Thinking about tomorrow:

Post-recession strategies for retailers

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February 2013

Recessions produce change, often at an accelerating pace each cycle. Weaker companies fall by the wayside, or are absorbed by stronger ones who generally gain market share in the aftermath. It takes time for consumers to restore their balance sheets and return to a normal level of spending; however, the recent recession appears to have brought about a longer lasting effect. Retailers and vendors need to readjust strategies that become obsolete and where competitive advantages can erode quickly. Shifts in distribution channels and new technology now represent the biggest opportunity for profitable growth.

It's all about the consumer

Economic growth and consumer spending over the next several years will likely trail gains of the past. A rising tide will no longer lift all ships, but rather market share will become a key ingredient to growth.

Retailers and vendors need to develop a new game plan to grow and prosper in tomorrow's environment. The first step is to engage in an intense self-analysis. This includes consumer research in order to determine the wants and needs of the target customer, increase the value proposition with new and differentiated merchandise, find a path to a more efficient sourcing and logistics structure, strengthen its brand (whether national or owned), and implement a multichannel distribution network. Success will be tied to customer satisfaction.

Consumers are frequenting different distribution formats depending on the product – consumables, soft goods or hardlines. That decision (by the same consumer) is often based on several factors: price, fashion, quality or service oriented, or a combination. It is increasingly important to realize that a growing percentage of consumers are using a variety of channels to purchase from the same retailer, making transparency an important issue.

Technology is providing increased consumer data for both retailers and vendors. Analysis of these findings will generally enhance their ability to better focus on that consumer, whether it is through new initiatives such as store level marketing or better targeted merchandise offerings. These should help achieve the goal of increased shopping frequency, conversion and average ticket. In addition, social media is growing in importance and critical to marketing efforts.

Complacency puts one behind the curve

Economic cycles often result in significant changes to the retail landscape as consumer spending patterns abruptly shift. Retailers who anticipate these changes and constantly evolve are those that gain market share, as even established brands with strong leadership can be caught off guard. Market position can be lost by doing the same thing you did yesterday. If you do not successfully anticipate change and implement new strategies, chances are a competitor will have caught up or surpassed you. Recessions impact retailers differently in each cycle. Consumers change spending habits, shift shopping patterns and place different emphasis on the price value relationship.

Recession typically presents dislocation in the market. The pace of change seems to accelerate each cycle; competitive advantage can erode faster and retail strategies often have a shorter life cycle. One needs to anticipate as there are changes in the retail landscape and reposition appropriately. Complacency generally puts one in a defensive position from which it is usually difficult to win.

Each economic cycle and recovery is different. Anticipation and adaptation to changes in the competitive environment should make it easier to remain ahead of the curve.

Connecting with the consumer

What drives a customer to your products? Why do they buy? Where do they buy it? And can you make your targeted profit?

It is increasingly important to identify your customers and anticipate their needs and expectations. There is a difference between what consumers say they want and what actually drives their purchases. A customer walks through the door expecting a shopping experience that offers the right product at the right price in the right place. Market share winners have become more sophisticated in engaging with their customers before and after purchase.

More emphasis needs to be made on post-purchase focus groups as to what drives customer satisfaction. Most important is what they were looking for and did not find, or why they did not buy. These insights need to be shared with the supplier, who should be involved in product development so as to better tailor the assortments, mix and promotions for the target customers and localize those offerings by market.

Value and uniqueness are both critical to the process. In theory, a retailer should sell items that cannot be sold anyplace else. The consumer either shops for value or according to emotion – and sometimes both. The Internet has made competition fiercer as consumers easily research prices and know a product's true value. Emotional factors are increasingly impacting the decision to purchase, rather than rational factors, such as category attributes. Building brand credibility is crucial in building perceived value.

Loyal customers must also be leveraged. Successful brands and retailers are sufficiently differentiated, which drives traffic, excitement, conversion and profits. Customer loyalty is rapidly becoming an important part of the value equation, and potentially, a more profitable one. A satisfied and loyal consumer will tend to purchase more often and in larger quantities than a new customer.

