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Retail in Australia Today: How to Manage COVID-19 Disruption and Make it to the Other Side

Shopping with friends or family has been firmly placed on the list of prohibited activities by the Federal Government in response to COVID-19, yet it was a normal part of daily life only a short time ago. COVID-19 has shuttered vast portions of the retail sector and the economy more broadly, with Treasury estimating over 800,000 businesses will qualify for the Federal Government's JobKeeper program as a result of significant declines in revenue.

Australian retailers have been adapting to a changing landscape for some time, including responding to unforeseen events such as last summer's bushfires. The enormous disruption of COVID-19 is the final obstacle that many retailers will struggle to navigate. Few, if any, will have planned for such an event that for many has closed the entire store fleet for weeks, if not months.

Essential vs. non-essential businesses

The Federal Government has not mandated the closure of any retail business, although the divide between the "haves" and "have nots" continues to grow. Although retailers classified as essential have been impacted by the pandemic, they can still maintain some operations and preserve cash flow. A handful of essential retailers — notably supermarkets — are even managing to grow during this time of crisis.

The reality is starkly different for retailers deemed non-essential, with many household brands having closed their doors and relying solely upon online trade to survive.

For those that are attempting to continue to trade through their stores, footfall appears well down with Google's April Mobility Report suggesting that visits to retail locations are down by between 24% and 49% across Australian states and territories.

The outlook for non-essential retail

Even if eCommerce is still operating, the shuttering of retail store fronts has brought cash inflow for most non-essential retailers to a halt. It's that "non-essential" subset of retail that we'll focus on in this article.

Consumer (and employee) confidence has been, and will continue to be, shaken. The Federal Government have indicated that unemployment may peak at 10%, with The Grattan Institute suggesting that between 1.9 and 3.4 million Australians could be out of work over coming weeks as a result of COVID-19. GDP is also forecast to shrink, with the IMF expecting a tightening of 6.7% in 2020. For context, GDP shrunk by 2.2% in the 1982-83 recession, and only by 1% in the 1991 recession.

For non-essential retail, we see this translating into a 50% decline in volume compared to last year. In our view, sales will be down by 66% in the first and second quarter 2020, down 40% in the third quarter, and recovering to 30% down for the Christmas trading period.

On 8 May 2020, Scott Morrison announced a slight easing of certain COVID-19 restrictions. However, restrictions impacting retailers appear set to stay in place for at least a further three weeks and potentially longer. Various state governments, particularly Victoria and New South Wales also appear to be taking a more cautious approach than that suggested by the Prime Minister.

What savvy retailers are doing to stay healthy

As we look at the reaction to COVID-19 from retailers, we expect to see smart retailers taking a series of actions over the short to medium term to conserve cash and structure their companies for post-COVID-19 operations.

The immediate priority is to stabilise and protect the business. This will involve using online and digital platforms to stay in touch with consumers and generate income; creating a **Minimum Viable Platform** that aligns functional areas against a revised sales forecast; developing a liquidity platform from which to operate; evaluating and securing access to relief funding; and ensuring clear, consistent and continual stakeholder engagement. The immediate plan is focused on stabilising and protecting the business.

Stabilise and protect the business (immediate to short term)

Respond to crisis | Communications

- Develop a strategy to stay in front of employees and customers (even while stores are closed).
- Provide updates from both a business and humanitarian perspective.
- Preempt the need for daily check-ins and real-time updates with employees, customers and vendors.
- Check you have the right feedback and listening mechanisms in place to anticipate emerging issues and adjust strategies.

Respond to crisis | Hoard cash

- **Reduce expense and cash outflow**
  - Suspend payment of dividends.
  - Defer vendor payments wherever possible.
  - Stop all discretionary capex spending.
  - Reduce all advertising and marketing spending, except email and digital where ROI positive.
  - Reduce salary costs:
    - Stand down store employees where necessary.
    - Terminate temporary staff and contractors where non-essential.
    - Consider reducing corporate staff by at least 25%, corporate salaries by 20%-25% and top executive cash salaries by ~50% for duration of the crisis.
    - Freeze hiring of any non-essential roles and defer start dates for any new hires in the pipeline.
- Consider rapidly monetising owned real estate assets.
- Cancel seasonal purchases and reduce/decrease open orders.
- Draw down available lines of credit and evaluate all available financing options.

Explore relief packages available

- Consider available federal and state government assistance in respect of:
  - Meeting obligations to employees (ie. The JobKeeper scheme)
  - Federal and state tax payments (such as PAYG, GST and Land Tax deferrals)
- Commence negotiations with landlords consistent with the *Code of Conduct for Commercial Tenancies*, introduced by the National Cabinet on 7 April 2020.
- Engage with financiers regarding deferral of principal and interest repayments.
- Be cognisant of various other packages providing relief from reporting, lodgment and other obligations.

Revise cash flow forecasts

- **Complete a detailed, 13-week liquidity forecast with varying scenarios.**
- **Create a Minimum Viable Platform — a footprint for the organisation to maintain the business during the shutdown.**
- Identify near-term cash improvement options (e.g., lessor/lender concessions, supply chains, inventory consolidation).
- Review ongoing initiatives for strategic impact, projected benefit/ROI, cash and other resource requirements.

