

Five Rules for Retailing in a Recession

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It was great to be in retailing during the past 15 years. Inflated home values, freely available credit, and low interest rates fueled unprecedented levels of consumer spending. Retailers responded by aggressively adding new stores, launching new concepts, building an online presence, and expanding internationally. While the U.S. economy grew 5% annually from 1996 to 2006, in nominal terms, the retail sector grew at more than double that rate—an eye-popping 12%. Revenues rose sharply, profits ballooned, and share prices soared.

But that's all gone now. Even before the financial crisis and recession began, retailers were hitting a wall. Same-store sales—or “comps”—have dropped by double digits for many chains, store closures have accelerated, store openings have slowed, and shareholder-value destruction has been massive. Starbucks—an icon of the good times—is a case in point. Last fall, it decided to shutter some 600 stores and cut back new-shop openings after the company suffered a first-ever year-over-year drop in same-store traffic and sales. The result: Its share price collapsed by almost 60% from the fall of 2007 to the summer of 2008, and it continued to slide as the economy worsened in the autumn.

Still, hard times—even a deep recession—can be an opportunity to win the loyalty of more customers, increase productivity, and strengthen market position. In this article, we draw on a study of more than 50 major U.S.-based retailers and over 20 years of global consulting experience and research to show how retail executives can respond to a downturn in their business and emerge from it even stronger than before. By following the recommendations laid out in these pages, companies like Starbucks will discover that a larger universe of growth and productivity opportunities is open to them than they might believe. What's more, they don't need to overhaul their entire business model to tap into these opportunities; they just need to alter their operating rules.

Rule 1: Go Where the Headroom Is

In tough times, managers instinctively rush to unleash a host of new programs and initiatives—they extend store hours (or cut them back), implement a new staffing system, reallocate store space, introduce or extend loyalty programs, offer “triple point days” and special promotions for big spenders, reorganize store operations or the merchandise or marketing department—even tinker with the parking lot. But without a clear sense of where the opportunity for profitably retaining market share is most promising—let alone where they can win new share—managers engage in too many initiatives that produce too little impact. That can prove expensive, perhaps fatal, at a time when resources are suddenly more limited and getting the highest return on those resources is paramount.

To avoid that trap, you need to understand where your true headroom lies and use that to guide a measured, targeted response. We define “headroom” as *market share you don't have minus market share you won't get*. Customers who are loyal to your competitors represent market share you don't have and will likely not get. Customers who are loyal to you represent market share you already have. Protecting your most loyal customers is an obvious priority in a downturn. But if they are suddenly spending 25% less, most of that will come directly out of what they spend in *your* stores. Your headroom, therefore, lies with customers who are loyal neither to you nor to your competitors—we

call them “switchers.” You may be collecting only 20% of what they’re spending today; taking that to 30% will represent a net gain even when their total spending drops by 25%.

Let’s see how that applies to Starbucks. Earlier in its history, a high proportion of its customers were loyalists for a simple reason: No one else offered the experience they were seeking—high-quality coffee, individualized service, that comfortable coffeehouse atmosphere. But the company has added things like over-the-counter food, drive-through windows, and cookie-cutter store formats, which have made the Starbucks experience more akin to that of fast-food chains than perhaps was ever intended. And this at a time when those chains have become more direct competitors, since corporate investment by such powerhouses as Dunkin’ Donuts and McDonald’s has allowed franchisees to install new, higher-quality coffee machines in their restaurants. As a result, according to customer research we recently conducted, about half of Starbucks’s customers are now spending an average of only 40% of their coffee-related dollars at the Seattle-based firm’s coffeehouses; they’re taking the rest of their money to competitors. These “switchers” are loyal neither to Starbucks nor to its competitors. While loyalists remain Starbucks’s best customers and have been willing to give it the benefit of the doubt, they are not where its headroom exists (see the exhibit, “The Real Opportunity for Starbucks”).

The Real Opportunity for Starbucks

You can measure headroom in many different ways—identifying switchers by category, by local market, by where or how customers shop, or even by competitor. One electronics retailer found its headroom by examining how customers relate to technology, seeking switchers among early adopters, mainstream users, and late adopters. A camera store chain organized its search by segmenting customers according to their level of product sophistication and the amount of service they require.

Whatever the analysis and measures used, we find, generally speaking, that over two-thirds of any given retailer’s opportunity for new market share is concentrated in only one-third of its business. Yet we also find that many—if not most—of its initiatives are aimed at those parts of the business with the least headroom. That explains why such programs multiply: Because they are not targeted at the true opportunities, they fail, and managers respond by firing off yet more projects.

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