

Don't Mortgage Your Future in the Downturn

By Paul Beswick and Matthew Isotta

As consumers tighten their belts, the pressure on retailers to find sources of short-term performance improvement is intensifying. However, many of the easiest ways to drive rapid increases in performance can seriously undermine a retail brand in the longer term. This note describes the risks of managing short-term performance in the present environment and discusses four quick and safe sources of short-term value.

There is no doubt that times are tough in the retail sector. The long boom fueled by consumer spending is over, and as consumers start to tighten their belts, retailers need to do so, too. In this environment, there is an even greater premium on being able to deliver the numbers. Unfortunately, hitting targets is becoming increasingly difficult as falling volumes and increasing competitive pressures hit the bottom line hard.

One of the gravest dangers for retailers in the present retail environment is falling back on easy ways of driving performance improvement. The temptation is to raise prices, cut promotions, and slash discretionary spending. In effect, what you are doing is investing less in the customer. This approach can certainly drive short-term improvements in profitability, because customer perceptions take time to change. However, the short-term improvement is borrowed from the future well-being of the company. And because customer perception is always much easier to lose than to win back, the longer-term impact will be to undermine your brand equity.

The good news is that there are a number of simple things you can do that can quickly have a dramatic impact on performance and buy the time you need to carry out your long-range plans. Just as important, tackling these issues doesn't require rewriting your strategy or turning your organization upside down.

This note focuses on four key initiatives that should be part of every retailer's toolkit in the present tough trading environment. Each is worth at least 50 basis points to

the bottom line. Taken together, they have the potential to dramatically transform performance in what can be a startlingly short period of time. Of course, tackling these topics is not in itself a substitute for sound long-term strategic planning, but it will ensure that you have more time to deliver your plans.

The safe and easy way to drive performance

We have raised the bar for profit improvement opportunities; the four opportunities outlined here do not involve harming your brand or borrowing profit from the future. They do not require any reduction in the power of your customer proposition and in many cases they will actually improve it. Neither should they prove a source of major distraction for the management team, or require fundamental changes to the long-term strategic plan. In effect, they offer what are almost risk-free improvements in profit and/or sales. This apparent miracle is achieved by focusing on rebalancing investment from low-yielding to high-yielding aspects of the offer (for example, from unproductive promotions to productive promotions) and on areas which provide the outcome of higher profitability and increased customer satisfaction (for example, by matching assortment more closely to customer needs).

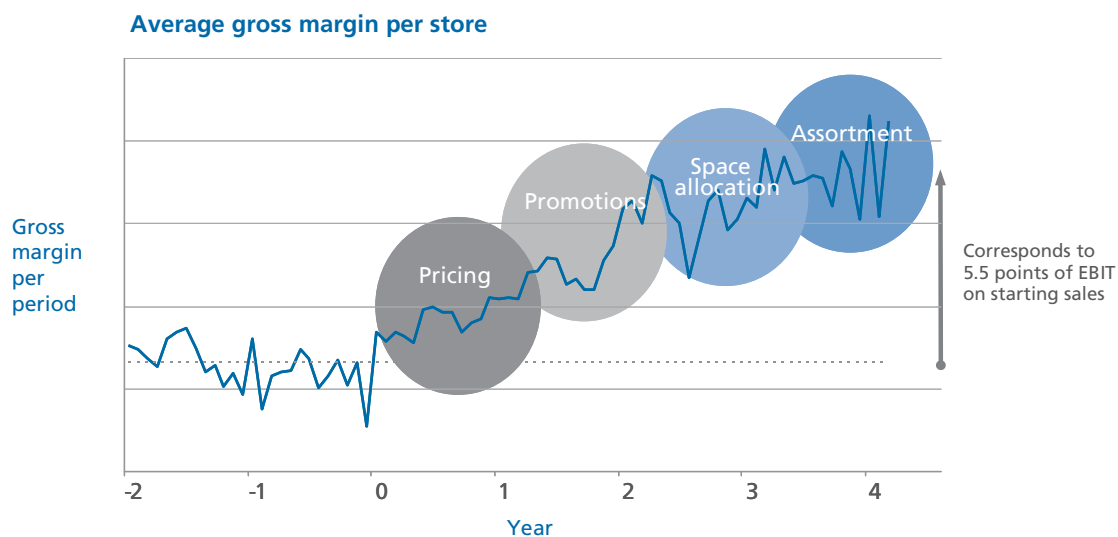
The table on the next page describes each of these four opportunities in more detail, outlining what drives the value and the typical amount of value available over different time periods. These opportunities exist because, currently, few retailers fully understand the economics of managing these levers in sufficient detail to be able to optimize them.

Opportunity	Where does the value come from?	Value
Rebalancing price investment across products, stores, and categories	Understanding the trade-off between price sensitivity (elasticity) and margin in each category and store and rebalancing investment into higher-yielding categories and stores at a constant overall price position	<ul style="list-style-type: none"> • 50-100 bpts • Half after 3-6 months • Full value within 12-18 months
Reconfiguring the promotional program to identify and focus on the most effective promotions	Understanding all of the different promotional effects in detail (uplift, cannibalization, stock-up, halo, funding) and identifying the tail of unprofitable promotions and core of profitable promotions	<ul style="list-style-type: none"> • 80-120 bpts • Half after 6-9 months • Full value after one year
Resetting space and assortment to better match the needs of customers in each store	Understanding how each product drives incremental sales and margin by adding <i>effective</i> choice after cannibalization of other products in the range and how demand variations across stores can be addressed with low complexity	<ul style="list-style-type: none"> • 50-150 bpts • Building up gradually from 6 months to 2 years
Reviewing terms with vendors to drive lower purchasing costs	Understanding vendor term structures better; freeing decisions from reliance on vendor data; better understanding the relative economics of different vendors; developing a structured negotiation process	<ul style="list-style-type: none"> • 50-300 bpts depending on sector • Half after 6 months, 2/3 after 1 year • Full value over 3 years

Case study – U.S. grocer

This case study shows how tackling a number of these opportunities in sequence can have a dramatic impact on performance. Our client, a large U.S. grocer, wanted to achieve a significant improvement in its level of profitability and sales per store. A series of different initiatives,

each designed to eliminate risk to the client's long-term position, had a dramatic impact on profit per store. Over three years, profit per store increased by an amount equivalent to 5.5 points of starting sales. At the same time, sales per store increased by 12%.



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