Test business plan/contingency scenarios

- **Recast business plan and drill down on business unit profitability.**
- **Determine achievability of plan under a variety of likely and "could never happen" scenarios.**

Plan for re-opening

- **Develop communication and execution plan for when the decision is made to reopen stores.**
- **Coordinate with key partners (landlords, security, cash management, marketing partners).**
- **Create contingency plans:**
  - **Closure of all stores that are not cash flow positive.**
  - **Closure of all "C" and "D" grade stores.**
- Plan any promotions to align with re-opening of stores.
- Design appropriate loss-prevention protocols.
- Assess inventory positions and timing of new product launches/merchandising reflows.

Once the business is stabilised, companies must shift their attention to manage through the downturn and be well positioned to emerge from the pandemic environment. There are a number of important steps that businesses should take to protect and strengthen their position, including communicating with customers; optimising operations; monitoring the likely state of recovery; strategising and stress-testing exit plans; launching a public affairs program to mitigate any scrutiny associated with government relief assistance; and clearly articulating mitigation plans to stakeholders.

Leading through the downturn (medium term to postpandemic)

Strategise

- **Evaluate longer-term restructuring solutions with landlords and lenders, including closure of low-volume/low-profit stores.**
- Define promotional strategy and plan for remainder of year.
- Develop communications and change management program to help teams understand the shifts that need to happen in order to quickly implement plans.
- Create messaging platform for the recovery period that puts people first, highlights the underlying strengths of the business, establishes a path forward, and conveys confidence in the future.

Optimise

- **Evaluate corporate and SG&A functions for cost reduction opportunities.**
- **Assess broad range of scenarios (including possible resurgence of COVID-19) for summer inventory; define balance between lost sales and inventory sell-through risk.**
- Finalise end-of-life strategies for inventory not sold through by the end of the season (e.g., delay floor set of Summer styles, integrate spring styles into the winter line, return inventory to the DCs to hold for next year).
- Reduce working capital.
- Evaluate vendor agreements to identify contracts that are no longer competitive and consider using force majeure language to terminate agreements.

Monitor

- **Monitor signals of economic recovery (acceleration/deceleration) and adjust inventory strategy.**
- **Monitor traditional and social media, analyst reports and other forums to understand how stakeholders are thinking and what competitors are doing.**
- Monitor inventory levels across all nodes of the network and redeploy as necessary to maximise sell-through.
- Monitor expenses and update scenario planning.
- Identify supply chain constraints/disruptions and define strategy to minimise the impacts on operations.

Engage

- **Communicate a clear vision for the future, specifically highlighting steps the company is taking to care for employees, customers and other partners while also protecting enterprise value.**
- **Engage, as appropriate, with media, investors, analysts and other third parties to shape the narrative around the business, mitigate any criticisms and build confidence in the future.**
- Train and support functional and field leaders in establishing clear expectations, accelerating the adoption of any new ways of working, and keeping teams motivated and sharing progress.
- Leverage store employees where possible to complete critical operations at the stores, including shipping inventory to the DCs to support online orders, changing signage and marketing, process reflows, etc.

The nation's response to contain the COVID-19 virus has caused an economic shock unprecedented in its speed and intensity. Even as infection rates and new case numbers diminish, it will likely be many months before life as we knew it resumes. Many Australians will remain apprehensive about large public gatherings and close contact for months afterward, until they are firmly convinced the threat has passed. This presents a quandary for retailers and other consumer-dependent businesses, as challenges will remain long after the "all clear" is given and restrictions are lifted. The challenges are twofold, as retailers will have to contend with the economic impact of recession on shoppers as well as their likely reluctance to fully embrace pre-COVID-19 lifestyles. Life will be different for the foreseeable future, and retailers need to be prepared to adapt to a new reality that we cannot yet completely envision, but one that almost certainly will heap new challenges upon an already challenged industry.

Insolvency: Is now the time for a retailer to fold?

In short, the answer is no, not now — if it is avoidable. Few retailers are entering external administration now, and we expect this trend to continue over the short term due to the following:

- The various strategies implemented by the Federal Government to allow the economy to enter effective hibernation, such as the suspension of insolvent trading laws, appear to be working and buoying confidence in directors.
- Banks are engaging with retailers to make it work. Many are working with impacted retailers to modify loan terms, including moratoriums on debt service/loan covenant compliance. Some are deferring payment, waiving fees and offering extensions.
- Whilst so far untested, the $130 billion JobKeeper Payment Scheme looks likely to go some way in preserving workforces, although the working capital requirement to meet employee wages before reimbursement under the scheme will need to be addressed by retailers.
- Landlords are being forced to work with retailers via the *National Code of Conduct for Commercial Tenancies*

As the economy and credit markets stabilise post-pandemic and companies adjust to the new normal, we expect to see insolvencies resume and increase, with a significant uptick in activity expected from Q4 2020.

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