
CONSUMER SPENDING AND RETAILER STRATEGIES IN THE CURRENT ECONOMY

A research paper on the state of the current economy in the perspective of retailing, how consumers' spending patterns are changing, what are some of the retailers' reactions and what areas do retailers need to concentrate on in the short term future



WHITE PAPER

RAVI SHETTY
KIRAN SINGH
SUDHIR KUMAR



Table of Contents

INTRODUCTION	3
CURRENT RETAIL ECONOMY WAVE OF BANKRUPTCY	4
BANKRUPTCIES AND RETAIL FINANCE	4
THE DOMINO EFFECT	5
CONSUMER CONFIDENCE	5
CONSUMER SPENDING PATTERN	6
CONSUMER RESPONSE TO HIGH GAS AND FOOD PRICES	6
STIMULUS PACKAGE A SHORT TERM IMPACT TO THE CONSUMER SPENDING	7
MERCHANDISE CATEGORY ANALYSIS	8
CONCLUSION	13
REFERENCES	14
ABOUT THE AUTHORS	14
ABOUT WIPRO TECHNOLOGIES	15



INTRODUCTION

The slowdown of the US economy has been having its impact globally. Major investment banks and economists are considering this a recession, and the National Retail Federation (NRF) has forecast retail sales growth of only 3.5% in 2008, the slowest year for growth since 2002. There are number of factors that together, put pressure on both capital market and consumers. These factors include (but are not limited to):

- The falling value of US Dollar;
- Mortgage defaults and sub-prime woes;
- A slowdown in the housing market;
- Increasing pressure on job creation; and
- The rising costs of oil, gas, grain, and other commodities.

Over the last decade, borrowing against the houses has fueled majority of the consumption. In 2007, as housing and credit markets declined, home equity borrowing plunged and consumption flattened out. The relationship between borrowing and spending is so intertwined that consumer spending will plummet in the near future, unless some of the factors mentioned above start showing positive signs.

For retailers, an economic slowdown will likely be difficult and they are currently engaging their strategies at multiple fronts; by slimming down their growth plans, shutting down the stores, trimming the inventory, slicing the payroll with a hope that it will help them endure this condition.

The aggressiveness in reviewing their strategy varies between different retail formats, and depends upon how vulnerable they are to the current economic setup. It's important to note that, some retailers even thrive in recession like conditions, when others struggle. Those that benefit from a slowdown will be retailers offering value to consumers. It is anticipated that in 2008 and beyond, price will be exceedingly important.

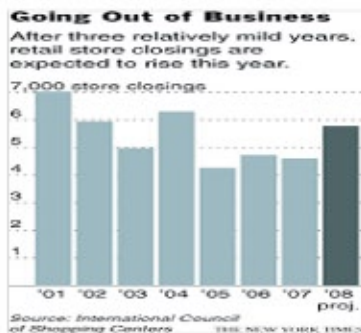
In this paper, we attempt to analyze how the current economy is affecting the retail business, how different income groups' consumer spending patterns are varying in key merchandise groups, and what some retailers are doing about these circumstances. Additionally we have analyzed findings on the consumer responses to past federal income tax rebates (during the last recession period). Based on the research and analysis we have highlighted certain key strategies for retailers to position their offerings in a scenario of declining consumer spending.



CURRENT RETAIL ECONOMY WAVE OF BANKRUPTCY

A wave of bankruptcies in American retailing is prompting thousands of store closings. This is believed to eventually remake suburban malls and downtown shopping districts across the country.

The International Council of Shopping Centers, a trade group, estimates there will be 5,770 store closings in 2008, up 25 percent from 2007, when there were 4,603. Sales at stores open at least a year fell 0.5 percent, the worst performance in 13 years, according to the council.