Management needs to have this insight, but often will fail because of poor execution. It takes a different and forward-thinking mindset. The game plan needs to be monitored continually. Retailers must be ready to react to any deviation from the plan. There is no crystal ball; reassessment and redirection should be done on a regular basis to maintain growth and widen the spread from closest competitors.

Leveraging *big* data

Technology has enabled massive data collection, and generally more than can be analyzed and digested. Application of these findings could be leveraged throughout all business activities including marketing, merchandising, operations and supply chain. There is no shortage of information, but rather ability to use it to grow the business more profitably.

Retailers, over the past 10 years, strived to improve profitability by reducing store payroll. Some department store chains, such as Macy's, passed the savings on to their customers, suggesting they were more interested in lower prices than service. Coach, on the other hand, found that increasing payroll hours during peak traffic times increased store productivity. The formula to drive profitable transactions is evolving, making them easier and faster, while gaining insights into consumer needs, at the same time. Follow-through is becoming most important to build and maintain the loyal customer.

Driving demand does not necessarily mean higher profits. Broadening a customer base is often mentioned as one of the key goals of a marketing program, and often takes focus away from existing customers. Costs to acquire a new customer are often three to four times higher than those of servicing an existing customer. However, if the latter is a loyal customer, they can be several times more profitable with respect to average transaction size and frequency. A recent study by Loyalty One noted that a store's top 10 percent customers often account for as much as 40 percent of its sales, reinforcing the importance of the loyal customer. Quality of sales is quickly becoming a key determinant to higher profitability.

Staying ahead with social media

Social media has become an integral factor in the success of all retailers and brands, regardless of size and capabilities. In fact, proper use of social media can compensate for weaknesses in other areas, provide increased customer service and help to reinforce your brand. It has changed the rules of engagement with consumers, as both small and large direct-to-the-consumer sellers are now on a more equal footing. Barriers to entry are minimal; all have an opportunity to connect with the consumer. Those that succeed will offer differentiated and compelling value propositions; the retailer must transform into a seamless multichannel business.

Winners tailor messages and product offerings to their target customers. Consumers are researching and creating shopping lists well in advance of purchases, reinforcing the importance of frequent direct contact. Retailers must provide informational content and create the want to purchase rather than the need to purchase.

Owning or controlling a strong brand is becoming a key criterion for success. Ongoing technology investment is critical; most important is staying ahead of competition through increased customer touch points that provide continuous interaction with the target consumer. There is no shortage of products to buy or places to buy them; however, building a loyal customer is one of the ingredients to profitable success and growth. Make it easy to shop at any place or time.

The first obstacle is getting product placement at retail, and then creating consumer demand for the product. This goes beyond traditional advertising and marketing, whether it is product placement in other mediums or creating a buzz among the millennials, the growing market for many products and services. It is not business as usual, but rather evolving and catering to the target consumer more effectively.

Retailers and vendors must understand the value of social media and its importance to the brand. It should be a main focus of its customer service platform, and its business plan as a whole.

Multichannel is key to survival

Ten years ago, many thought brick and mortar retailing was bound for extinction because of the growing threat of the Internet. That turned out not to be the case; however, online retailing threatens existing store economics, measurement systems and incentives. Bricks and mortar have an advantage over online only with the ability to create excitement and the *want* to purchase—Apple is a prime example as well as some luxury retailers. Retailers have always believed customers will always be there, which was a wrong assumption. Moreover, customers have become less tolerant of a poor shopping experience. Integrating the process and reaching out to the target consumer with a specific product or idea can drive incremental traffic to a site or store. The shopping experience is further enhanced with store pick-up for instant gratification or ease of return to the store.

While there are retailers growing and thriving, online sales are growing about four times faster than overall retail sales. As retail consolidation continued over the past decade, strong companies not only survived, but appear to have secured a solid position in multichannel retailing. Furthermore, it is estimated that customers who shop both in store and online spend at nearly twice the rate of in-store shoppers alone. It appears as though many multichannel retailers are growing their online distribution faster than many of those who sell only over the Internet. Albeit from a smaller base, the trend is worth noting.

