddelke, told reporters."[10]

Exhibit 1. Shopping preference by retailer type

"At which of the following retailer types are you likely to shop this holiday season (2022)?"



KPMG conducted surveys of a representative sample of 1,004 consumers across the United States, and, if applicable, they were asked the question, "At which of the following retailer types are you likely to shop this holiday season (2022)?"

*N count is lower since some respondents have not answered the referenced question

Source: KPMG Consumer Holiday Survey, fielded September 2–9, 2022

[5] Source: "Economic Slowdown Survey, Consumer & Retail," KPMG, July 18, 2022
[6] Source: The World Bank, April 2022
[7] Source: "Kroger Q2 2022 Earnings Call Transcript," Sept. 9, 2022, fool.com
[8] Source: KPMG Consumer Pulse Survey, May 2022
[9] Source: "Unusual Christmas shopping expected for Target, Walmart," FreightWaves, Sept. 8, 2022
[10] Source: "Target's earnings take a huge hit as retailer sells off unwanted inventory," CNBC, Aug. 17, 2022

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The immediate challenge is the fourth quarter of 2022 and first quarter of 2023. FedEx shocked the stock market in September when it reported falling shipping demand, which CEO Raj Subramaniam noted, is an indicator of a slowdown in "everybody else's business."[11] In September, the International Monetary Fund issued a warning that the chances of a global recession in 2023 have increased.[12]

If FedEx is right, then a lot of companies could be entering the holiday season with too much inventory. In Q2'22, Amazon's inventory was up more than 58 percent from Q1'22, Walmart's was up more than 25 percent, and Target was up more than 36 percent.[13] With many inventory liquidators at capacity, offloading unsold inventory next January will very likely be difficult.[14]

Our sense is that C&R leaders are closely watching the economic situation and continue to take tactical steps, such as pulling back on orders and receipts where possible and shifting volumes to lower-priced items. However, only 11 percent of C&R executives surveyed by KPMG over the summer said they had a "comprehensive plan" in place to navigate a slump.

What you can do now

Top performing companies not only do better at protecting the bottom line in a downturn, but also use the downturn to plot future growth. That means it's time to think of new ways to grow and position your company to make the most of the eventual recovery. It's time to take a step back and ask, "What do we need to do now?"

Attack costs, but cut selectively: In the past two years, many companies have added infrastructure and staff. To address that, first look at SG&A for quick wins. Consumer goods manufacturers and retailers that went through cost-takeout programs during the worst of the pandemic have taken on new costs since, particularly labor costs. But companies should be tactical in cost cutting. Make sure you don't cut yourself out of future growth opportunities.

Rethink automation: Labor costs have risen, but it is still difficult to fill some jobs in factories, warehouses, and stores. It's time to redo the math on investments in advanced robotics and automation in factories and in distribution and fulfillment centers. Stores can reduce dependence on selling floor labor with self-checkout. In a recent KPMG survey, more than 70 percent of retailers said they are already using or plan to introduce new technology to reduce their reliance on labor.[15]

Keep innovating: Despite record-high inflation, tightening labor markets and ongoing uncertainty, retailers cannot afford to hold back on innovation. They must continue to transform, invest, and innovate to remain competitive and create their future or risk falling behind. One area with immense untapped potential is the burgeoning metaverse, especially when it comes to reaching future consumers. Nearly half of the retail executives in a KPMG survey believe the metaverse is a marketing channel that will increase brand awareness and consumer engagement. For consumer goods businesses the opportunity has been proven during the pandemic to continue to advance the direct-to-consumer channel and build customer loyalty.

Use M&A for offense and defense: A downturn is a good time to use M&A to adjust the business portfolio. You may be able to buy new assets to support growth—retail technology startups, or higher margin consumer brands, for example—at a discounted price. And it's a good time to look at businesses that do not have great growth potential and could become a significant drag on earnings in a recession. You might not get last year's price, but you can remove the risk and distraction and use the proceeds more productively.

[11] Source: "FedEx's bleak warning could reflect global economy and company's own shortcomings," CNBC, Sept. 21, 2022
[12] Source: "Risk of Global Recession in 2023 Rises Amid Simultaneous Rate Hikes," World Bank, Sept. 15, 2022
[13] Source: "Unusual Christmas shopping expected for Target, Walmart," FreightWaves, Sept. 8, 2022
[14] Source: "Off-price retailers shift tactics as inventory gluts squeeze the industry," Supply Chain Dive, Sept. 13, 2022

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Revamp supply chain: The shortages of the past two years have demonstrated the need for better visibility and flexibility to de-risk the supply chain and be more responsive to consumer behavior shifts. China lockdowns, port delays, and shortages of truck drivers have proven how fragile supply chains are. This is inspiring companies to get creative about alternative shipping methods and ports.

Improve customer experience: When times get tough, it pays to cement relations with valued customers. Retailers, for example, can continue to improve the omnichannel shopping experiences for their customers. In a recent survey of retail executives, retailers with up to 1,000 stores are projecting growth of up to 10 percent for BOPIS. In addition, 63 percent plan to increase training to improve BOPIS service. The key to BOPIS is that it brings customers into stores and can increase basket size when they pick up their order. And if they have a great experience, consumers will come back. Consumer goods manufacturers can focus on improving in-stock levels of most favored products as well as packaging sizes that provide options for budget-conscious customers.

How KPMG can help

KPMG helps its clients overcome deal obstacles by taking a truly integrated approach to delivering value, leveraging its depth in the C&R industry, data-supported and tools-led insights, and full merger and acquisition (M&A) capabilities across the deal life cycle. KPMG knows how to prepare your team and execute across the deal life cycle so you can achieve your deal thesis and create sustainable value through M&A. With a C&R specialization, our teams bring both transactional and operational experience, delivering rapid results and value creation.

Contact us

Matt Kramer
Partner, National Sector Leader C&R
614 241 4666
mattkramer@kpmg.com

Duleep C. Rodrigo
Principal, Advisory
949 278 2899
drodrigo@kpmg.com

Julia E. Wilson
Principal, Advisory
404 805 2110
juliawilson@kpmg.com

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