# Retail and Consumer Goods Strategy in Uncertain Times

By Madison Riley and Michael Dart

At a time of conflicting indicators, incredible volatility and a lack of historical examples, guessing how the U.S. and global economies will recover from the current recession is clearly a gamble.

How should retailers and consumer goods companies manage successfully through such uncertainty? This article offers both ideas from financial theorists and perspectives from the Silicon Valley dotcom bust on how to survive and eventually thrive in the current environment.

## Lessons from Financial Theorists

Today, the debate among economists is whether the rebound from the current recession will be quick and steep, in a "V" shape; longer and slower, in an "L" or "U" shape; or the "W" shape, characterized by sharp peaks and troughs. KSA's recent analysis of consumer behavior over seven years demonstrates that consumer volatility and uncertainty are at historic highs. This volatility shows up in key metrics such as consumers' changing confidence in the economy (it has improved by 10 percentage points since February), their perceptions of job security (27% of consumers still expect more layoffs compared to 52% in February) and their savings patterns (consumers are saving more but not paying down debt), among others.

Given this volatility and uncertainty, many retailers are anticipating and planning only for an "L"-shaped recovery, with deep cost cuts and hold-back on investments. These actions are mostly necessary and expected, but they cause companies to miss the opportunity to take advantage of the peaks in a "V" or "W" and emerge stronger in the event of a "U" recovery.

## Lessons from Investment Managers

Investment managers have recently shifted their strategy to both preserve cash and take advantage of any unpredictable swings in the economy.

In short, the longstanding "buy and hold" investment strategy has been replaced with a "utility and options" strategy. This new approach prescribes that the majority of an investment portfolio be allocated to low-risk "utility" investments to safeguard against new economic shocks or a prolonged recession. But it also allows for the possibility of an uptick, with a minority position in riskier "options" investments so that investors can take advantage of a quick or steep rebound should one take place.

This approach can be applied by retailers and consumer goods companies whose goal is to survive the recession and emerge more competitive.


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Kurt Salmon Associates is the leading global management consulting firm specializing in the retail and consumer products industries. We leverage our unparalleled industry expertise to help business leaders make strategic, operational and technology decisions that achieve tangible and meaningful results.

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## The Utility and Options Approach to Retail Strategy

By treating their asset base like an investment portfolio, retailers can use this same approach. The result is a strategy that safeguards the business and ensures survival—but still leaves the opportunity to take advantage of growth once the economy starts to rebound.

> Most, say, 80%, of a company's focus (resources, assets and time) should be devoted to actions and decisions necessary to survive, much like placing 80% of an investment portfolio in utility stocks (or Treasury bonds) that are likely to generate slower and smaller—but also more certain—returns that preserve capital. These are the basic blocking-and-tackling activities that keep the business viable.

> Executives then allocate the remaining 20% of their focus on riskier "bets," activities and decisions that can position them far ahead of the industry in an uptick. These are creative solutions outside of the norm, much like buying options that are riskier and less certain, but which also have potential for an enormous upside.

By cementing current operations and business with an 80% focus on "utility solutions," and preparing for new opportunities with a 20% focus on "options solutions," the retailer will be well-positioned for the eventual rebound—whether it's U-, V-, W- or L-shaped.

### Utility Solutions

By now, the activities categorized as "utility" solutions may be familiar to everyone: hiring frosts, across-the-board budget cuts, supply chain renegotiations, discounts and promotions and other belt-tightening, cash-preserving tactics.

### Options Solutions

The "options" solutions, on the other hand, take a more strategic view. We selected the top four based upon potential economic impact, risk and resources to implement.

