Trends in the Reset Economy And Their Implications for Retail & Consumer Goods

Executive Summary

Technology has entered the decision-making process, with customers typically entering the store with greater product information and technology than store employees.

The global economy is resetting. Financial markets continue to be unsure about the pace and depth of the global economic recovery. Reduced leverage and appetite for risk is reducing the availability of capital for marketplace investments. Increased consumer protection in Europe and North America has had the unintended consequence of stimulating credit card companies to reduce consumer credit lines thereby choking off increased consumer spending. Consumers have "tightened their belts" reducing credit card outlays $101 billion over the last 14 months, according to Billshrink. Geo-political risk continues to rise with increased antagonism between the U.S. and China over trade policy and currency, giving rise to increasingly protectionist measures on both sides of the Pacific. Sovereign risk, never before a true issue, now dominates capital market discussions, with the increased risk perception of sovereign debt in countries such as Portugal, Iceland, Italy, Greece and Spain. Uncertainty over the future cost of capital has conspired with market access challenges to call into question the sustainability of the nascent economic recovery.

Consumer-based industries are also resetting. Increasingly sophisticated consumers/shoppers are demanding higher quality products with better service at the same or lower prices. Technology has entered the decision-making process, with customers typically entering the store with greater product information and technology than store employees. Retailers are leveraging their store brands to fill out their product brand architectures. Tensions are rising between manufacturers and retailers as each tries to optimize shelf space, margin, product portfolios and inventory position based on their business and financial strategies. Reduced shelf space is driving brand manufacturers to rationalize their SKU mix to maintain profitability. Trade management spend is coming under increased scrutiny as manufacturers seek to optimize their incremental marketing spend and question the return received from heir customer marketing investments. Supply chains are under increasing stress to optimize product landed cost, service levels, and pursue global sourcing options that reduce cost and spread supply risk. The rise in transportation and labor costs in China, for example, are causing supply chain networks to evaluate the location of incremental manufacturing plant capacity in countries such as Vietnam.

The role of the CIO has reset. The CIO must now be a full partner in business discussions and decision-making. The ability of the company to sense marketplace changes rests with business intelligence solutions constructed by the IT leadership team. The CIO must possess advanced deal-making skills as methods of acquiring, delivering and paying for information services have changed with the advent of SaaS delivery models. The ability to quickly optimize product and assortment portfolios based on

changing customer demand is based on data and information communicated to product planners and merchants from the IT organization. Optimization of supply chain networks and determination of the best ways to optimize product costs are based on the IT organization's ability to aggregate costs at multiple levels across the enterprise and harmonize them for consumption by supply chain and merchandise planners. The increasing need for transparency and a strong governance model remains an enduring requirement for the modern day CIO.

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The goal of this white paper is to offer (in aggregated form) perspective into key marketplace trends and actions we think should be taken by nimble marketplace participants. We hope it provides you with context for the conversations likely ongoing within your organization and offers recommendations for ways to take advantage of emerging opportunities within your market.

Consumer Trends

The recession has caused a fundamental change in the shopping behavior of consumers. Consumers in the "post recession economy" tend to be more purposeful in their spending. In fact, there is a noticeable change from conspicuous to practical consumerism. The recession has certainly dampened the excessive consumption patterns as consumers now seek cost-saving deals by using coupons, comparing products online before purchase, and partaking in reward programs, etc. A Miller Zell study[1] in 2009 found that 60% of all consumers use coupons for transactions, up from 29% just two years ago.

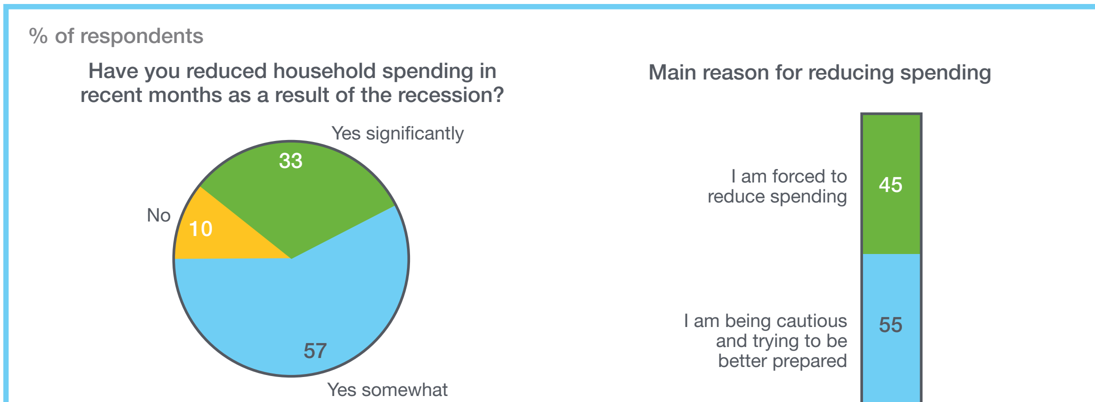
Overall, U.S. consumer attitudes towards thrift have changed considerably due to the recession.