Retailers are becoming more reactive, adapting to social media and mobile use by their customers. The objective is to make stores and wares friendlier to the online environment. Product descriptions and reviews allow for ease of comparison, which, along with competitive pricing, are a winning combination. While there are many online-only sites that offer these, retailers provide the opportunity for instantaneous pick-up through their store network. In the case of Best Buy, this represented about 40 percent of the retailer's online sales. The keys to success are integration, implementation and execution, making the process seamless to the consumer. Ability to ship from a store eliminates the need for a separate distribution center and potentially solves many out-of-stock issues.

Cost differentials are beginning to narrow. Free shipping, once a perk or an incentive, is now becoming the standard. Retailers, from Nordstrom to Wal-Mart, with a wide variety of goods, are now offering free shipping for both purchases and returns. These sales tend to be more profitable than average for most retailers, however, bearing the burden of shipping is raising the cost structure for Internet sellers. There also appears to be more pressure building by states and local entities to capture sales tax. This will probably succeed in time, eliminating another advantage of the online-only sites.

Ease of return is becoming more important to the consumer. Despite free return shipping, physical stores are rapidly becoming more desirable because of their ability to exchange for another size or item. Perhaps more important, the resulting transactions are often larger than the original placed online. A satisfied customer can become a loyal customer—and a more profitable one.

Building a customer relationship is a key ingredient to profitable growth. Dialogue and interaction before, during and after the transaction are essential to building a relationship. Retailers and vendors should analyze and explore opportunities to enhance the shopping experience. Develop a strategy to become more proactive with the consumer—reach out with new ideas, products, fashion, technical specifics and specially-focused

promotions. Listen to customers and implement changes based on what they say. Flash sales are now becoming a new and useful tool for a number of stores, and can generate incremental and profitable sales growth.

Redefining the game plan

Management should be developing an updated strategy for profitable market share growth through the appropriate and strategic allocation of cash flow. Credit markets have eased somewhat, relieving the pressure to fund ongoing operations and presenting management with the opportunity to again pursue innovation, the historic driver of sales. This is the time to go on the offensive rather than the defensive, as there will likely be less investment in store openings and entry into new markets, although possible implementation of new growth concepts.

Consumer spending patterns have changed steadily for decades and will likely continue to evolve. Following years of an expanding affluent market and increased aspiration among consumers, the pendulum is now moving in the other direction – in fact, it never stops. The consumer is still buying, but more cautiously and with more focus on value, shifting to less expensive products, buying less clothing and eating out less often. These are likely to be longer-lasting trends, as lower- and middle-income groups fall further behind in bills and debt repayment in the near term.

More affluent shoppers have historically been the first to rebound; however, higher taxes are likely to put a damper on even their spending. They are buying fewer goods as opposed to significantly *trading down* when it comes to the quality or brand status of purchases. All this is coupled with increased focus on lower price points within existing brands.

During recessionary periods, consumers will typically shop more at value retailers, returning to preferred stores as the environment improves. However, recent studies have shown that some customers will be lost for good – buying less expensive versions of national or high-end brand products, replacing them with store brands, shopping routinely at discount and value-format stores or trading down to less expensive brands. In most cases, though, quality remains a high priority, which retailers can largely maintain in a variety of ways for this *new* consumer. Some retailers are also broadening price points with an increased offering at the lower end to maintain consumer appeal.

Retailers and vendors must be positioned to refine their game plan for growth and prosperity in this different environment. Those that don't will be left further behind.

Managing for higher profitability

For most vendors, the operating environment has become more difficult as consolidation leads to retailers gaining more leverage. Enhanced buying power and demands for increased margin support are cutting further into wholesaler margins as wholesalers find it more difficult to further lower their costs. Increasing penetration of private and exclusive brands is also enabling retailers to buy direct – and in many cases, bypass their historic vendor structure.

Vendors with strong brand recognition have the opportunity to better control distribution and pricing. Brand credibility provides opportunities to extend product categories internally or through a licensing format. In essence, they are better able to control their fortunes if they stay ahead of the curve. Most of the other vendors are essentially middlemen, supplying private label brands, a business that is in a steady spiral of

margin erosion as more customers source direct or find lower supply costs. Many are doomed to failure as it is very costly to develop a brand from scratch, although the licensing model may represent some opportunity. Volume growth and economies of scale should offset related costs.

