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Special Report: Dealing with the Downturn
The Customer

How to make the most of the Great Consumer Trade Down

By Paul F. Nunes, Carolyn J. Polka and Larry Thomas

As discretionary spending all but disappears, companies must make adjustments in product mix, pricing, promotions and channel strategy to deliver the innovation today's customers value. By providing offerings with a clear range of desirable benefits and delivering them at the right price point, leading companies will be showing a clear way forward.

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The global downturn has turned big spenders into penny-pinchers just about everywhere.

In Accenture's most recent global survey of cross-industry consumer sentiment, 67 percent of respondents said they believe it could take up to three years before they are confident enough to spend freely again. Until then, many said, they plan to shop at discount stores, avoid premium-priced products, postpone the purchase of big-ticket items like cars, eat at home more often and wait for the next sale.

These worldwide developments have left many in the retail and consumer products industries struggling to adapt. Not surprisingly, luxury and specialty goods companies have been gravely affected. But others are also feeling the squeeze—witness the bankruptcy of the popular mid-market US home furnishings company Linens 'n Things and the demise of the iconic Woolworths stores in the United Kingdom. Only discount chains and a few department stores seem to be holding their own—though even the recession-resistant are far from recession-proof.

Some managers might be inclined to take a long view, comparing recent events to previous downturns and looking at strategies that worked during troubles past for insight. Those strategies, however, are unlikely to be helpful.

It's a stretch to draw too close an analogy to the Great Depression, a time when consumer demand slumped so catastrophically and for so long that tens of millions of unemployed workers worldwide subsisted on hand-outs and meals from soup kitchens. Social safety nets across the developed world and high savings rates in many emerging markets should cushion consumers this time around. Besides, 80 years after the 1929 Crash, people spend very differently—with significant implications for industry.

Thanks to the relative decline in the real cost of most basic goods, and to the real growth in average wages in both developed and developing countries, shoppers in many markets now spend significantly more on once-discretionary categories like health care, education and transportation than they do on food and clothing. In many cases, they now spend nearly as much on categories like consumer electronics and entertainment as they do on necessities.

Coping with consumers' purchasing volatility—as recession-chastened shoppers continue to trade down and even out of many discretionary categories, at least temporarily—probably constitutes the biggest challenge for retailers and consumer goods companies. And it will remain so for some time if, as many expect, the quest for greater value at lower prices becomes a long-term trend. Meanwhile, ongoing uncertainty about consumers' real needs and desires will require companies to study their behavior and attitudes even more closely than usual.

Profound consequences

The consequences of the downturn are profound, not least for companies seeking to achieve or sustain high performance (see sidebar, page 3). It is important to note, however, that not all companies in all sectors are being hit with equal force. In a recession, how customers perceive cost-benefit trade-offs changes. They will start to value different elements of a product or service. In the current downturn, some retailers and manufacturers have actually benefited from this aspect of the trading-down trend.

Take the specialty-coffee drink sector. While sales of \$4 lattes at premium outlets are slumping, drinks at less fashionable vendors, where a cup of coffee can cost at least 20 percent less, have been enjoying an upswing. It's a similar story in other food and restaurant sectors. Not only are

Consumer behavior and high performance

Changes in consumer behavior and cuts in spending affect each of the five key measures that Accenture's High Performance Business methodology uses to define such companies—growth, profitability, positioning for the future, consistency and longevity. Declines in consumption can slow, halt and even reverse healthy revenue growth trends in leading companies that rely on discretionary spending. Profits are squeezed when consumers seek bargains and discounts. Future value—the portion of market capitalization above the value of current earnings in perpetuity—evaporates as shareholder confidence in future sales growth deteriorates, even for otherwise attractive offerings and business positions. Consistency flags as business performance becomes harder to predict and manage. And longevity of performance is threatened as consumers think twice about what—and where—they buy.

consumers eating out less, they are favoring lower-priced establishments when they do. Indeed, shoppers in general seem to be seeking alternative sources for products and services that offer nearly the same benefit—particularly emotionally, like dining out with friends—but at a lower cost.

Still, many seem disinclined to give up life's little luxuries entirely, especially when treats like a night out can help lift the spirits. Chocolate appears to have particular staying power—especially if it's priced right. Chocoholics are eschewing premium truffles in favor of the good old-fashioned chocolate bar, giving the producers of more traditional, less expensive candy a much-needed sales boost.

At the high end of the income scale, the rich seem to be seeking solace in what some have dubbed “stealth wealth”—avoiding (or at least disguising) conspicuous consumption with a new emphasis on low-profile chic. In Beverly Hills, for instance, stores on Rodeo Drive report that customers are opting for less extravagant versions of must-have designer goods and are requesting plain white shopping bags for their purchases.