A 2009 McKinsey consumer survey indicates that over 90% of the consumers have reduced their household spending to varying extents. Out of these consumers, over 45% indicated that they were forced to reduce their spending.[2] While there are signs of the recession easing on a global front, U.S. households still believe the recession will last until 2011. The Nielsen "economic current"[2] study in December of 2009 revealed the following trends:

- Reduced consumer confidence
- Significant drop in shopping trips
- Lesser expenditure per trip
- Increased shift to value channels

Overall, U.S. consumer attitudes towards thrift have changed considerably due to the recession.

Thrifty Consumers[1]



Source: 2009 McKinsey consumer survey

By the Numbers: Consumer Behaviors[3]

	Jan 09	Feb 09	Mar 09	Apr 09	May 09	Jun 09	Jul 09	Aug 09	Sep 09	Oct 09	Nov 09	Dec 09
Nielsen Market Index Volume*	–	–	– –	+	0	0	0	0	0	+	0	0
Nielsen Market Index Volume**	++	+	–	++	+	0	0	0	0	0	–	–
Are consumers moving to Store Brands?	++	++	+	++	++	++	+	+	+	+	+	+
Are shoppers shifting to value channels?	++	+	+	++	+	+	+	++	+	+	0	+
Are retailers selling more on promotion?	– –	–	– –	+	0	+	+	+	++	++	++	++
Are consumers shopping more frequently?	0	0	–	–	–	–	–	0	0	0	–	–
Are consumers spending more per trip?	+	+	+	+	0	–	0	0	0	0	–	0
Nielsen Global Consumer Confidence^			– –			– –			–			– –

++ Very Strong Growth: >= +5%
+ Growth: between +1 & +4%
0 Neutral: between -1 & +1%
– Negative: between -1 & -4%
– – Very Negative: <= & -4%

Tough holiday season – declining dollar sales from fewer shopping trips & less spending per trip.

*Nielsen Market Index Volume defined as unit change vs. YAGO
**Nielsen Market Index Volume defined as dollar change vs. YAGO
^Nielsen Global Consumer Confidence measure is from 10/08 & is benchmarked vs. the Global Confidence avg.of 84

nielsen

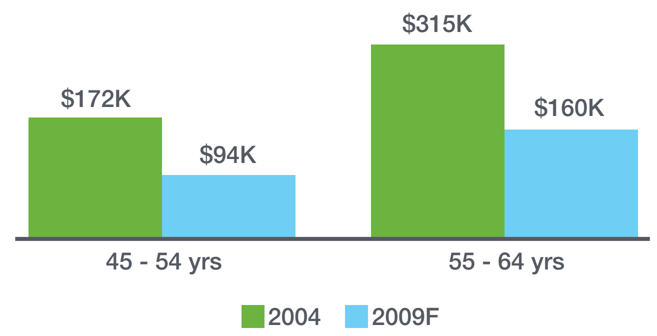
Customer Segment Trends[4]

Despite the recession, generations X and Y consumers seem to be shrugging off the recession faster and spending their way out of trouble. Based on industry trends and studies, two patterns very clearly emerge:

1. The Boomers will not lead the recovery.

This is the hardest hit segment due to the recession. Their voracious appetite for material consumption has been dramatically impacted. According to a study by the Center for Economic and Policy Research[5], an economic think tank, the median household wealth of Boomer households has shrunk considerably, hampering the role they have traditionally played in leading the U.S. out of economic downturns.