Store closings A snapshot:

- Foot Locker would close 140 stores over 2008
- Ann Taylor will shutter 117
- Jeweler Zales will close 100
- Charming Shoppes, which owns the women's clothing retailers Lane Bryant and Fashion Bug, is closing at least 150 stores
- Wilsons, the Leather Experts will close 158
- Pacific Sunwear is shutting a 153-store chain called Demo.

Though smaller retailers appear to be struggling more at the moment, the ill-health is slowly spreading to the larger ones too. Macy's has said it will close nine stores. Linen n Things is joining the fray too. J. C. Penney, Lowe's and Office Depot are scaling back or delaying expansion. Office Depot had planned to open 150 stores this year; now it will open 75. Even retailers that can avoid bankruptcy are shutting down stores to preserve cash through what could be a long economic downturn.

More closings could leave gaping holes in the nation's retail centers, which have already seen average vacancy rates creep up to between 7 percent and 8 percent from 5 percent over the last six months, according to data from NAI Global¹, a commercial real estate services firm. Another 130 million square feet of retail space will become available this year; it's predicted, on top of last year's 143 million. That is well above the average 100 million square feet added per year earlier in the decade.

Bankruptcies And Retail Finance

Since last fall, eight mostly midsize chains as diverse as the furniture store Levitz and the electronics seller Sharper Image have filed for bankruptcy protection as they staggered under mounting debt and declining sales. Unless the economy dramatically improves, retail bankruptcies this year could reach the highest level since the 1991 recession.

Given the big ups and downs in retailing during the year, retailers rely heavily on borrowed money to finance their purchases of merchandise and even to meet payrolls during slow periods. Stores may appear to make huge profits by paying \$2 for a T-shirt and charging \$10 for it. But because shopping is based on weather patterns and fashion trends, retailers must pay for merchandise that may sit, unsold, on shelves for long periods. So, chains regularly borrow large sums to cover routine expenses, like wages and electricity bills. When sales are strong, as they typically are during the holiday season, the debts are repaid. As an example, Fortunoff, a jewelry and home furnishing chain in the Northeast, relied on \$90 million in loans to help operate its 23 stores, using merchandise as collateral. But by early 2008, as the housing market struggled, the chain's profits dropped, meaning its collateral was losing value and the amount it could borrow fell, thus prompting it to apply for bankruptcy.

¹ David Solomon, president and CEO of ReStore, New America International Global's retail division, expects the vacancy rate could hit 10 percent by the end of the year.



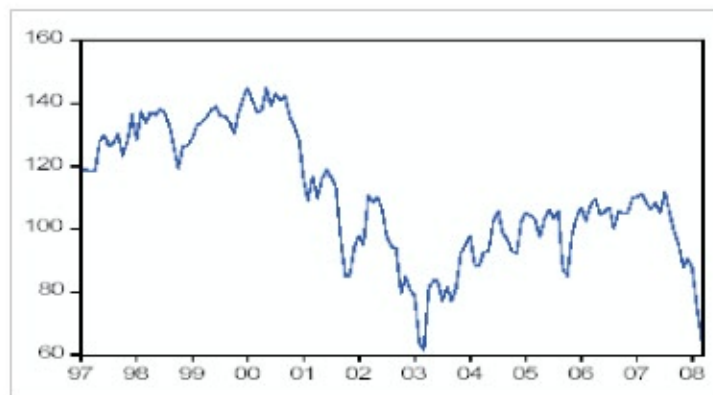
The Domino Effect

Because retailers rely on a broad network of suppliers, their bankruptcies are rippling across the economy. The cash-short chains are leaving behind tens of millions of dollars in unpaid bills to shipping companies, furniture manufacturers, mall owners and advertising agencies. Many are unlikely to be paid in full, spreading the economic pain. An example, when it filed for bankruptcy, Sharper Image owed \$6.6 million to United Parcel Service. The furniture chain Levitz owed Sealy \$1.4 million.

