Weathering the Storm

Preparing for the "New Normal" in Retail

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What comes next?

The North American retail industry has been pummeled by recession. The lagging numbers tell a dismal story: four consecutive quarters of double-digit comp-store declines in selected categories,[1] more than 40 bankruptcy filings by well-known retail brands since late 2007,[2] and the highest retail real estate vacancy rate in the last 10 years.[3]

The leading indicators—those found in consumer shopping behavior—suggest that a period of sluggish performance lies ahead. A "new austerity" has set in as a response to lingering unemployment and sharply reduced housing values, which could put pressure on retail top lines for the next two to three years.

This recession-based change in consumption, as long-lasting as it may be, is not the only market transition that will change the rules for North American retailers.

Beneath the economic storm are several technological and demographic transitions that will ultimately reshape the North American shopping landscape to an even greater degree than the Great Recession of 2008-09. Leading-edge retailers will turn these transitions into opportunities to exit the recession faster, stronger, and better positioned for future growth.

This paper examines these transitions and their implications for retailers, and suggests six steps retailers can take to prepare for the "New Normal" of North American retail.

The "New Austerity" Reflects Long-Term Changes

The so-called "new austerity" reflects both reduced spending and a new consumer approach to spending.

As of October 2009, the U.S. unemployment rate topped 10 percent for the first time since the early 1980s, with 15.7 million Americans officially listed as unemployed. One in three of these unemployed workers had been out of work for six months or more, the highest proportion since World War II.[4] Though larger economic indicators now show that a general recovery is under way, employment may not reach prerecession levels until as late as 2014.[5]

The bursting of America's housing bubble—a signal indicator of this recession—also deepened the recession's impact upon the retail sector. From 2003 through 2006, American homeowners borrowed nearly $2 *trillion* via home-equity loans or "cash-out" refinancing. House-rich middle-class consumers indulged in daily tastes of the good life, to the point where an estimated 60 percent of luxury demand was attributed to "aspirational" customers

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[1] "Retailing in the Recession," WPP (The Store), October 2009.
[2] Bernard Sands Weekly Ratings Alert, September 23, 2009.
[3] *The Wall Street Journal,* October 8, 2009.
[4] *The Wall Street Journal,* November 7, 2009.
[5] Heidi Shierholz, Economic Policy Institute, quoted by the Associated Press, October 19, 2009.

rather than the wealthy elite.[6] Average household debt in the United States peaked at 138 percent of disposable income in 2007.[7] The mortgage-based retail run came to a screeching halt in 2008, and by the third quarter of 2009, 23 percent of American mortgage holders owed more on their homes than the homes were worth, according to First American CoreLogic, a California real-estate information company.[8]

A new commitment to household savings has also reduced spending. The average U.S. household savings rate has nearly doubled since the beginning of the recession, reaching 5 percent of disposable income by the second quarter of 2009, up from 2.7 percent in the years 2002 to 2007. The impact on retailers has been significant, as every extra percentage point of savings is estimated to take $109 billion from the tills of U.S. retailers.[9] In addition, consumers are purchasing less on credit; in the 12 months after October 2008, revolving credit (credit card) balances were reduced by more than $86 billion.[10]

Additionally, consumers are taking a different approach to spending.

Shopping data from the early, shocking period of the downturn suggested that consumers were responding to price, and price alone. Discount coupon redemption grew 10 percent in the four-month period of November 2008 through February 2009,[11] and commentators pointed to the early 2009 success of deep-discount retailers such as Wal-Mart and ALDI as evidence of a trend.[12]

A more patient analysis, however, suggests that consumers have moved more toward an appreciation of value, quality, and utility. The advisory firm WPP (The Store) pointed in October 2009 to the emergence of a newly confident consumer, less responsive to lowest price than to a well-communicated sense of how a product or service improves the life of the consumer and his or her family. The recent "price-plus" value strategies of retailers such as Zara, The Home Depot, and Wal-Mart were cited as examples of success.[13]

A Consumer World Shaped by Personal Technology

The past decade has witnessed remarkable growth in the adoption and cultural centrality of personal technology. Cisco's Internet Business Solutions Group (IBSG) finds consumer behavior is being reshaped by four key personal technologies—technologies adopted to help consumers make smarter and faster decisions, and to increase the utility and overall value of their purchases.