Can't Count on the Boomers



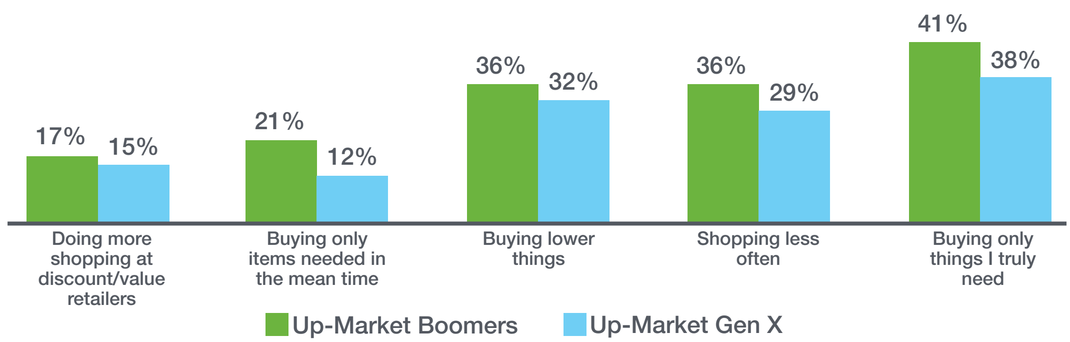
Source: Center for Economic and Policy Research

Even though Gen X constitutes about 75% of the Boomer segment in terms of size, they present a very strong outlook in terms of their spending potential.

2. Initial stages of the recovery will be fueled by Generation X consumers.

Even though Gen X constitutes about 75% of the Boomer segment in terms of size, they present a very strong outlook in terms of their spending potential. This is mainly attributed to the following factors. Gen X has spent recent years establishing their family foundation. This segment is entering their peak earning years. The "up market affluent" segment of this category will have maximum impact on post-recession spending. Compared with Boomers, up-market Gen X consumers are less likely to continue recession-induced shopping behaviors, according to a study by Retail Forward.[6] However, the Gen X consumers are likely to be bogged down by debts incurred due to credit cards, student and home loans, children's education and retirement savings.

Gen X Charges Ahead

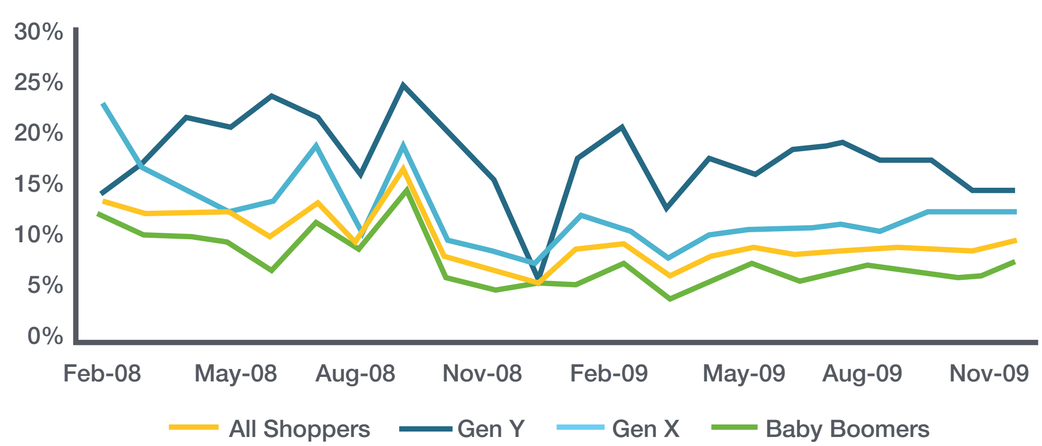


Source: Retail Forward ShopperScape™, May 2009

3. The resilience of Generation Y customers is quite noteworthy and will be more important in the recovery.

This is probably the least recession-impacted group of consumers. The Retail Forward study indicates that Gen Y consumers have indicated the highest willingness to spend in the forthcoming months compared with other generations of shoppers. They are the least changed in terms of their spending behaviors, attitudes and future intentions. This may be attributed to the fact that they possess limited disposable incomes. They are referred to as an "instant gratification generation" which is accustomed to instant satisfaction by purchasing the latest technology and gadgetry. Gen Y is also the most environmentally and globally-attuned segment.

