The New Retail

Evolutions and Outlook

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The New Retail: Evolutions and Outlook

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After a long fifteen months, the vaccine rollout and falling COVID-19 cases in the United States promise retail its first respite from the challenges of the pandemic. The industry proved its resilience by adapting quickly to overcome the obstacles of the past year. Now, with consumer spending returning and foot traffic at stores increasing, a new evolution of retail is beginning.

Strategies developed during the pandemic are proving useful beyond it, and the winning retailers are incorporating what they learned from the hardships of 2020 in their future plans. Key trends include new store inventory models, cashless payment options and robust fraud protection.

TD's experts shared what they think lies ahead for retail. Here are some key takeaways:

- Consumer spending is coming back, and quick. Consumer spending growth averaged 2.1% monthly the first three months of 2021.
- Stimulus money paired with high savings levels for many Americans spell opportunity for retailers.
- Inventory rebuilding could lead to rising working capital needs, and retailers will need to consider financing options.
- E-commerce grew exponentially during the pandemic, making it important for retailers to re-evaluate their distribution models.
- Contactless payment and automation helped keep treasury management costs down and will continue to help retailer's post-pandemic.
- Consumers embraced contactless payment this year which is likely here to stay.
- Fraud also grew rapidly during the pandemic as criminals took advantage of the disruption and is projected to continue to increase.

Consumer Spending is Rebounding

TD Economist James Marple has seen strong consumer spending recently. "Choose your superlative," Marple said when asked about consumer spending growth, which he said averaged 2.1% monthly over the first three months of this year. "We usually see average growth around 0.3%-0.4% on a monthly basis, so a 2% increase is akin to putting several years of spending into a single quarter."

Of course, this rebound comes after a major plunge in spending during the early months of the pandemic, but Marple still believes this is good news for retail overall. "Consumer spending is roughly where one would have expected it to be if the pandemic never happened," Marple said.

Spending growth has been led by spending on goods. Marple said that goods spending is up 4% on average over the first three months of 2021. That is more than 10% higher than he estimates it would have been had the pandemic not happened.

Durable goods– things like vehicles, furniture and home gym equipment– are even more above their pre-pandemic trend, roughly 25% higher in March of this year than Marple would have expected absent the pandemic. This strong growth in goods spending has in part substituted for lower spending on services.

Though service spending still remains down from pre-pandemic averages, it is recovering quickly. It has been increasing 1% on average each month, but is still down 3% from its pre-recession peak, and down 8% from where Marple would have expected it to be absent the pandemic.

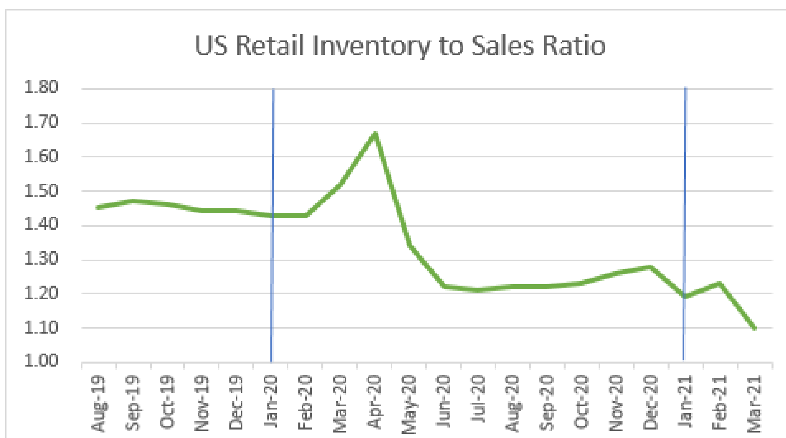
This is important because spending on services represents a bigger portion of total spending, representing nearly seven out of every 10 consumer dollars spent prior to the pandemic. The components of services spending that are still the most depressed are, not surprisingly, high-contact industries like restaurants and bars, gyms, airlines and hair-salons. Retailers should expect continued strong growth in consumer spending, but they should also be prepared for the composition to shift away from goods and toward services. This will be fueled by the re-opening economy and high saving rates that have been accumulated during the pandemic. Consumers have built up over $2 trillion in extra savings through March and are well positioned to keep spending as the economy re-opens. TD Economics forecasts services spending to surge ahead at a double-digit pace in the second quarter, while spending on goods may cool.

Marple cites the stimulus as a major reason for the strong acceleration in spending, noting that in aggregate, income supports have more than offset the loss of employment due to the pandemic. In some cases, supports have even raised the level of income well above its pre-pandemic level. This was as intended. Income supports have allowed people to make ends meet through the health crisis. Stimulus is likely to slow, but the high level of savings should prevent this from posing a downside risk to the spending outlook. At the same time, jobs should come back with the re-opening of the economy, making these supports less necessary.

Overall, Marple expects solid growth this year, with stronger growth in services relative to goods. The growth won't impact all sectors equally, however. "People are likely to spend more on clothing now that they can leave their homes, but they might spend a bit less on gym equipment," Marple explained. Retailers who can pivot to shifting consumer needs will be the best positioned to take advantage of the growth in consumer spending this year.

To Grow, Retailers Need Inventory

As consumer demand returns, retailers will need to ramp up inventory levels to position themselves to benefit. This could be a challenge, since retail inventory to sales ratio are at a historic low. US Census Bureau data puts inventory-to-sales at a very lean 1.10 for the industry as of March 2021, down nearly 28% from the same time last year.