1. The Smartphone

It is, in one sleek five-ounce package, a telephone; address book; receiver and sender of emails, texts, tweets, and Facebook updates; cloud computer; calendar; alarm clock; map;

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[6] Bernstein Research, quoted in *The Economist,* September 19, 2009.
[7] *The Economist,* October 3, 2009.
[8] *The Wall Street Journal,* November 24, 2009.
[9] *USA Today,* September 9, 2009.
[10] U.S. Federal Reserve, November 2009.
[11] Inmar, Inc., 2009.
[12] *The Wall Street Journal,* January 13, 2009.
[13] "Retailing in the Recession: The Sky Did Not Fall," WPP (The Store), Autumn 2009.

Internet search engine; and music and video player. It is personalized with ringtones, wallpapers, up to 75,000 mobile applications, and a unique 10-digit personal identifier.[14]

The smartphone places Internet search, every form of contemporary digital communication, and a future limited only by the imagination of application developers into the purse or pocket of the consumer. No longer must the consumer go to the store (or to the online site via a computer). Now, for the first time, the store can go with the consumer. At home, at the beach, or even amidst a competitor's aisles, a favorite retail brand is no more than a finger's length away. And, inside a brand's own brick-and-mortar locations, the smartphone has the potential to become the ultimate self-service shopping device.

In the United States, nearly half of all consumers are expected to carry "smart" mobile devices, such as the iPhone or BlackBerry, by 2012.[15] Mobile devices are reshaping U.S. shopping behavior. Recent studies show that roughly two-thirds of American shoppers carry a cell phone, more than 60 percent have used the phone in stores to discuss purchases, and 14 percent of consumers under 30 years of age have used a smart mobile device in stores to access the Internet and compare prices.[16] The next decade is expected to bring rapidly expanding mobile commerce, including product scanning, credit-debit services, ticketing, shopping, advertising, social networking, and gaming to daily retail. Mobile commerce is predicted to reach $300 billion in global transactions by 2013.[17]

What Channel Is She In?

A big party this Friday. She's in your store. Trying on the latest looks. Checking out your competitors' looks online. Photos. Uploads. Texts to her BFFs: *u like? 4 Fri nite*. Checks Facebook. Friends post: *it's so u*. Sold.

The Answer Is, *Yes*

Mobile commerce will also accelerate price transparency—and potentially, product commoditization—among retailers. As an example, the "Shop Savvy" application for the Google Android mobile platform allows users to scan a product bar code, and instantly search the Internet for the best prices (as well as receive online reviews and promotional alerts). More than 1 million users were active as of October 2009.[18]

What this means for today's retailers: Mobility is rapidly erasing the traditional channel walls between brick-and-mortar and e-commerce, and demands of retailers an integrated, one-brand/multiple-touchpoint strategy. In addition, the retailing of the Internet— e-commerce, social networking, and price-feature-function search and transparency—has now moved from the desktop to the store floor.

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[14] Twenty years ago, the same functionality would have demanded multiple devices, with a collective weight of more than 100 pounds. Source: Cisco IBSG, 2007.
[15] Gartner, 2008.
[16] Cisco IBSG Global Mobility Survey, 2008.
[17] Jupiter Research, 2009.
[18] biggu.com, November 2009.