Gen Y to the Rescue



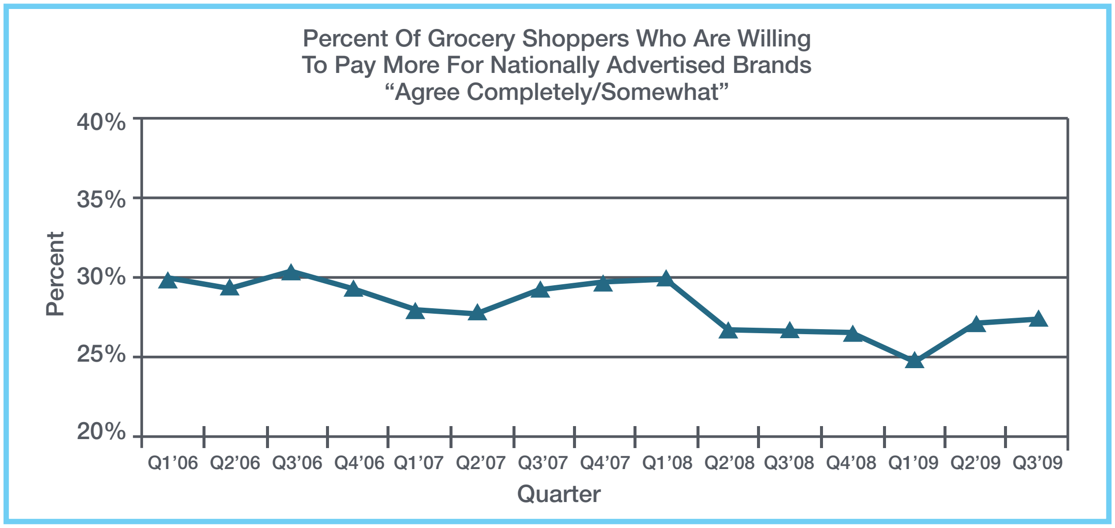
Source: Retail Forward ShopperScape™, January 2008 - October 2009

Loyalty to Brands[7]

Regardless of their generation, shoppers appear to be increasingly disloyal to premium brands. Decision Analysts notes in its "Anatomy of a Recession" report that there is a rapid rise in the number of consumers purchasing less expensive brands. In comparing the third quarter 2007 to the third quarter of 2009, the number of consumers who reported they purchased the least expensive brand increased by nine percentage points. During the same period, the percent of Americans who are "willing to pay more for nationally advertised brands" declined. The most dramatic drop (five points) occurred in the period between the first quarter of 2008 and the first quarter of 2009. Finally, Decision Analysts noted that the private label dollar share of sales in grocery stores rose from 15.1% in February of 2004 to 17.4% in February of 2009.

Regardless of their generation, shoppers appear to be increasingly disloyal to premium brands.

As the economy declined, consumers hunkered down to save money by switching to less expensive alternatives. While reduced disposable income certainly influences this trend, changes in retailer strategies were also a driver. A Mintel analysis provides some insight. Mintel noted that 78% of consumers feel store brands (at lower price points) have the same level of quality as national brands. Retailer investments in packaging, merchandising and product quality are leveling the playing field between store brands and national brands, especially second- and third-tier national brands. Mintel also noted that a change in business outlook has not necessarily translated historically into a resetting of consumer brand loyalty. Instead, it notes, that once consumers have switched, they will tend to stick with the store brand if they find no change in the value equation.



Coupons Use

Coupon usage is a somewhat mature in the current economic environment, yet it still warrants discussion. As noted earlier, Miller Zell research indicates that 60% of U.S. shoppers use coupons. There is also an increased propensity to dispense and redeem coupons. According to a Coupon Sherpa article[8] titled "Top 22 Coupon Trends of 2009", it was noted that over 158 billion coupons were distributed in the second half of 2009. The distribution of coupons in the first half of 2009 increased by 12%, while the redemption rate increased by 19%. Miller Zell research further notes that shoppers are using coupons as a key strategy to test or sample products they have not purchased previously. Miller Zell also noted that for Generation Y, coupon use is their preferred way to test a newly released product.