> **Create a value orientation**
Most consumers are buying less or trading down, but they still love great brands and quality. In the consumer packaged goods sector, a recent study found that on average brands lost about 30% of their formerly very loyal customers. Another 30% remain loyal, but they say they are spending less, either buying on sale or buying fewer items. Only 40% reported no changes in behavior. Similarly, in high-end apparel, we found that about 20% of once loyal customers are trading down and approximately 70% say are buying less. Of those who are buying less, over 90% wanted to stay within their existing brand portfolio if broader pricing ranges or promotions continued. Only 5% indicated a desire to look at lower-tier brands. In the long run, the market will reward consistently great brands and quality. Take advantage of this by:

- Employing a "barbell" strategy in which a line of more wallet-friendly items is presented with the higher-end products of the same brand (e.g., $700 designer leather handbag along with a $28 designer key fob), or
- Redefining value as the totality of use, whether it's classic apparel pieces that get more wear or products of exceptional quality that last longer (e.g., Procter & Gamble's "performance-based value messaging"—Bounty costs more, but you use less because it's better).

Instead of discounting, this assortment optimization offers value options for the consumer while protecting the brand and its perceived quality.

> **Creatively rethink the entire store fleet**
Closing weak stores based on, say, the bottom 10% of performance may seem the efficient way to cut costs and optimize the store fleet. But determining how many, and which ones, to close in order to optimize the entire fleet performance, as well as position for future growth, may not be as straightforward. Given the changes in consumer behavior, shifting patterns of local trade areas and corrections in the real estate market, store fleet optimization should take into account more than the current store performance numbers.

The key is to review the store fleet more holistically. For example, if one store is closed, what and where are the alternatives for its customers? Is there an opportunity to close all existing stores within one area and take advantage of the current real estate market to consolidate into better locations in the same trading area? In a study of home furnishing retailers, KSA found that by digging deeper and applying multivariate analyses on such local factors as cannibalization, competitive impact, store costs and population demographics, the overall profit margin for the truly optimized store fleet was improved by 55%.

### The Shape of Recovery

Economists often refer to the rebounds by describing their shape.

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| **V:** *Steep recovery that follows a deep recession.* | U.S. economy grew at a 6%+ pace in the four quarters after the 1973–75 recession, and at a 7.75% pace after the 1980-82 recession. |
| **U:** *Gradual slide down followed by a gradual slide up.* | The majority of economists today believe the present recession will be followed by a U-shaped rebound. |
| **W:** *Temporary recovery driven by government stimulus.* | When the impact wears off, the economy will retreat before the final recovery. |
| **L:** *Long period of virtually zero-growth.* | Japan experienced .5% growth in the "lost decade" following the real estate bubble burst in 1990. |

> **Invest in the experience**
During a recession, many retailers resort to competing on price instead of offering differentiated, fresh merchandise and exciting displays. The key to long-term success is for retailers to recognize that consumers are looking for "co-created experiences"—participatory experiences that give them a reason to come back to the store again and again. Apple may be the standard-bearer in providing co-created experiences for its customers (e.g., learn about iTunes in-store, then download songs directly to personal iPods), but there are many other examples of co-creating experiences.