Source: US Census Bureau / St. Louis FED

Jeffery Wacker, Head of U.S. ABL Originations at TD Bank, said retailers juggled supply chain disruption, over-supply of seasonal goods and gauging restocking needs throughout the pandemic. "Overall pandemic level inventories dropped 25%-40% compared to the same time a year ago," Wacker said. The inventory-to-sales level in August 2020 fell to the lowest level in six years according to the US Census Bureau data and stayed low from then out.

Still, there were many bright spots amidst the challenges. The retail and at-home delivery sectors exhibited an unprecedent level of resilience and creativity while ramping-up their digital e-commerce and marketing strategies – in many cases with staffs working remotely. E-commerce picked up drastically, with UPS reporting a 65% increase in home deliveries in July of 2020. Many in the industry pivoted their physical stores to fulfillment points for some e-commerce sales and contactless pick-up locations.

Retailers have had to juggle changing local laws, employee safety and health while also managing inventory, financing, liquidity and working capital needs. Many reduced store-level inventories due to store closures, while others were stuck with unsold seasonal merchandise. Supply chain disruption resulted in delays and empty shelves for in-demand goods, and decisions on merchandise ordering for 2020-2021 became an increasing source of uncertainty.

Now, inventory restocking is ramping-up, stores are reopening and working capital needs are increasing. There are still supply-chain challenges in some sectors that increase lead times and limit the level of goods on hand, as well as significant pent-up demand that is driving inflation in the prices of certain goods. Being sure stores and distribution centers are stocked to accommodate the expected rebound in sales is critical and a point of competitive difference between retailers.

Providing working capital financing to support the sales recovery has been a focus for financial institutions seeking to help meet the needs of retailers. The first step is to make sure that there is adequate operating liquidity to run the business. The Payroll Protection Program loans helped many smaller retailers and their suppliers bridge the COVID shutdown, while larger retailers have been able to access broader capital markets for funding. Lenders have been supportive of new consumer finance programs allowing the retailer's customers to finance larger ticket items over time.

Customers Love Contactless Financing and Payment Flexibility

Another popular pandemic innovation was the rise of contactless financing, and Jim Warrington, Head of Retail Card Services Business Development at TD Bank, believes this trend is here to stay.

"Contactless financing will continue to evolve. Moving forward the experience must be in the shopper's hands," Warrington said. As credit becomes a more seamless part of the in-store shopping experience, retailers and customers alike are gravitating towards options that make that possible, including new programs that allow customers to apply for store credit cards from their mobile phones.

It has also become increasingly important for retailers to offer consumers a variety of financing options, not only revolving credit cards but also point-of-sale installment loans that enable consumers to pay off purchases over time.

"Today's consumers are looking for affordability and flexibility, particularly in the low interest rate environment," Warrington said. Long-term financing options help to encourage spending while accommodating customer's immediate purchasing needs.

Locking Up Against Fraud

Fraud has long been on the rise, but it spiked drastically during the pandemic, and there is no sign of it going away. "If you're not thinking about fraud, you are going to be compromised," said Bob Gale, Head of Corporate Banking Treasury Management Sales at TD Bank. This was true even before the pandemic but is even more important now.

Fraudsters are being more creative and preying on people who work from home, which has created new vulnerabilities. Man-in-the-middle schemes where criminals create fake bank login pages are on the rise, as are email phishing schemes. In some cases, fraudsters have even watched email traffic to know when a senior team member or executive is out of the office, and then send emails posing as that employee to convince unsuspecting employees to execute urgent payments.

Banks offer solutions to check fraud and ACH fraud, but often the best prevention is education. Even with multiple layers of protection including two-factor authentication and firewalls, employees can expose a business to losses if they let their guard down. Many banks offer client education around the new types of fraud to watch for, and retailers can use these resources to educate their employees how to detect, respond, and recover.

Another treasury management issue retailers face is managing physical cash. "It is the smallest portion of the treasury, but the biggest pain point," said David Jamison, Director of Treasury Management Sales at TD Bank. During the pandemic, many banks closed physical locations or restricted hours, making this even more difficult for retailers. Many switched to options like armored couriers and smart safes, but these costs rose quickly, with as much as 8% price increases for their services during the pandemic.

"There were safety concerns for employees leaving the premises," Alexander Moskalenko, Treasury Management Sales Officer at TD Bank, explained. During the pandemic, there was a fear of employees being exposed to the virus, but there are also logistical concerns. To solve this, many companies set up remote deposit capture services and turned to digital and paperless solutions.

"Commercial clients are going to continue to utilize the digital," Jamison said. "Now it's business as usual." Enhanced options like BAI reporting allowed retailers to streamline many of their processes, as well as simplify cash management and reconcilement.

"We're definitely not going backwards," said Adrienne Terpak, Commercial Segment Manager at TD Bank, noting that the pandemic led many retailers to accelerate adoption of treasury management solutions they had been advised about for years. What might have taken years to implement suddenly became urgent, and the bank was well-positioned to meet the demand driven by the unprecedented crisis. "Now we need to use the advantage of that mindset to automate, streamline, and digitize even further."

The Road Ahead

With consumer spending rebounding and demand returning, things are looking up for the retail sector. Although there remain many challenges ahead, for communities, impacted workers and companies alike, there are real pockets of strength in the retail economy. Retail proved its resilience this past year, demonstrating again and again the creativity and adaptability of the industry.

"There are so many aspects of 2020 that I'm sure we are all happy to leave behind," said Wacker. "But there are a few creative breakthroughs in retail that I think will shape the industry in the years to come."