Most of the ailing companies have filed for reorganization, not liquidation, under the bankruptcy laws. But, in a contrast with previous recessions, many are unlikely to emerge from bankruptcy, lawyers and industry experts are saying. Changes in the federal bankruptcy code in 2005 significantly tightened deadlines for ailing companies to restructure their businesses, offering them less leeway. And the changes may force companies to pay suppliers before paying wages or honoring obligations to customers, like redeeming gift cards.

Consumer Confidence

Recently New York based Conference Board, a private business and research organization ran a consumer confidence survey on a sample of 5000 U.S. households, where consumer confidence rating comes at five-year low of 64.5 in March, from 76.4 in February 08.



Although confidence figures don't necessarily predict a slowdown in spending, households are evidently under stress from a slowing job market, sluggish wages, declining home equity and high food and energy prices. In economy, where consumer spending accounts for more than two-thirds of economic activity, then any response from consumer plays a critical role.



CONSUMER SPENDING PATTERN

Consumer Response To High Gas And Food Prices

More than two-thirds of US shoppers² are changing some aspects of their shopping behaviors as a result of high gasoline and rising food prices e.g., shopping closer to home, cutting back on dining out, trading down or at-least not splurging on expensive food items. Apart from buying a fuel-efficient car, which anyway does not happen every day; consumers are consciously choosing to shop closer home.

Stomach Pains
The rising cost of food purchased for home consumption.

ITEM	PCT. INCREASE 2005-2007	FORECAST INCREASE FOR '08
Food at home	6.0%	4.0%-5.0%
Meats	4.0	1.5-2.5
Poultry	3.3	2.5-3.5
Fish and seafood	9.5	3.0-4.0
Eggs	35.5	3.0-4.0
Dairy products	6.8	3.0-4.0
Fats and oils	3.1	8.0-9.0
Fruits and vegetables	8.8	3.0-4.0
Sugar and sweets	7.0	3.0-4.0
Cereal and baked goods	6.3	7.5-8.5
Nonalcoholic beverages	6.3	3.5-4.5

Sources: Labor Department (historical prices); Agriculture Department (forecasts)

A snapshot of response to high gasoline prices

- 49% are more mindful when running errands to minimize their driving distances
- 37% are shopping closer to home
- 29% are yet to change their driving behaviors
- 47% are spending less to compensate for paying more at the pump
- 38% are dining out less often, which portends to restaurant woes

As per the survey done Retail Forward, consumers are trading down in the goods they buy, but not many are changing where they shop. That leads to an interesting implication for retailers that they need to modify their merchandise mixes and/ or prices to accommodate increasingly price conscious consumer to retain their customer base at least in the short term through rough economic patches.

Rising food and gas prices are affecting the lower capita income group the most, who tend to buy grocery items from extreme-value grocery stores, where as high capita income group consumer who buy grocery item from health/ organic food store are shifting their spending pattern the least. Almost half of the consumers at extreme value store are moving towards the cheapest version of product and/ or private label brands, whereas only quarter of the consumer from organic/ natural stores are inching towards the cheapest version.

As discussed earlier, Consumer is looking for better price as value for the necessities items like food segment, hence retailers needs to overhaul their pricing strategy by introducing the margin blending to contain the fast moving item prices and projecting price image to the consumer.

Consumer Group	Income Range
Down Market	Under \$22,500
Middle Market	\$22,500 to \$84,999
Up Market	\$85,000 and above

