



2010 Retail Industry Perspective

During the past year, many retailers closed amid the global economic recession, and survivors count themselves among the fortunate. Yet survival does not guarantee much.

The economic environment remains tough, and even if sustainable growth returns to key markets in the coming months, retailers are not assured success. In fact, if the theme of 2009 was “survival at all costs,” the theme for 2010 will be “who wins next?” Over the year to come, retailers can either pursue strategies that help them build a lead over the competition, or stay locked in on actions that permit them merely to hang on until this slowdown—or a future one—claims them.

In 2010, we see a winning strategy with three elements:

- Develop “customer ownership” tactics with active programs aimed at deepening knowledge of consumer behaviors and segments.
- Create a seamless customer experience in moving between the online and bricks-and-mortar formats to bring new dimensions to the entire store brand.
- Move beyond cost-cutting tactics to focus on more systematic efficiency as the economy begins to settle.

A Brief Look Back

The prolonged global economic recession trapped retailers in a downward spiral of cost pressures, loss of pricing power, and falling demand. During the previous decade, retailers in all categories had launched major expansion programs, with rising leverage predicated on growing profitability. Then, in 2008 and 2009, retailers had to take a sharp turn away from expansion as consumers cut spending and grew cautious amid the collapse of the housing and credit markets, massive job losses, and the sudden need to pay down debt and rebuild cash savings.

Not one area of the retail sector was spared the decline. The industry witnessed a wave of store closings and bankruptcies: Circuit City, Linens 'n Things, and Mervyn's, among others, did not survive. Many still operate under the protection of Chapter 11 or in the shadow of imminent collapse. Last year's holiday shopping season was the worst in the past 10 years, and retailers resorted to dramatic markdowns to clear out inventories. Those strategies, combined with consumers' unwillingness to spend, destroyed pricing power across the industry.

A modest rebound is now under way. Same-store sales have started to inch upward, and the recovery in equity markets has helped restore some confidence to the industry. Certain retail segments have begun to recover. Overall, however, consumers remain wary. Job losses continue, the U.S. unemployment rate has surpassed 10 percent, and easy access to consumer credit has been shut off. The economic recovery forecast for 2010 appears to be precarious.

The Way Forward

As retailers move beyond survival and cash-conservation mode, they should focus on strategic investments in their defining strengths: processes, products, knowledge, capabilities, or some other advantage. In 2010, that strategy should have three notable elements.

Increase Your Customer Knowledge

Economic uncertainty and losses have driven significant changes in consumer behavior, and some of those changes – such as frugality – will persist even during the coming recovery. In pursuit of the best deal, consumers have increased their willingness to make several shopping trips; the notion of the “one-stop” retail experience seems to have run its course.

Retailers know from experience that recession-driven frugality does not last forever. But depending on customer segments, geography, and retail category, the recovery in consumer confidence and consumers' willingness to spend may be uneven. We recommend that retailers not expect an across-the-board recovery, and instead prepare for certain retail segments to emerge before others.

The first segments and retailers to rebound will have closely studied their customers, not only to evaluate how to better serve the existing ones, but also to discover potential new customers.

It requires significant investments to collect, analyze, and leverage customer information in order to build customer knowledge. Many retailers are already making such investments. For example, Tesco PLC and Kroger Company have successfully mined their loyalty card information to tailor promotions, assortments, and store services to their different customer segments, with significant results. For instance, while only 1 to 2 percent of coupons are redeemed on average in the industry, Tesco reports a redemption rate of 15 to 20 percent. Similarly, Kroger, after analyzing its shopping data, introduced three-quarter-gallon milk containers in its stores to address the needs of two-person households in which a half gallon is too little and a whole gallon is too much.

In the non-grocery area, Zara (the flagship brand of the Inditex Group) has created an open channel between store managers and design and merchandising teams to quickly convey shifts in consumer buying patterns. The company has created a process in which designers can quickly track changes in demand, creating a culture of responsiveness that puts new styles on the racks within three to four weeks when a shift in demand is noticed.

A better understanding of customer segments does more than guide retailers as they adjust marketing and existing offerings. It can also lead to the development of new store formats. For example, Walmart has initiated a version of its Sam's Club warehouse store targeted at Latino immigrants in the U.S., called the Más Club. These stores feature a special focus on foods and items familiar to the fast-growing Latino population along with the usual warehouse offerings.