2. E-Commerce

While brick-and-mortar retailing stumbled during the past 12 months, e-commerce sales in the United States grew by 13 percent in 2008, and were projected to grow 11 percent in 2009—with Amazon.com growing 29 percent, to annual sales of $19.2 billion.[19] Though skeptics may scoff that e-retail accounts for only 6 percent of total U.S. retail sales,[20] the impact of today's e-commerce must be understood by segment. In 2008, online retailing accounted for 45 percent of computer products, 24 percent of books and music, 19 percent of toys and baby products, 18 percent of consumer electronics, 11 percent of jewelry, and 10 percent of shoes and apparel.[21] With merchants dabbling now in online coupons and mobile commerce—and with Wal-Mart and Sears joining Amazon in bringing additional merchants beneath their respective dot-com banners—the percentage of business moving to e-retail will continue to grow.

What this means for today's retailers: In all but the grocery and dollar store segment, success online will increasingly determine overall success. In addition, traditional real estate strategies will increasingly be called into the question; the most valuable real estate in retail may soon be the 60-square-inch screen of the consumer's notebook computer and the six-square-inch screen of his or her iPhone.

3. Web 2.0 Social Networking

The rapidly expanding peer-to-peer Internet realm is evolving into an important sales and customer communication channel.

Facebook is the fourth-most-popular website in the world, with more than 300 million active users[22] and a rapidly growing 25-and-older participant base. Nearly 60 percent of the top American retailers have a fan page on Facebook,[23] and more than 40 percent of e-retailers maintain a social network page on sites such as Facebook.[24] For retailers, Facebook is becoming both a brand loyalty and transaction engine. For example, one national quick-serve restaurant chain uses its Facebook fan page to announce local promotions and tie-ins to a high school event or game, with positive results.[25] Facebook's Platform allows consumers to post videos, photos, and links of favorite items, which online friends can then click through to purchase directly from the retailer.

In addition, visits to online social shopping sites such as Etsy, Kaboodle, and Crowdstorm increased 244 percent between February 2007 and February 2008,[26] and participation shows no sign of letting up. This reflects a growing trend, driven by technology and demographics, of turning to "online friends" for advice on retail products and services. A 2008 study showed that 27.6 percent of adult Internet users worldwide had posted a

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[19] National Retail Federation; Shop.org, 2009; Morgan Stanley, October 2009.
[20] *Internet Retailer,* May 5, 2009.
[21] Morgan Stanley, March 2009.
[22] Facebook, November 2009.
[23] *eMarketer,* 2008.
[24] Jupiter Research, 2008.
[25] Cisco Executive Collaboration Roundtable, May 2009.
[26] Hitwise Intelligence, February 2008, cited in RetailMeNot, March 2008.

product-relevant opinion on a social network profile, and 28.9 percent had written a review on a retail website.[27]

Twitter—with its search tool, and search tools of add-on apps—makes it easy for consumers to monitor the conversational "buzz" of the moment on retailers, movies, restaurants, and more.[28] Also showing potential as a retail sales channel are online interactive games, such as the Café World, Restaurant City, and FarmVille applications now operative on Facebook. Some 21 million persons had played Café World by late October 2009, purchasing both real and virtual goods.[29]

What this means for today's retailers: E-commerce is no longer just a branded transactional website. And if demand creation is about investing dollars where the eyeballs (and interest) reside, retailers must run (not walk) to social media—especially in this era of slack demand.

4. Video

In January 2009, 147 million U.S. Internet users watched an average of 101 videos per person. Total online video consumption in that month alone: 14.8 billion clips. (With YouTube videos averaging two minutes, 46.17 seconds in length, that suggests 77,984 human years of video viewing within 31 days.)[30]

The implications of this for retailers are just beginning to take shape. There's little question as to the growing popularity of online video sites such as YouTube; in March 2009, YouTube reached its 100 millionth viewer. But there is also a remarkable burst of individual content creativity, with an estimated 13 hours of video uploaded to YouTube every minute.[31] It is becoming increasingly easy to shoot, edit, and upload relatively complex videos into an ever-expanding cloud.