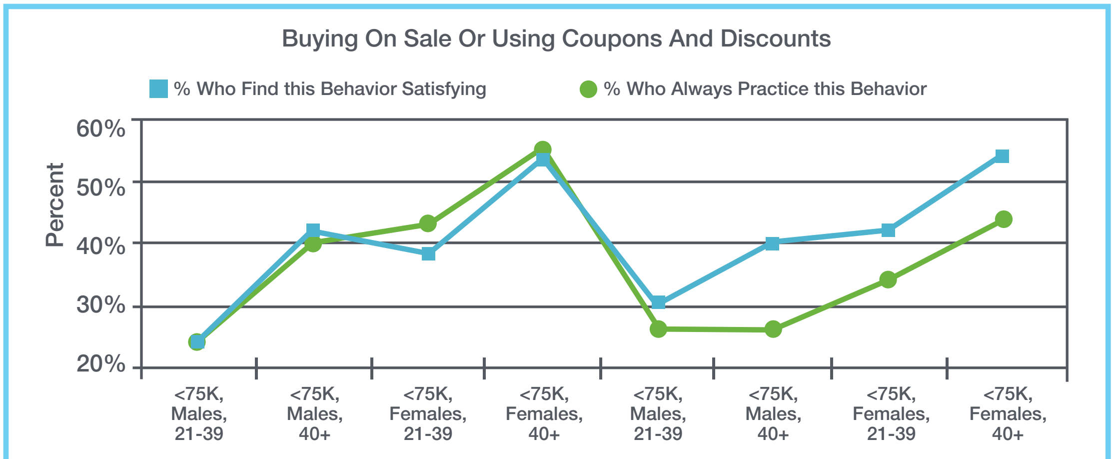


Chart Source: Decitica: Marketing to Post Recession Customers

As noted earlier, consumer credit drawdown is also impacting aggregate transactions. Interestingly, we are seeing the return of a previously dormant retail practice, the layaway. MSNBC and *The Herald Review* noted recently in articles that companies such as Kmart and the Burlington Coat Factory are using the layaway process to help drive purchase volume to make up for volume decreases associated with credit card drawdown.

Interestingly, we are seeing the return of a previously dormant retail practice, the layaway.

Message Explosion[9]

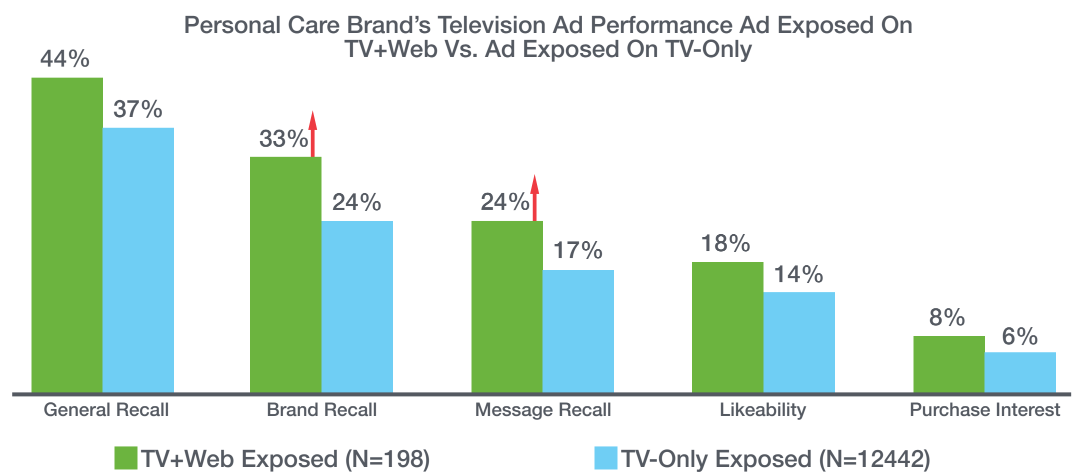
Today's US consumer is experiencing message and channel overload. Just 35 years ago, the typical American could be expected to confront advertising through an average of television three network channels, a small number of radio stations, and a single newspaper. The average number of marketing messages would be close to 200. Today's typical American absorbs marketing messages through a plethora of direct mail, e-mail, social media, telephony, and Internet advertisements, in addition to more traditional mass media channels. It is estimated Americans receive as many as 5,000 marketing messages per day according to Manager's Guide for Marketing, Advertising and Publicity, by Barry Callen.

Channel explosion directly accompanies message explosion. A recent HipCricket mobile marketing survey indicates 37% of consumers would be interested in participating in a mobile customer loyalty program from a brand they trust. 83% also say that their favorite brand has yet to market to them via their most personal device, representing an opportunity for brand marketers in partnership with their IT organization. The research also indicates that brand recall for mobile marketing offers was very high, with 47% having brand recall and 94% of that segment remembering the call to action.

A recent HipCricket mobile marketing survey indicates 37% of consumers would be interested in participating in a mobile customer loyalty program from a brand they trust.

As a result of these trends, marketers are increasingly shifting towards mix-media marketing plans. As evidenced by Nielsen research on the integrated marketing, this trend is paying off across all measurable elements of marketing effectiveness.

Comparison between ad-campaign brand performance when exposed to TV + Web as opposed to TV only



Source: Nielsen IAG Television Ad Performance and internet/TV Exposure: 8/7 - 10/26/08. F35+; Prior internet ad exposure defined as tagged ad(s) impression in two-day period before TV ad exposure; indicates significant difference at 90% confidence.