Developing a better understanding of changing customer patterns and emerging segments will yield a variety of responses. Retailers will adjust assortments, factoring in existing brands as well as private-label offerings; they will invest more time in communicating with vendors on market shifts; they will look at every aspect of the supply chain to improve responsiveness.

The end result will be greater value to consumers in both service and product.

Integrate the Entire Shopping Experience

With its convenience, security, range of offerings, and built-in ability to deliver price comparisons, the online channel has accelerated during the economic slowdown, even as bricks-and-mortar locations have watched sales decline. Customers' flight to online vendors is putting pressure on all retailers to develop strategies to integrate their traditional and online channels so they can support and drive sales to one another.

For consumers, the walls between online and offline are crumbling. For retailers, the benefits of having an online presence include far greater knowledge of customers, more awareness of consumer preferences, and an ability to drive sales through online-only discounts and broader assortment without accompanying bricks-and-mortar infrastructure. It's no wonder that Target decided to end its arrangement with Amazon and develop its own online strategy. And it's clear why Walmart and Target have engaged in an online-only price war with Amazon on hardcover books: By going after Amazon's best-known offering in a high-profile price war, both are generating traffic to their complete array of offerings, and hoping consumers never look back.

Should retailers want to pursue a more integrated strategy in earnest, they will face high consumer expectations for a seamless experience. That means, for example, consumers will want to be able to check inventory at local outlets, place orders online for pickup in the store, and then return online purchases at physical locations.

In addition, bricks-and-mortar retailers will have to learn to take advantage of the infinite floor space and "endless aisle" of the Internet environment. Consumers value online shopping precisely because it offers multiple choices at multiple price points; retailers will therefore need to offer a deeper selection than they might at their physical locations. Of course, without space constraints and with lower working capital requirements, such offerings can be accommodated, and the knowledge gained from offering greater variety will improve the assortment decisions in bricks-and-mortar locations.

When they build a strong online presence, retailers have the potential to connect with customers, not just on a simple click-and-buy basis, but in the richer relationships informed by user and online community feedback, real-time data on consumer search patterns, and prior purchases. This, too, is a form of deeper customer knowledge – one that can be quickly translated into actions in traditional stores, in the form of either new products or differentiated services.

The final result is not the end of traditional retail but the improvement of it. The online channel has heightened expectations among consumers about pricing transparency, ease of purchase, and availability of goods. It has also increased awareness among retailers that there is much to be gained from the relationships with consumers now available through an online channel. Those retailers who integrate these two experiences will be able to offer the speed and pricing advantage of a website with the personal product interaction available at a traditional store.

Keep Driving Efficiencies

In 2010, retailers must continue to drive efficiencies to sustain profitability. Efficiency strategies have ranged from fairly conventional cuts of headquarters staff and overhead to more advanced approaches such as SKU reduction and better management of the retail footprint (not just by closing stores, but by reducing their size where possible).

However, we believe that driving efficiency is more than a way to improve the bottom line. It can also serve to refine the operating model.

In a recent e-book published by Harvard Business Press, *Cut Costs, Grow Stronger*, Booz & Company partners argue that merely cutting costs is not enough to ensure long-term success or even survival. Across-the-board cuts tend to have a limited effect and might harm those areas with the potential to generate growth. The key is to focus on the areas of the business that create the greatest competitive advantage, to preserve and build those areas, and to dispassionately cut the rest. And unlike many who view efficiency as a buzzword useful only in downturns, we view efficiency as an ongoing aspiration, in good times and bad.

Given our view that 2010 will be another challenging year for retailers, we believe that retailers who make efficiency a habit will not only emerge stronger more swiftly, but will hold an advantage longer.

A Concluding Thought

Even among the strongest retailers, the reversals of 2009 (and 2008) revealed weaknesses few could foresee. In response, retailers have accelerated efficiency strategies that, in retrospect, should have been in place long before the downturn. Now, as retailers adopt new approaches to their product offerings, processes, consumer experiences, and online integration, the early results are clear: Those retailers adapting to the new realities of retail are starting to build a foundation for growth. We expect that as the economy begins to find its footing in 2010, retailers who adopt market-leading strategies will be the first to emerge from the current period with not only a strong growth profile, but an enviable category position.

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