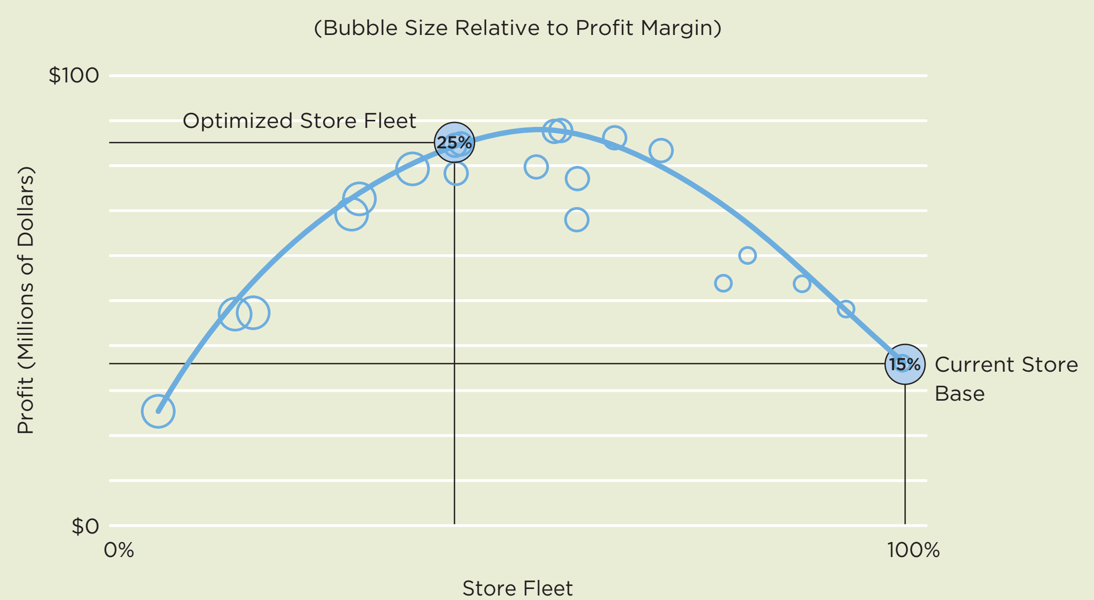
- Best Buy has morphed its stores into a series of experiences with its accessible touch-and-feel displays. This, combined with customer service that helps customers navigate through increasingly complex technology, gives Best Buy the advantage to compete beyond price.
- Retailers should not be constrained by their internal resource base. Now's the time to partner with other brands to create a new and innovative in-store experience. Gap partnering with designer Stella McCartney or Club Monaco selling high-end European bicycles are two recent examples of retailers investing in a risky but rewarding "options" solution.
- Many specialty apparel retailers have shifted marketing dollars from brand and media advertising to in-store events, where customers can experience and create a connection with the brand.
- All retailers can offer co-created experiences. Dollar stores, for example, design the layout and periodically reposition merchandise so that consumers can participate in a "treasure hunt" shopping environment. The thrill of the hunt is as exciting as getting a good bargain.
- Customize Web content or activities to mimic offline store experiences (e.g., Borders.com and its intuitive rolling book shelves).

> **Invest in integration across channels**
When the recovery comes, those who will benefit most will have not only a coherent cross-channel strategy, but the systems to support it. Recent data suggests that 60% of retailers are using legacy systems not designed for agile cross-channel operations. Retailers should invest now in integrating merchandising, logistics, fulfillment and customer data across channels.

Many retailers are reporting that 15% of revenues are either Web-based or from a catalog. With the expectation that this may double, focusing investment dollars here will provide the basis for dramatic market share gain.

While it's understandable to focus on hunkering down during this time of turmoil, there can be too much hunkering down. Retailers should still be creative and innovative.