Retailer Trends: Social Media Emerges as a Force

This past Christmas showed a marginal 3.6%[11] improvement in sales from 2008 (as reported by Reuters) and a substantial reduction in promotional activity, which improved margins. However, the more interesting trend during Christmas 2009 was the advent of social media as a driver of purchase transactions. Reuters reported that 28% of all transactions were influenced by social media research. Activity across numerous retail channels was also swayed by consumer generated reviews and expert reviews. Facebook has emerged as a new key influencer in social media research; for example, numerous brands have created pages to interact with consumers.

In a sign that social media is rapidly taking a transcendent position on the Internet, research firm Hitwise said Facebook outpaced Google in visits the week ending 3/8/2010. The two sites accounted for 14% of all U.S. internet visits that week. Facebook's homepage represented 7.07% of all Internet traffic, while Google's share was 7.03%.

Clearly, social media trend is a long-term trend rather than an emerging fad. While social media is currently hard to quantify in terms of profit or revenue impact, it is very easy to quantify in terms of risk impact. As we have seen with the quality issues Toyota has encountered, losing control of the social media message resulted in tremendous brand damage. Traditional risk management techniques employed by Toyota did not work in the face of enormous word of mouth communications emanating from social media outlets. The result was Toyota's need to expend enormous amounts of money on traditional media for mea culpas as well as the loss of prestige associated with Congressional hearings.

However, the more interesting trend during Christmas 2009 was the advent of social media as a driver of purchase transactions.

The question for the CIO is "how can social media platforms integrate with corporate systems"? The unstructured data associated with social media and the structured data on which corporate systems are built will require substantial effort and thought in order to not only integrate the two environments, but to determine the appropriate data to capture and meld.

Social Media Influence on U.S. Holiday Shopping Behavior Dec. 4-7, 2009; n = 425 Total U.S. - Home Work University Locations Source: comScore 2009 Holiday Shopping Survey	
How Social Media Influenced Purchase	Percent of Respondents Who Have Begun Their Holiday Shopping
Social media has influenced my holiday purchases	28%
Reading a consumer-generated review about a product online (including personal blogs) influenced me to purchase it	13%
Reading an expert review about a product online influenced me to purchase it	11%
I have followed a company Fan Page of Facebook to take advantage of special offers/deals	7%
A friend's status update about a product on Facebook influenced me to purchase it	6%
Watching a related video online influenced me to purchase a product	5%
I have followed a company on Twitter to take advantage of special offers/deals	5%
A tweet about a product on Twitter influenced me to purchase it	3%
Other	2%

Predictive Analytics for Decision-Making

Since the current economic environment is making it more difficult to pass along price increases (either from manufacturer to retailer or retailer to shopper), marketing and merchandising executives are turning to optimization and analytical systems to maximize margin and prices while not sacrificing purchase transactions.

Jeffrey Smith, a partner with Kohlberg, Kravis and Roberts notes "retailers and brand manufacturers are transforming their operations with analytics and decision management." He suggests that price optimization and analytic merchandising solutions are making increased headway in the market. This is due to reduced hardware costs, improved software usability and proven results. Analytic merchandising and marketing analysis has been especially effective as demonstrated by companies such as Best Buy with their Consumer-Centricity program, Unilever with its Dunhumby program, and Walmart with its ongoing market analysis programs.

Merchandising professionals feel the reduction in assortments leads to fewer stock outs, reduced labor costs and ability to apply pressure on the remaining vendors for better deals.

Consumer Goods and retailers are also using predictive analytics based on real-time POS and other data feeds to move product where there are imbalances between supply and demand (at a store or geographic level). As an example, instead of the traditional sourcing model of DC to store, detailed analytics that take into account transportation cost, category turnover at the store level and future predictive sales might indicate the best source for re-stock might be another store with slower moving inventories.

In addition to marketing and pricing optimization programs, we are seeing the world of optimization move to other specialty areas. Supply chain network optimization is now a standard feature in supply chain software packages to optimize distribution center placement. Causal analysis is increasingly used to inform demand planners in their order forecasting processes. All of these capabilities are allowing operators to optimize operations and improve margins where they can.