² According to survey done by TNS Retail Forward in March 2008

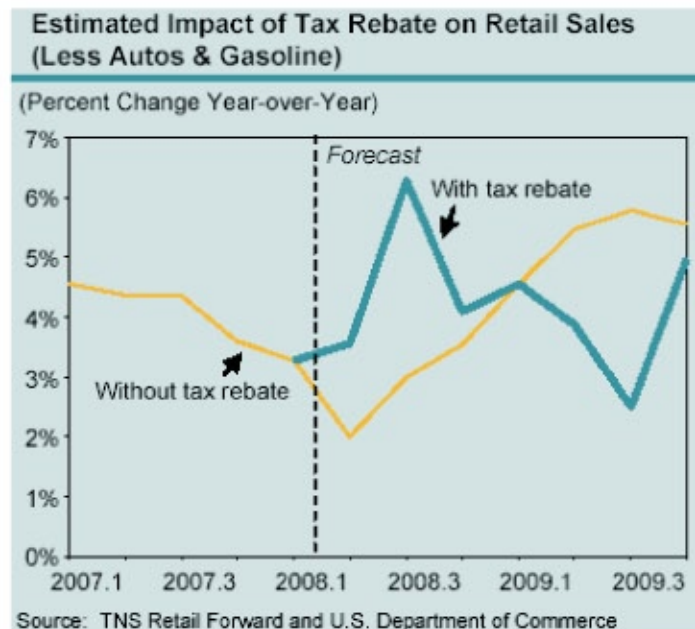


Stimulus Package - A Short Term Impact To The Consumer Spending

US Federal Government is currently making an attempt to stimulate the economy by providing tax rebate to almost 100 Million households in the range of \$600 to \$1800. The impact of tax rebate is going to be significant, in part because this stimulus package totaling \$105 Billion is much larger than the previous tax rebate packages³.

A recent study was done by Harvard business School along with H&R Block by analyzing the spending decision of over 1.5 Million credit constraint consumers for their tax refund during last year. The findings highlights that most credit constraint and impatient consumer will spend the income tax refund (or rebate) on necessities. The only disadvantage of that study is data population, which was much skewed and does not cover the consumers who did not opt for that specific service from H&R Block.

In conjunction to that, Wharton School has also conducted study on the similar tax rebate provided by Federal Government in year 2001, which covers much larger data population and analyzes consumer spending pattern. As per the findings, the average consumer initially saved some of the rebate, by increasing their credit card payments and thereby paying down some debt and increasing their liquidity. But over the period, consumers spending got increased by over \$200 cumulatively in the period of 9 months after rebate receipt, which was almost 40% of the average household tax rebate. Contrary to the normal conception, the overall debt increased for the credit-constrained consumer, where as unconstrained consumer was able to lower their debt. This marks a striking concern because though the upcoming tax rebate may provide some relief to the economy but in the end low-market consumers may become more cash strapped and credit constrained.



In recent studies done by leading institution, down market and mid-market shoppers, who are most likely to receive and spend the tax rebate, will remain focused on value and everyday purchases. Mid-to-up market households will be more inclined to make big-ticket purchases, which will likely benefit sales of consumer electronics and some home furnishing.

³ The tax rebate of 2001 was \$38 billion and the child tax credit in 2003 was \$15 billion



MERCHANDISE CATEGORY ANALYSIS

Retailers do not just accept the effects of a slow economy lying down. Initial reactions from retailers come in the way of slimming down, shutting stores, trimming inventory, slicing payroll and taking other strategic steps they hope will help them endure the pain. Some stores even thrive in recession as others struggle.

With fears that the coming months could be the toughest for them since the 1991 recession, retailers are fighting to gain any edge they can over their rivals and to cushion themselves from the slide in customer spending. Many of them are redeploying staff and revising promotions⁴; some are putting a new stress on low prices.

Some retailers are better positioned to manage a downturn. Those with low, low prices like Wal-Mart and off-price retailers including T.J. Maxx, Ross and those that cater to the wealthy are tending to outperform those in the middle. But opportunities exist for midlevel retailers, too. If shoppers are trading down to Wal-Mart, as its sales suggest, then more affluent people may be ready to cut back on their Bloomingdale's trips in favor of Kohl's.

Given the downturn in the economy, low consumer confidence & spending, it becomes imperative that retailers fine-tune or tweak their strategies in order to thrive through this period. Below is an analysis we have done on certain merchandise categories based on the current consumer spending patterns, how retailers are getting affected are reacting to it, and what are some of the areas that they need to concentrate on during this period.