In some markets, luxury purchases have been holding up strikingly well. Sales at the French company

LVMH, for example, which makes Louis Vuitton leather goods among other high-end products, are buoyant—especially in emerging markets, where the wealthy are less inclined to stealth and the company enjoys considerable cachet.

By 2015, wealthy consumers in Japan, China and Korea will account for 80 percent of total discretionary spending in Asia, according to a recent survey by MasterCard Worldwide. The number of affluent Asian consumers is expected to almost triple in the same period. Indeed, the burgeoning bourgeoisie in many emerging markets is helping keep consumer demand in these markets relatively robust. Hence, despite the downturn, leading global retailers, from Wal-Mart Stores to Sweden's H&M clothing stores, are still expanding in Asia.

Tactical adjustments

Rethinking what markets they choose to compete in will be an important strategic response for leading companies in these troubled times. But they will also make tactical adjustments to the kinds of products they sell, as well as to their marketing strategies, to help them achieve or sustain high performance.

By focusing on selling the right assortment of products (by mini-

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mizing those at the high end, for example), companies can boost margin and capture share. When one large home-improvement retailer reevaluated the assortment of lighting products it was selling, it found too many high-end items in some categories—a mix that was clearly out of alignment with consumers' increasingly frugal tastes. The company repositioned itself, emphasizing more basic styles and good or better price points, and selling the more expensive products only through special order. As a result, sales increased and so did overall category margin, allowing the retailer to make fewer markdowns.

New categories and products can also boost sales. One US department store chain tailors a portion of its merchandise to local tastes and conditions. By changing the clothing styles to suit the more conservative tastes of shoppers in certain parts of the country, the chain has been able to improve performance.

Or consider how Dollar Tree extended the range of food products that appeal to its thrifty customer base—introducing coolers and freezer cases in 150 locations to store more food, which has helped the discount retailer drive healthy sales growth.

Even old offerings can look new when they are unbundled, although this tactic must be used with caution and its effects frequently tested if customer expectations are to be managed. Still, if used correctly, it can be effective. Case in point: the move by most major airlines to impose à la carte pricing for the services customers use, including charging them for checked baggage. (Luggage handling is an expensive proposition for the airlines because it is so labor-intensive.) Although the move has not been exactly popular with passengers, they seem to have more or less accepted it—and it does appear to be helping the airlines' beleaguered

bottom lines. One large US carrier, for example, has said it expects to collect about \$275 million annually from first- and second-bag fees.

Meanwhile, adding pay-per-use options to services that are typically membership or subscription based, such as health clubs, can help make some consumers feel they are getting better value for their money—and attract new ones. So can reducing minimum-purchase requirements, as a number of luxury resorts now are doing by allowing shorter minimum stays.

Private labeling

The best-performing companies will also be swift to exploit the private-label opportunity the downturn presents. Accenture research shows that private-label products generate margins in excess of 15 percent more than a manufacturer's branded product. To be sure, companies that offer private-label goods may need to build and manage new sourcing and supply chain capabilities. But for many, the investment is worth it, especially because private label doesn't always have to be at the bottom of the value assortment. The key to success is to know the customer well enough to be able to identify specific opportunities; done this way, private label can be an important differentiator.

In Europe, where it's usually known as "own brand," the private-label concept is well established. For some years, the UK retailer Tesco has been leveraging the customer information gathered via its famous Clubcard loyalty card to divide its customers into distinct segments and create private-label products tailored to each one. The retailer's Finest range of relatively expensive own-brand food products, for example, caters to more affluent shoppers; its Value line, as the name suggests, targets families on tight budgets. Recently, as the UK recession has deepened and competition from deep discounters like

Germany's Aldi has intensified, Tesco has recognized the change in customer preferences and introduced yet another range of own-brand discount products. (For more information on Tesco, "The new globalization play-book," *Outlook*, June 2009.)

As cash-strapped US consumers modify their traditional loyalty to big-name brands, more stores have been introducing private-label lines as well. Even the upscale grocer Whole Foods Market has acknowledged its customers' increasing price sensitivity, offering a large number of private-label organic products. Non-food retailers have also been embracing the shift to store brands—witness Best Buy's Insignia brand of electronics and Home Depot's line of Hampton Bay ceiling fans.

Meanwhile, in an effort to lure customers away from more expensive department and specialty stores, retailer Kohl's now offers higher-end fashion lines such as Vera Wang. And in 2006, Target launched Go International, a designer line of limited-edition collections created exclusively for the retailer by brands such as Rogan, which is usually carried only at Barneys New York.

Old-fashioned practices

Many well-worn marketing practices are regaining favor during the current credit crunch, and the right ones, if used correctly, can help hard-pressed retailers and consumer goods companies stay profitable.