Assortment / SKU Rationalization Drives Revenue Increases

The proliferation of SKUs was a rampant problem in many channels over the last decade. Merchants and brand managers sought to reduce the opportunity of shoppers to say know through the widest possible product offering. Clean store efforts have demonstrated that rationalization of the store assortment can actually have a positive effect on overall stores. While the elimination of "aisle interrupters" and other product cramming strategies are believed to be a revenue reducer, retailers have demonstrated profit and revenue increases through adoption of these practices. Retailers are also reporting improvements in customer satisfaction and ease of store navigation and as a result embarking on these strategies. Walgreens has eliminated the number of superglues in its assortment from 25 to 11. Kroger is planning to reduce its existing cereal assortment by 25%.[12] Merchandising professionals feel the reduction in assortments leads to fewer stock outs, reduced labor costs and ability to apply pressure on the remaining vendors for better deals.

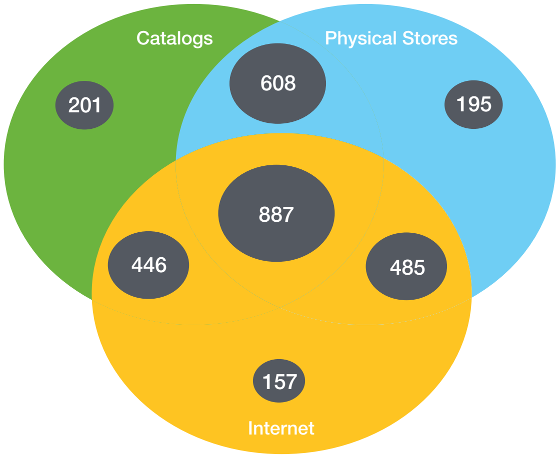
Without the ability to track purchases and to understand customer buying behavior across channels, marketing efforts can be misdirected, customer service poorly executed and opportunities missed.

Multi-channel's impact on overall customer lifetime value

Multi-channel has become a required component of every consumer industry-oriented company. Whether you are a brand manufacturer with hundreds of brands or a retailer with a small assortment, shoppers are increasingly turning to all media sources and information channels to obtain product quality, price point and comparison information. However, this rapid increase in multi-channel strategies has created a host of data management issues. Without the ability to track purchases and to understand customer buying behavior across channels, marketing efforts can be misdirected, customer service poorly executed and opportunities missed.

One of the critical ingredients for success in the multi channel world is fulfillment flexibility across different channels. The IT organization needs to consider alternative distribution and order management capabilities to provide the necessary visibility and fulfillment across channels. Processes such as the returns process, order online/pick-up in store or order in store and deliver to home have become standard customer expectations.

The Mulltichannel Bonanza
Average annual dollars spent per customer (apparel example)



Source: Aberdeen; Interviews; JC Williams Group; McKinsey Analysis

Where must the CIO focus?

It is a different environment, economy and industry than the one most CIOs signed up for just three years ago. Credit restrictions, customer behavior change, retailer/manufacturer tension, government regulation and lengthening supply chains are just a few of the challenges facing today's IT organization. The cost reduction strategies of 2009 must give way to the revenue improvement strategies of 2010 to drive Wall Street shareholder value.

While it is normal to say "business and IT must be aligned", we believe the next step needs to be taken. This means IT must become a seamless part of the business – in the same way that marketing and supply chain are parts of the business. Here are our "reset" recommendations.

The cost reduction strategies of 2009 must give way to the revenue improvement strategies of 2010 to drive Wall Street shareholder value.

Consumer Behavior

- The number of trip visits, along with average transaction sizes, is stagnant or declining in many categories. The new norm is store level assortments based on local customer behavior that extract maximum basket size per customer per trip. Best Buy's customer-centricity program provides an execution example for this strategy. Aligning not only assortments, but customer service, store design and pricing based on customer segment behavior is an emerging best practice.

The IT organization must work with the brand management or merchandising organizations to ensure consistency of data across channels to include product ingredients, pricing and promotional efforts.

- Critical IT organization capabilities include construction of enterprise master data management (MDM) strategies, particularly for customer and product master information. De-centralized master data solutions don't easily allow aggregation and accurate reporting of data, let alone offer the ability to take differentiated action based on analytics of the data.

IT must assist the marketing organization in its transition from traditional demographic and geographic marketing techniques towards the use of operational information to enable improved customer segment behavior analysis.

- The consumer is now increasingly conducting research prior to the store trip. The IT organization must work with the brand management or merchandising organizations to ensure consistency of data across channels to include product ingredients, pricing and promotional efforts.

Loyalty towards Private Labels

- Loyalty to private/store brands are on an increase, especially with Generation Y shoppers. However there are some issues with private labels. According to a study by decisions.com, "eight out of 10 private-label packages require rework because critical labeling/certification information is missing or quality assurance sign-off is lacking."