⁴ Retailers are more aggressive about promotion and reviewing the strategy by which they promote and how often they do it, says Madison Riley, a retail strategist with consulting firm KSA



CONSUMER SPENDING AND RETAILER STRATEGIES IN THE CURRENT ECONOMY

Merchandise Category – Grocery		
Current Situation	Retailer Reactions	Future Outlook
<ul style="list-style-type: none"> • Consumers are finding more direct ways to save money at Supermarket as compared to at the gas pump. • Consumers are increasingly using store and manufacturer coupons. • Consumers are switching to cheaper version and/or store brands. • Consumers started buying at multiple stores and inclined towards buying more from discount stores. Only in case of discount stores being far from home, to save on gas, they are buying at nearby stores. • Buying selective items, or items that are on sale. • Buying selective items, or items that are on sale. 	<p><u>Grocery Supermarkets</u></p> <ul style="list-style-type: none"> • Mid-west supermarket retailer like Rainbow and Cub Foods are offering gas discount coupons based on total purchase at store. • Many supermarkets started offering deep discounts on fast moving items. • Keeping the prices of organic and premium products intact to maintain the margin. • Started offering more ready to eat dishes, as consumers are shying away from restaurant. <p><u>Super-centers</u></p> <ul style="list-style-type: none"> • Wal-Mart Super -centers are offering more products in their weekly discount flier's and also emphasizing lower prices in in-store displays. 	<p><u>Grocery Supermarkets</u></p> <ul style="list-style-type: none"> • More consolidations between regional grocery chains to build competitive economies of scale. • More volume discounts to increase basket value of purchase <p><u>Super-centers</u></p> <ul style="list-style-type: none"> • As consumers are becoming more price conscious, grocery supermarkets need to overhaul their pricing strategy: from occasional step discounts to everyday low prices. • Improve customer service, checkout, and in-store display to retain affluent consumers so they return when economy turns around. • As consumers are inclining towards private label brands, retailers can optimize price by reducing the gap between private label and national brands to increase the overall margin, and still provide an attractive substitute over national brands.



Merchandise Category – Apparel		
Current Situation	Retailer Reactions	Future Outlook
<ul style="list-style-type: none"> • Traditional Specialty apparel stores are mostly badly hit • Down-market shoppers cutting down on apparel spending a lot more than up-market segment • Up-market shoppers spending less but remain loyal to high end stores • Middle market shoppers likely to shift loyalties from specialty to departmental stores and mass retailers • Off price retailers attracting more customers 	<ul style="list-style-type: none"> • Mass retailers looking for opportunities to move sales from traditional soft – good retailers and specialty retailers • JC Penney scaling back on store openings from 50 to 36 for 2008 • JCP introduced private label lingerie to compete with Victoria's secret • Neiman Marcus looking to preserve high customer service and optimize inventory • Macy's concentrating on localizing decision making related to assortments and reduce management workforce 	<ul style="list-style-type: none"> • Strengthen online offerings, drive more customers online for better purchase value • High end retailers need to concentrate more on optimizing inventories to counter lesser demand and heavy markdowns • Mass retailer should act like a specialist; launch specific brands at a fraction of stores. Assortments for specific stores can increase cost, but can be offset by potential repeat sales and leaner inventory with high margin. • Optimize prices to ensure higher markup on premium products • Lower end departmental stores can offer private label products at lower prices • Increase use of labor scheduling and productivity tools