With pocket-size, high-definition video cameras now costing less than $200 retail, video has become the 21st century spiral-bound notebook—the easy, impactful, and immediate way to capture and communicate content of all types.

For retailers, video breaks new ground. As the video clip becomes the norm for daily communication, static media of all types (printed store signage, Sunday circulars, direct mail) will continue to diminish in value. Employees can and will make and share their own videos, and will increasingly shun traditional employee training methods, such as slides or printed handouts. Unhappy customers will not hesitate to express their dissatisfaction in ways that can reach millions.[32]

Each one of these personal technology market transitions is remaking the shopping and retail operational landscape. What truly shapes the New Normal, however, is that these

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[27] Universal McCann, 2008; Hitwise Intelligence, 2008, cited by Chief Marketer.com/Channels/ online/enews_031908.

[28] RNG Strategy Alert, November 24, 2009.

[29] "Social Climber," *Forbes,* November 16, 2009.

[30] comScore, YouTube Report 2009, March 2009; "Social Media, Web 2.0, and Internet Stats," Adam Singer, March 2009; Cisco IBSG, 2009.

[31] "Social Media, Web 2.0, and Internet Stats," Adam Singer, January 2009.

[32] For a prime example, see "United Breaks Guitars" on YouTube, a video that has received more than 5.9 million viewings since its original July 2009 posting.

transitions now overlap and intersect, and as noted earlier, will not only cross traditional channel boundaries, but erase them altogether.

Anyone can now shoot videos with smart mobile devices and send them via the Internet to Facebook. Consumers click through to e-commerce sites from social networking sites, and through interactive games, which are accessed on notebook computers in an economy-class cabin at 35,000 feet. Consumers check prices, research products, post photos, and text friends from inside the store. Online retail brands invade competitive brick-and-mortar spaces.

This overlapping, intersecting use of personal technology places the consumer in control, able to access and customize every type of digital experience instantly, on demand—anywhere, anytime. Loyalty programs become much less about "purchase points" and much more about opportunities to opt-in to personalized digital coupon and offer lockers, participate in social networks, and receive notifications of special promotions and shopping opportunities.

Changing Demographics Will Also Tilt Shopping Norms

The impact of the personal technology transitions upon the U.S. retail industry will be further amplified by the emergence of Generation Y, or the "millennials."

Born between 1977 and 1997, the millennial population will be 12 percent larger than that of baby boomers by 2015,[33] and will represent the most ethnically diverse generation in U.S. history.[34] The millennials are the first generation to grow up Internet-savvy; they boast the highest percentage ownership of personal technology of any American generation; and they spend 30 percent less time reading newspapers and magazines than do adults in the next-older group.[35]

The emergence of the millennials as a market force is perhaps the most significant demographic shift since the baby boomers came into their own. Although boomers still spend significantly more in U.S. stores than do millennials,[36] millennials spend *five times* more than their parents did at the same age, adjusted for inflation.[37] Dubbed "Gen Buy"[38] in a new book about their shopping habits, this powerful consumer group is socially networked, ethnically diverse, and accustomed to instant, real-time access to music, news, videos, and their peer network.

Not only are millennials important to retailers as *consumers*—they will also become the largest retail *employee* demographic. Their expectations for the use of personal technology, access to the Internet, and content creation and personalization will change the ways retailers approach both their customer experiences and their employee relationships.

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[33] U.S. Census Bureau, New Politics Institute, 2007.
[34] Young Voter Strategies, 2007; Forrester, 2008.
[35] Don Tapscott, *Grownup Digital*, 2008.
[36] Retail Forward, October 2009.
[37] Chris O'Brien, *San Jose Mercury News,* October 21, 2009.
[38] "Gen Buy: How Tweens, Teens, and Twenty-Somethings Are Revolutionizing Retail," Kit Yarrow and Jayne O'Donnell, 2009.