- As previously mentioned, master data solutions are critical to information accuracy. In addition, as retailers move into the private label / store brand world with larger portfolios, investment in product lifecycle management processes and solutions will be essential to managing the idea to shelf process.

- Building a collaborative Web-based system with suppliers will help brand managers more quickly and consistently communicate with suppliers (such as alerting them to packaging changes). Suppliers can proactively monitor inventory and control production of finished goods, thereby reducing wastage.[13]

Brand Loyalty

- The proliferation of marketing messages will require brands to sharpen their marketing messages based on customer segment consumption patterns. Gone are the days when brand marketers could rely on television, radio and print saturation to drive trial and purchase conversion.

- IT must assist the marketing organization in its transition from traditional demographic and geographic marketing techniques towards the use of operational information to enable improved customer segment behavior analysis. Tools from companies such as Dunhumby, Oracle, SAP and SAS have proven the value understanding customers require at this level.

- The IT organization must arm brand marketers with improved predictive analytics for incremental marketing spend. These analytics must be customer segment- specific, category- specific and channel-specific. They then must be tied into operational systems to drive value recognition.

Customer Loyalty

- Loyalty programs continue to provide not only actionable customer-behavior data, but also true programs that drive transaction size increases. Kroger's strategy, which centers on gas price reductions with $75 or more in store purchases, is a case example of loyalty programs that are not giveaways but serve as revenue drivers.

- The IT organization needs to work with marketing to ensure at least baseline loyalty programs are in place. This improves the ability for the retailer or brand to capture and leverage self-reported customer behavior, understand response to promotional, pricing and product initiatives and tailor programs to suit specific customer segment needs.

- The IT organization will need to work with new product development to incorporate social media product feedback into new product development processes. New techniques such as "crowdsourcing" are leading the way in terms of proving quicker insights to product innovation.

Gen Y Shopper Targeting

- As Generation Y takes to the forefront with its 60 million members, the IT organization will need to increasingly re-construct retail solutions to meet this generation on its stage — the social networking arena.

- The IT organization will need to ensure social media integration with mobile and e-Commerce Web sites. This integration will need to be two-way.

- Current consumer electronic commerce solutions will need to evolve from static and crowded sites, to interactive environment that drive not only increased personalization but also provide improved social interaction. Research demonstrates that all customer segments now take for granted the availability of product feedback for use in their product decision-making process.

- Increase focus on mobile commerce-based applications. The success of the iPhone and the emergence of the iPad represent untapped revenue opportunities that brand manufacturers and retailers can readily exploit.

- In the future, the IT organization must investigate strategies to leverage Generation Y's investment in and dependence on technology. With the increase in personal computing power, the opportunity to digitally reach the customer in new ways at the point of purchase represents a chance to improve brand awareness and drive differentiated consumer interaction.

Coupon Usage

- As the number of shoppers wishing to use their mobile devices to assist in the shopping process proliferates, the IT organization must work with marketing to deliver mobile coupon solutions with bar code or second generation bar code solutions (e.g., Microsoft Tag).

New techniques such as "crowdsourcing" are leading the way in terms of proving quicker insights to product innovation.

- The IT organization must integrate its operational systems with social networking buying sites (such as Groupon or Living Social) as Generation Y shoppers seek to augment their shopping strategies with increasing use of digital coupons.

SKU Rationalization

- Optimization solutions will be one of the top focus areas for the IT organization in 2011. As organizations seek to maximize margin performance, companies will increase investment in trade promotion management to optimize trade spend, price optimization to improve initial price point setting to maximize top line revenue and margin, assortment optimization as retailers seek to reduce in-store SKU count and demand planning as they seek to improve the alignment between expected sales/purchase intent and the supply chain.

Global Supply Chains

- The IT organization must ensure continued flexibility of supply chains to accommodate changing sourcing strategies, fluctuations in product demand and increasing fuel costs that require route optimization. For example, as Chinese manufacturing turns northward and inland away from the Southeastern coast of China, transportation time, cost and dependability will degrade. Multi-country sourcing analysis and optimization must understand the trade-offs of sourcing product or unfinished materials from alternative locations such as Vietnam or Mexico.

Optimization solutions will be one of the top focus areas for the IT organization in 2011

The IT organization must ensure continued flexibility of supply chains to accommodate changing sourcing strategies, fluctuations in product demand and increasing fuel costs that require route optimization.

Reference:

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