**EXHIBIT 1: Store Fleet Optimization**



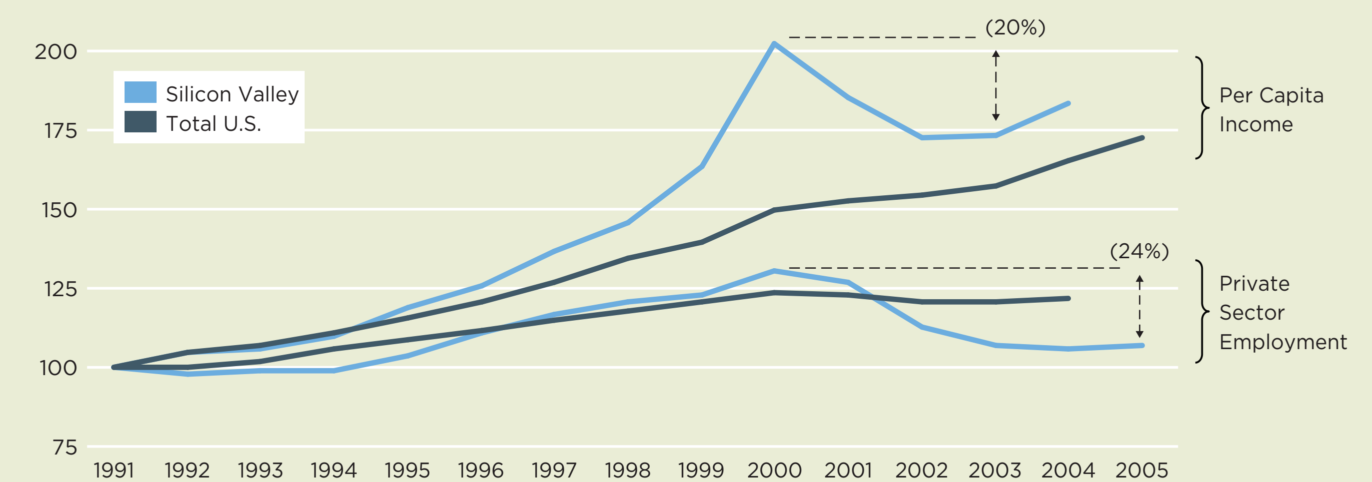
## Lessons from the Dotcom Bust

The dotcom bust of 2001–2002 is a recent example of how quickly a downward trend can reverse after substantial economic decline—one more severe than what we face now.

In 2003, Silicon Valley, the center of dotcom activities and investments, experienced a 20% decline in per capita income and a 24% decline in private sector employment from their heights in 2000. Average home prices also fell as much as 16% over the same period. But by 2004, the recovery was dramatic and well on its way, driven by easy credit access and a particularly resilient, youthful, technological workforce. (See Exhibit 2.)

Although it is impossible to know when the economy will rebound or what shape the recovery will take, retailers can prepare for any possibility by investing in "options" solutions to creatively and effectively differentiate themselves.

### EXHIBIT 2: 1991–2005 Per Capita Income and Employment Index (1991 = 100)



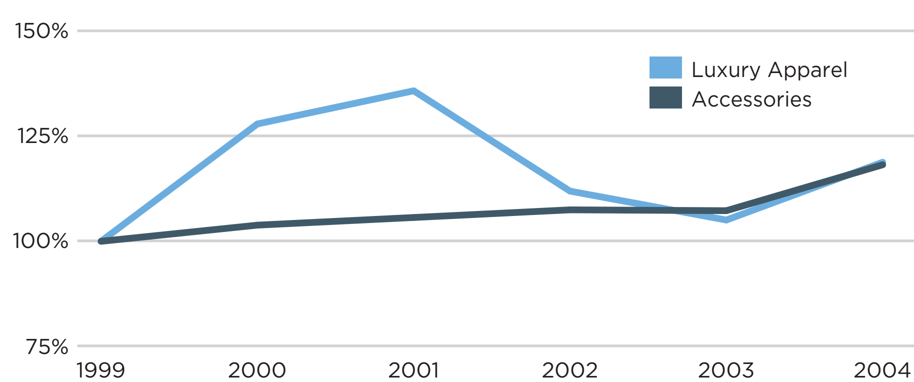

Source: Census, Bureau of Labor Statistics, Bureau of Economic Analysis

### More Lessons from the Dotcom Bust

It may be tempting to write off luxury apparel because of its current steep decline, but in the Silicon Valley recovery, not only did the luxury category rebound, but some of the quickest returns came from the top-tier brands and highest price points.

- In a composite of "luxury apparel" retailers, sales declined by 23% from the height in 2001 to the trough in 2003, but rebounded with a stunning 13% year-over-year growth in 2004.
- Meanwhile, the "accessories" category held its own and stayed flat during the same recession. Regardless, it too enjoyed substantial sales growth between 2003 and 2004, at 10.2% year over year.

### 1999–2004 Sales (1999 = 100), Silicon Valley




**YOY Growth**

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|---|---|---|---|---|---|---|
| Luxury Apparel: | 14% | 28% | 7% | -18% | -6% | 14% |
| Accessories: | 7.3% | 3.8% | 1.8% | 1.7% | -0.2% | 10.2% |

Source: KSA Analysis