Anecdotal evidence suggests that haggling is back in fashion, for instance, and retailers should be prepared for it. They may need to train staff in the art of negotiation, or consider incorporating margin-based incentives into their compensation structure. Meanwhile, a once-popular form of "poor man's credit"—the layaway plan, which allows a buyer to select a piece of merchandise, leave it in storage and pay for it over a set period of time—

is enjoying a revival among some retailers as a promotional tactic. Kmart made layaway the centerpiece of its holiday advertising, and soon after customer requests for layaway drove its sister store Sears to also offer the option.

A new firm, eLayaway, has updated the concept, allowing customers to choose products online from more than 1,000 retailers and arrange for monthly deductions from their bank accounts in return for a 1.9 percent service charge. Once payments are completed, the merchant ships the product to the consumer. The firm's customer base has grown tenfold in a year.

Discounting has also become widespread, even with high-end retailers. Saks Fifth Avenue abandoned a longstanding unwritten agreement between retailers and designers about when and by how much to cut prices when it slashed the cost of some of its designer goods a whopping 70 percent last November. The move was, of course, a prudent effort to get rid of clothing fast before the fashions changed.

Discounting may be an obvious way of trying to move unwanted inventory, but it can become a dangerous habit if customers get used to markdowns and start waiting for sales. And of course there are never any guarantees that it will produce the desired result: Despite Saks's steep price reduction, the store's January same-store sales still fell nearly 24 percent.

Coupons, by contrast, can encourage customers to try products and can raise the profiles of brand names. For example, Procter & Gamble, the largest advertiser in the United States, recently opened a retail version of P&GbrandSaver, the coupon booklets the company inserts in Sunday newspapers, in a temporary store in midtown Manhattan. There, visitors

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could receive advance copies of the P&G brand Saver coupons, along with product samples and demonstrations for such brands as Clairol, Downy, Olay and Tide. In fact, 2007 was the first time since 1992 that coupon redemption rates in the United States did not decline from the previous year.

Tangible results

In a downturn, the power of sound pricing strategies increases appreciably. So, too, does the challenge of understanding its effects. Not enough companies analyze price changes after the fact to determine what worked and what didn't in terms of sales, margin or the speed at which a product moves off the shelf. As a result, they find it impossible to design better pricing and promotion strategies for the future. Leading companies, by contrast, recognize that pricing power does not weaken along with the economy. Resisting the temptation to give away pricing power, they instead take systematic steps to boost pricing efficiency (see "How to price smarter in uncertain times," *Outlook*, September 2008).

It's important to take a similar approach to promotions, which, if misused, can encourage customers to cherry-pick. And in the interests of preserving brand equity and earnings, successful companies will also resist the urge to cut advertising budgets in the downturn. In fact, if companies can afford it, they should be boosting their marketing budgets and exploiting the opportunity to seize market share—as the Japanese automakers did during the US recession of the 1980s.

Accenture research shows that advertisements are still the main source of product information for consumers. What's more, advertising boosts confidence in the brand, reassuring not only consumers but also the trade as a whole.

Capturing the attention of today's cautious consumers will be chal-

lenging. But leading companies are striving to make their messages relevant to the public's current mood—witness Hyundai's promise to take a car back if its purchaser loses his or her job. Leading companies are also carefully placing messages where today's customers are most likely to find them, and then systematically monitoring feedback.

Savvy companies will get ahead of the cash-strapped consumer's shift to multi-channel buying. Online sales have certainly soared since the downturn. Tesco, for one, is planning to launch a discount clothing section on its website to compete head-to-head with online discounter Asos, which has seized substantial market share in this rapidly growing segment.

Still, Accenture research shows that websites are less effective than either word of mouth or advertising as a source of product information for consumers. While cost-conscious companies should surely aim to boost their e-commerce capabilities—the Internet, for example, allows ever improving pay-for-performance marketing—they should also take care not to lose their focus on delivering a seamless and consistent customer experience from all channels: Web, catalog and store.

High performers know who their customers are and are able to establish and maintain a close and personal connection with them. In Europe's diverse markets, for example, leading retail grocers have benefited by adapting store formats to the communities they serve. Edeka's "50+" stores, for instance, appeal to older Germans by offering single-serving meals, places to sit, spacious aisles and shopping carts that attach to wheelchairs. Some of these features are popular with other demographics too. Younger single people like the meals, and shoppers with young children in tow appreciate the wider aisles.

As non-essential spending of all kinds shrinks, companies must look across the spectrum of their marketing efforts, making adjustments in product mix, pricing, promotion and channel strategy to deliver the innovation today's customers value. This sort of attention to detail may not resolve the big challenge of this downturn—the decline in discretionary spending. But by providing offerings with a clear range of desirable benefits, and by delivering them at the right price point, leading companies will show a clear way forward.

Indeed, for nimble companies with the right value proposition, the new frugality offers an important opportunity for growth.

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