ADVISOR PERSPECTIVES

Retailers Face the New Frugality

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Whether they sell high-end designer clothing or tractors and pet food, retailers across the country are girding for leaner times. Consumer spending has dropped to 10% below its historical trend line, creating a landscape with far too many stores and far too much merchandise for consumers' thinning wallets to support.

This is the new frugality, and it is forcing many retailers into a struggle for survival.

"Consumers coming into this recession were overwhelmed," Mindy Grossman, CEO of the $2.8 billion shopping network HSNi, told fellow retail executives last week. She was among a group of CEOs from Fortune 500 retailers who spoke to an audience of their peers at Argyle's 2009 Leadership in Retail and Consumer Products Forum, which was held last week in New York.

Now, she says, consumers are demanding things on their own terms and their decisions are driven by value – and that is true from the low end to the high end of the retail chain.

"The attitude of consumers has changed immensely," said Linda Heasley, President and CEO of The Limited. "More used to lead to more," she said. "It's not anymore. Now less is more."

Heasley has been encouraging customers to "shop their closets" before they come into the store, which would have been heresy just a year or two ago.

Marcello Bottoli, a former CEO of Samsonite who now advises high-end retailers, said this environment is "totally different than anything we have seen in the past." The focus of retailers, he said, has changed from growth to cash conservation and efficiency improvements in stores.

James Wright, Chairman and CEO of the $3-billion Tractor Supply Company, said that he initiated steps to deal with the recession at the beginning of 2008, and focused his strategy on "CUE" products – consumables, usables, and edibles. He has cut costs primarily in those areas furthest away from the customer – in administration and distribution – and has also reduced inventory.

Wright cancelled all television advertising, although he said that was more a reflection of TV's inability to perform relative to other media than a reaction to the depressed environment. "Until we see more clarity on the macro issues, we are taking it slower on growth," he said.

William Lauder, CEO of the Estee Lauder Companies, said shoppers are heading toward venues traditionally perceived as offering value. "The perception of value has returned to the department store," he said. "And the perception of value for the high-end retailer in the middle of the mall is not the same."

Lauder has seen some small up-ticks in his business, but he is not convinced the retail industry has turned the corner toward recovery. "There has been a tremendous gap in retail consumption and capacity available, and that will put a damper on the slope of recovery," he said. "It will be a long slope of recovery, and it will last a fairly long time. Whatever confidence the consumer has is fragile. She is looking for excuses to come out and shop but is easily scared into hiding."

It's important that retailers understand what motivates consumers to spend money, Lauder stressed. "Value is the single most important factor," he said, defining value as simply whether something is "worth it" to the consumer.

Tom Murry, President and CEO of Calvin Klein, said revenues and income for his company have improved "by a few points" over the last year. He agreed that there has been a structural change in the buying patterns of consumers, particularly in the U.S., and said that consumer spending at 70% of GDP is "not sustainable."

Murry attributed his company's performance to its geographic diversification – 15% of his revenues come from Asia and 35% from the European Union – and to diversification across price points. Calvin Klein sells in three product segments – luxury goods, "bridge" markets, and mass merchandise. Not all segments are thriving, though, and Murry said he would not want to be positioned solely in the luxury market right now.

Bottoli also noted that other parts of the world – specifically India and China – are proving to be fertile for retailers who are positioned to push into those markets.

Navigating the new terrain

Retailers must innovate to effectively identify, keep and serve customers, even as those customers spend less money.

Heasley is exploring non-traditional methods to reach customers, including social media such as Twitter. She has found that users of social media live in close proximity to store locations and is using this information to target the selection of future store locations.

Grossman has focused on retaining existing customers and increasing their lifetime value, while simultaneously working to conserve cash. She recognizes that customers are more discerning, and does not want to disappoint them "in any shape or form."

Heasley is focused on cost at all levels – product and operating – and has emphasized research aimed at identifying their customers and their preferences. She is approaching the current environment very cautiously and not assuming there will be an upturn any time soon. She is not expecting a robust holiday season, and she indicated that the Limited will not be "overly promotional" and will focus on inventory control.

The key, she said, is to make sure she is not hurting her brand and to balance short-term cash conservation with the long-term imperative to maintain her brand's positioning and image. She has seen an upturn in demand for her private label line of merchandise, and she has been able to adapt to manufacture quickly in response.

"Keeping up the morale of staff is very important too," Heasley said, and she is continually striving to reinforce confidence among her staff that things will improve. Botolli echoed this point, saying that what distinguishes excellent retailers from average ones is their ability to succeed at motivating employees in times of crisis.

Technology is proving critical to creating consumer demand. At HSNi, Grossman is mining her data to capitalize on trends like consumers' increasing tendency to dine and exercise at home.

Grossman is also working to create a more exciting venue for clients, through pricing and merchandising. Along these lines, Heasley recently held a "Recessionista Night," where customers were invited to bring an item from their closet, and salespeople at the Limited were trained to identify merchandise to accompany the item.

Botolli said the companies he advises are focused on two things – increasing the life value of existing customers and focusing on the local market. Grossman said it typically takes them 10 new customers to replace an existing customer.

The salvage yard of failed retailers

Those retailers who fail to survive the current business cycle may end up in the hands of Jamie Salter, president and CEO of Hilco Consumer Capital Corp.

Hilco is the salvage yard of the retailing industry.

Salter acquires name brands (e.g., Polaroid, Tommy Armor, and Sharper Image), eliminates virtually all of their in-store operations, and re-launches their products through the web, direct mail, and other low-cost distribution channels.

His success has been remarkable. He said one of the biggest challenges he faces is working with management teams to change their mindset from one of 80% cost and 20% margin to his paradigm, where those numbers are reversed.

While retailers struggle, Salter sees opportunity. Those opportunities are typically the result of changes in consumer preferences, he said, and today's environment is clearly putting a number of companies in Salter's crosshairs.