Inventory management is one of the important keys to managing the distribution process. Simply put, inventory management is the means to ensuring that the appropriate selection and quantity of merchandise is in place to ensure a higher rate of sale at regular price, or at the first markdown. The strategy of a steadily increasing initial markup to offset the increasing markdown rate or allowance must be reversed so that the consumer perceives greater value at the outset, as opposed to searching lower-priced channels. This will help to preserve integrity of the brand, and at the same time limit the amount of branded product distributed through off-price outlets and discount formats.

The issue has been compounded as the tempo of promotional activity had increased steadily in recent years, while at the same time, inventory turnover rose. The consumer has been well educated to wait for the sale, with much of those price drops funded by manufacturers taking on an ever higher rate of markdown allowances. A number of retailers have tried to wean customers off the promotional cadence, only to see store traffic and volume decline.

The sourcing strength of large organizations is a significant advantage, especially for their owned brands as well as push back on the manufacturer. The latter is becoming more difficult due to deterioration of vendor financial condition; therefore, the strategy of better collaboration must evolve to provide the incentive of fresh, new and differentiated product. The largest of the national retailers have become too commoditized through their brand's reliance on *safe* merchandise, with buying decisions today tending towards the overly price sensitive.

Management's mindset needs to gravitate towards the specialty store model, focused on turnover and profits per square foot. This again comes back to Retailing 101 - knowing your customer, providing the appropriate level of service and offering the right product, at the right time and at the right price. Maintaining focus should drive traffic, sales productivity and profitability.

SKU rationalization as a means to profitability

Avoid the trap of broadened assortments accumulated over the years, which has led to the need for a larger store. This common but major miscalculation led to lower sales productivity and profitability. That downward spiral has taken time to reverse, but we are beginning to see its effects today. In some cases, SKU rationalization went too far, resulting in loss of sales, as Wal-Mart experienced a few years back. It has since reversed that strategy.

Wherever possible, minimize presentation clutter. Inventory reduction and allocation have been a prime focus over the past 12 months. The consumer will remain value-focused and promotional activity will continue. However, merchandise presentation and differentiation should be a catalyst to drive higher conversion, transactions and sales.

Reducing inventory assortments could provide a more customer-friendly shopping environment, making it easier to tell a merchandising story and create excitement. A too varied and wide selection can blur the message. By simplifying the selection process with fewer distractions, more full-price selling can result. Eliminating the marginal units and redundancy in the assortment should lead to a higher gross margin.

Multiple benefits can be realized for both retailers and vendors. Narrower assortments could lead to lower labor costs and fewer out-of-stocks for retailers and perhaps provide a little more buying power. Out-of-stocks can create a disappointed and perhaps lost customer. Vendors can benefit from sourcing efficiencies from fewer suppliers and lower markdowns and allowances, consistent with an improvement to retailer profitability.

A better-managed pipeline can also improve profitability. By concentrating on fewer SKUs, the global supply chain should benefit from economies of scale. These would include the already-mentioned question of logistics, from manufacturing point to customer. Ensuring products hit the stores on a more timely basis can provide fashion excitement ahead of competitors.

Price matching buzz

Target's recently announced new price policy, an extension of its holiday price match strategy that will include online sites such as Amazon.com, Bestbuy.com, Walmart.com, and Toysrus.com on a year round basis. Although this action appears to go one step further, to include all local competitor and online advertised prices. This follows Target's disappointing holiday season, and realization that price comparison is a key issue and of growing importance for online shoppers. It will also ensure store prices are comparable to those online. In reality, most stores already match competitive advertised prices so it is difficult to see how this strategy will be more successful than it was during the holiday season, although it makes for good reading in the press.

Eliminating or reducing the number of comparable items has been a key focus of many retailers in an attempt to offer differentiated merchandise to insulate themselves from competitive price comparison. Last year, both Target and Best Buy announced it would not carry any products identical to those offered by Amazon.com in an effort to minimize showrooming, so one has to wonder to what degree price matching will be a key issue ahead.