Six Recommendations for Retailer Action

Cisco IBSG recommends six actions retailers can take now to survive and thrive in the New Normal:

1. Focus on Conversion—in Every Channel

The numbers don't lie: Even a small increase in conversion percentage and/or basket size will drive a significant top-line difference. In addition to a narrowing of assortments and heavy emphasis upon in-stock performance for key volume SKUs, this suggests the need for some critical capabilities:

- A best-in-segment ability to answer questions, resolve problems, and bring value-added knowledge to the increasingly tech-savvy consumer[39]
- The ability (especially through mobile communication and video) to draw immediate on-floor attention to special purchases or promotions[40]

2. Differentiate and Defend Your Brick-and-Mortar Turf

Yes, e-commerce will capture an increasing percentage of business in nearly all non-grocery segments. But brick-and-mortar locations will continue to provide the vast majority of transactions and revenue. The new austerity and wave of personal smart devices suggest a three-step strategy:

- **Deliver expertise and assistance services.** As noted above, consumers will continue to choose brands that deliver *value*—and these days, value is as much about services, do-it-for-me assistance, and usage expertise as it is about competitive price. Brands that provide this value in-store will win today's value-seeking traffic.
- **Deliver convenience and ease.** It's an important value message, and many brands—for example, Wal-Mart, Walgreens, and Family Dollar—are narrowing assortments or adding categories for easier decision making and one-stop shopping. This approach will also win value-seeking traffic.[41]
- **Drive mobile consumers to *your* offers-features-prices.** Mobile bar-code recognition and price-feature transparency have the potential of turning brick-and-mortar floors into catalog showrooms for the competition. A turf-defense plan will include capabilities such as onsite mobile bar-code scanning with direct links to product knowledge and the brand's own virtual experts.

3. Get Ahead of the Personal-Smart-Mobile Device Tsunami

The smart, Internet-connected mobile phone is a game-changer in regards to consumer communication and behavior. Cisco IBSG recommends a three-step development strategy—one that begins with simple connection (sending texts on special events, for instance), continues to information sharing (such as Internet access to store, service, and product information), and moves eventually to full m-commerce.

4. Get Ahead of the Personal Video Tsunami

Envision how the quickly produced, two-minute-plus video clip could bring value-added trend, usage, or implementation expertise to your website. Imagine how it could be used to

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[39] "Retail Store Execution: An Empirical Study," Fisher, Krishnan, and Netessine, Wharton, December 2006.
[40] Cisco IBSG, 2009.
[41] WPP (The Store), October 2009.

communicate best operational practices from store to store, or how it could be used by merchants to share an overview of product samples, by display professionals to scale great ideas, and by vendors to train on new products. Envision how it could be used in a brand-positive way by consumers.

5. Deliver an Integrated, Multi-Touchpoint Brand Experience

Retailers must develop a strategy for operating in a new, seamless world of multi-touchpoint, virtual, and brick-and-mortar retailing. The brand strategy should stretch traditional e-commerce to include the mobility and social network channels. Retailers must also begin to plan so-called "flexible fulfillment," where physical and virtual channel inventories are meshed, and where consumers can transact in one channel, and take delivery or return merchandise in another.

6. Prepare for the Generational Change

Millennials are now an important part of the retail workforce, and they are entering their prime consumption years. Both as employees and consumers, it is normal for them to use digital technology to communicate, create, entertain, and learn. Retailers must respond first in the areas of employee communication and training, using video for daily employee communication, video and social networking tools to share ideas and best practices, and mobile communications clips and collaboration as daily communication.

For more information on how retailers should be preparing for the "new normal," contact Jon Stine, Cisco IBSG Retail/CPG practice, at jostine@cisco.com.

More Information

The Cisco Internet Business Solutions Group (IBSG), the global strategic consulting arm of Cisco, helps CXOs and public sector leaders transform their organizations—first by designing innovative business processes, and then by integrating advanced technologies into visionary roadmaps that address key CXO concerns.

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