

STRATEGY

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How retailers can **make the best** of a slowdown

Moving quickly to improve performance can help retailers to recover faster.

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**Article
at a
glance**

Retailers are quick to suffer the effects of downturns in the overall economy but often slow to bounce back, according to McKinsey research.

Moving quickly to minimize performance deterioration is therefore important—but raises the question of how to choose from the wide variety of potential, short-term priorities.

A tough self-assessment, combined with a hard-nosed scan of a retailer's external environment, can be invaluable in helping retailers decide where to focus.

For retailers operating with decent financial strength in reasonably attractive markets, investing for future growth, rather than hunkering down to minimize losses, often yields the best long-term results.

Downturns are tough on retailers. Recent McKinsey research indicates that during the last two recessions (1990–91 and 2000–01), growth slowed for nearly every retail subsector in the United States. Ninety-three percent of the retailers surveyed that existed during both downturns experienced slowing revenue growth in one of them, and 59 percent endured it in both.¹

Unfortunately for retailers, their position on the front lines of consumer spending doesn't translate into a rapid turnaround when the general economy experiences a subsequent uptick. The average retail subsector growth rate during the first year of recovery following the 1990–91 and 2000–01 downturns was 0.3 percent. And 12 of 15 retail sectors lagged behind even that rate of growth during one or both upturns.²

These downturn dynamics—declining sales followed by a sluggish recovery period—mean retailers should move quickly to minimize performance deterioration. The challenge, of course, is that retailers have a large number of options to sort through, ranging from cutting costs by shutting stores or restructuring support functions, to increasing revenue by refreshing stores or overhauling promotions. Many make the mistake of focusing on what is easy or known to them and fail to tackle more challenging goals that might improve their competitive positioning during the inevitable upturn.

In our experience, some basic rules of thumb are invaluable for helping retailers rapidly sort through their options and set priorities for action—in particular, determining whether to take an offensive or defensive approach. Combining a tough self-assessment with a hard-nosed scan of the environment can help retailers decide on the relative importance of reducing costs, increasing investments, creating financial flexibility, and seeking near-term revenue growth (exhibit).

Retailers should start by taking a rigorous look at the health of their balance sheets, management teams, and overall operating performance. Companies with reasonable cash reserves and ready access to credit lines, for instance, have options—such as investing in stores, people, or acquisitions—that weaker competitors simply lack.

At the same time, retailers need to be realistic about the potential of their businesses. Do they operate store formats or play in a subsector with strong growth prospects? To what extent is the market already saturated, and where does the retailer stand versus competitors? Recent growth rates, market penetration figures, and a serious review of the strengths and weaknesses of competitors are all important factors to consider.

EXHIBIT

Sorting through the options

Analyzing options for retailers during a downturn

Maturity level of retailing format/concept	High growth potential	<p>Reduce costs (margin and revenue lift)</p> <ul style="list-style-type: none"> • Reduce direct costs, eg, migrate additional sourcing to low-cost countries • Eliminate waste, eg, apply lean operation techniques in stores to reduce labor costs • Restructure SG&A costs, eg, renegotiate sourcing of indirect costs¹ 	<p>Increase investments for strategic advantage (margin and share)</p> <ul style="list-style-type: none"> • Refresh stores, eg, selectively invest in remodeling stores in key markets • Acquire, eg, identify acquisition opportunities given decline in retail valuations • Recruit talent, eg, recruit talent from struggling players; lay off low-potential employees • Win locally, eg, focus resources on key local markets
	Mature	<p>Create financial flexibility (cash for survival and consolidation)</p> <ul style="list-style-type: none"> • Clean up balance sheet, eg, reduce working capital by reducing noncore inventory • Increase effectiveness of investments, eg, close some stores while increasing investment in those with potential for future growth as economy recovers 	<p>Drive near-term revenue growth (market share)</p> <ul style="list-style-type: none"> • Communicate values, eg, adjust pricing/promotions to increase customers' perception of value • Drive traffic, eg, shift promotions/marketing to traffic-generating vehicles such as Internet, broad-reach TV • Never miss a sale, eg, improve availability of fast-moving SKUs²; increase store labor during peak hours • Improve web conversion, eg, improve cross-selling using customer insights
		Weak	Strong
<p>Relative company health (balance sheet, management capacity, overall performance)</p>			

¹SG&A = sales, general, and administrative; indirect costs are nonpersonnel- and nonmerchandise-related purchases that support store operations, eg, fixtures, supplies, technology, and outside services.


²Stock keeping units.

Companies with good financial strength in markets with significant growth potential should lift investment to gain strategic advantage over competitors. Big bets, such as doubling down on new stores or remodeling old ones, are one possibility. Equally important are smaller bets, such as recruiting talent from weaker players or investing in more precise local market execution. For example, when one specialty retailer began suffering from declining foot traffic in its stores, the company built an analytic tool to help merchants and members of the central marketing organization more effectively use data from customer-relationship-management (CRM) and transaction databases. This allowed the retailer to better predict local demand and decide which items should receive how much space in its advertising circular. Comparable store sales have risen

between two and four percent in test markets employing the new promotion-effectiveness tool.

Retailers with good financial health in mature industries can also go on the offensive, taking actions to quickly grow revenue by driving traffic into stores through more compelling offers and ensuring that staff is ready on the floor for the assisted sale. For example, a North American soft goods retailer has reversed declining sales, improved customer satisfaction, and increased the frequency and average size of transactions by focusing on eliminating out-of-stocks, raising the effectiveness of front-line salespeople, and making small store-layout changes that help customers find the goods they want.

Companies with weaker financial health will need to focus more aggressively on reducing costs. Our recent experience suggests that weak performers have major opportunities to rationalize inventory stock keeping units (SKUs)—freeing up working capital—and to renegotiate terms on direct sourcing. These companies can also increase shop-floor efficiency, an area where they frequently lag. By applying lean operations techniques to redeploy labor, they can shorten the time staff spend on noncustomer-facing tasks and increase the time spent helping customers. The focus should be on getting more from existing sales resources, not just on cutting labor hours. Indeed, the key driver of economics is sales—not just cost as a percentage of sales.

More broadly, retailers should bear in mind that the least effective thing to do during a downturn is to simply “hunker down” and “weather the storm.” Though there’s no escaping some pain, moving quickly to improve performance can reduce the odds of a deep dip in sales and position retailers to participate fully in the inevitable upturn. 

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Notes

¹Our research focused on the sales histories of 280 retailers. One hundred and eleven were in existence during the 2000–01 recession but not during the earlier period. Ninety-one were in existence during the 1990–91 recession but not during the later period. Seventy-eight were in existence, with sufficient sales histories for our trending methodology, during both time periods.

²Our research indicates that five subsectors (discount, dollar stores, drugstores, grocery stores, and shoes & accessories) experienced growth below 0.3 percent during both recoveries. Seven subsectors (consumer electronics, DIY, jewelry, national chain, office supply, specialty apparel, and wholesale club) experienced growth below 0.3 percent during one of the two recovery periods. Three subsectors (department stores, off-price apparel, and specialty hard goods) experienced growth during both recoveries.

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