Nevertheless, the competitive arena will intensify. There could be further erosion in profitability as lower gross margins are now offset by operating leverage. Could the next step be additional push back to suppliers, with those with the biggest buying clout lowering costs the most? The obvious ripple effect to those smaller and less efficient retailers could set the stage for further industry consolidation.

The slippery slope for weaker retailers

Sears Holdings has encountered the most turmoil over the past few years, and that will likely intensify in 2013. The grand scheme of combining the strengths, or rather weaknesses, of Sears and Kmart has produced little in the way of positive results. Store closings and asset sales helped bolster the company's financial position last year, and is now faced with another turnover in management. Lacking strong retail experience at the top and lagging comparable store sales, more intensive promotion will likely be needed to drive volume, both online and at the store level.

But is it really all about price? There is no shortage of any place or products to buy. In the case of Sears and Kmart, maybe there is little consumer loyalty and reason for them to exist. Promotions might create excitement, but it is merchandising that drives sales. Focused product assortment and marketing aimed at its target customer, along with the appropriate price and value relationship will be the winning strategy in the long run. Each customer perceives value differently and is more responsive to retailers who create the want to purchase. Those retailers who focus on the consumer's need to buy based on price, will be the losers in the long run, as there will always be a lower price somewhere - so trying to win on this basis is a loser's game.

Differentiation is an important key to success

For many years, high cash flow provided for rapid retail expansion and diversification into new formats, driving further store growth. Today, store rationalization is fully underway. There is still excess space and, more importantly, there is too much sameness. Consumers can walk into any mall in the country and find it difficult to ascertain where they are shopping. The only clues are the exception – some regional differences in design, or perhaps a regional department store chain. Furthermore, each end of the mall is nearly identical; the sole point of differentiation is which storefront is the first to mark down its wares.

This homogenous look could intensify with the prospect of further consolidation. If anything, management must focus on redirecting cash flow towards greater differentiation. A top priority would be intense research into its target consumer, something very few brands or retailers do on a consistent basis. The answer to why mall and store traffic has been on the decline for most is simple – aside from the economic slowdown, there is little incentive for consumers to visit if they will not see anything new.

Newness, differentiation and merchandise excitement will drive consumers into stores on a regular basis. This provided brands such as Coach, Nike and Ralph Lauren with the pricing power necessary to offset higher operating costs.

Many apparel and footwear brands have operated retail stores for many years. At first, factory outlet stores helped liquidate excess merchandise (and in many cases, evolved into a format carrying merchandise dedicated to that channel). More recently, a trend took hold in which full-price stores were opened as part of an effort to reduce dependency on the department store channel. This provides better understanding for retailers and vendors of their customers and their customers' motivation to purchase, which should translate to more, full-price selling over the long term.

Think about doing it differently

Retailers and manufacturers need to engage in intense self-analysis. This includes consumer research in order to determine the wants and needs of target customers. They need to increase their value proposition with new and differentiated merchandise, find a path to a more efficient sourcing and logistics structure, strengthen the brand (whether national or owned) and, finally, implement a multichannel distribution network.

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The sourcing strength of large organizations is a significant advantage, especially for owned brands that can push back on the manufacturer for better pricing. Such pushback is becoming more difficult due to deterioration of vendors' financial conditions; better collaboration between the two could provide the

incentive of fresh, new and differentiated product. The largest of the national retailers have become too commoditized through their brands' reliance on safe merchandise, with buying decisions today reflecting a trend towards the overly price-sensitive.

Be the differentiator

Winners don't get ahead by chance; their strategies are carefully planned, executed and adaptable to change. Those managements do not react; they anticipate. Paraphrasing one of the founders of Patagonia – "you have to offer something no one else has, and if they do, then you have to find a way to do it better." It has been said about Steve Jobs – he created something no one knew they needed, and now cannot do without.

In conclusion, economic growth and consumer spending over the next several years will likely trail gains of the past. A rising tide will no longer lift all ships, but rather market share will become a key ingredient to growth.

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