Merchandise Category – Electronics		
Current Situation	Retailer Reactions	Future Outlook
<ul style="list-style-type: none"> • Consumer spending towards electronics category has been impacted to the least, as compared to other categories. • Demand for digital products, particularly HDTV's is still buoyant in current economy. A rationale for some consumers for buying HDTV's is to cut down visits to the Cineplex. • Due to Internet retailing and new product proliferation, consumers are finding huge bargains from across retailers, and that's keeping the momentum in sales. • Consumers are widely using the other consumer review and expert comments before placing an order or going to the store. 	<ul style="list-style-type: none"> • Nearly every retailer seems to be getting pummeled - except for Best Buy, who is currently evolving its business model from product centric to consumer centric, with heavy emphasis on services • Circuit City introducing smaller concept stores, which are producing higher sales returns as online content replacing DVDs, CDs, and video games sold in stores. • Amid pressure in improving margin, CCY is focusing on the cost containment, by closing non-performing stores and cutting headcounts in non-store area. • Best Buy has streamlined its Reward Zone Program to make it easier for consumer and prompt them for repeat sales. • Retailers like CCY are focusing more on the cross channel retailing, as half of the online orders are picked up from their brick and mortar stores. 	<ul style="list-style-type: none"> • Consumer electronics specialty chains are going to face increasingly stiff pressure from mass retailer and pure online retailers. • In order to sustain the sales growth, retailers need to focus on digital and wireless products & services • Price deflation and mass commoditization of the key technologies are going to be a norm and not exception. • Retailers are going to be more aggressive in offering private label programs, thereby driving down the margin in many electronics categories. • Specialty retailers need to emphasize on their staff training as pace of technology product development can provide them a differentiation from other mass retailers.



Merchandise Category – Home Furnishing		
Current Situation	Retailer Reactions	Future Outlook
<ul style="list-style-type: none"> • Consumers are spending less or nothing on furniture and home furnishings products, which is not surprising since the economic downturn has been led by housing financial crisis. • Consumers are moving away from finished product at home improvement retailers, and more are opting for Do It Yourself. • Credit crunch is also playing another negative factor where interested consumers with lower than average credit rating are facing bad credit terms. • Even with low prices, consumers are still not looking at Wal-Mart as a destination store for fashionable home furnishing. • Consumers are spurning small indulgences, and shifting from more expensive furniture to cheaper and trendier styles. 	<ul style="list-style-type: none"> • To minimize the cost, many large-scale chains like Home Depot are either closing their non-performing stores or holding their expansion plans. • Making an attempt to create some level of excitement by offering steep discounts on big-ticket items. • Stores like IKEA, which has few number of stores (total 35 in whole US) have clear advantage in terms of offering unique experience with moderate prices but high gas prices is going to resist many consumers who travel long distance (sometime from neighboring states) to buy products from IKEA. • Retailers who are offering only niche and expensive products have to bear the economic pressure more as compared to others, and many retailers have already started filing for Bankruptcies. 	<ul style="list-style-type: none"> • Home furnishing and furniture category would undergo closing down stores or major cut down in expansion plan. • Mass merchandise r like Wal-Mart need to continue focus ing on basic home furnishing items. • In order to sustain sales growth, better credit offers may need to be provided to consumers • As consumers are cutting down on eating out and watching movies at Cineplex, home furnishing retailers can still pitch in with cost economical DIY units for home theatres solutions. • Retailers need to invest in providing value proposition "price" and family oriented shopping environment, where busy families can furnish a home at a cheaper way. • Need to find innovative solutions to minimize the shipping and assembly cost.



CONCLUSION

Retailers need to constantly and consistently focus on developing winning value propositions to get through the current economic turmoil. Poor economy does not mean that customers will stop buying, but the question remains which retailer they will buy from. It is important in this economic situation, for a retailer, to first achieve and maintain financial stability. Retailers can then evaluate low-risk strategic options to make investments. A strategy that works for one retail format or for one merchandise category may not work for another. However there are certain common 'value proposition' themes that retailers will need to focus on. We discuss some of those themes here. Retailers in the current economy need to:

- Focus on providing 'solutions', rather than 'items' complete planning, delivery, and installation services for the whole new home theater system. Consumer demand for value based solutions is higher during these kinds of periods.
- Increase usage of analytics to identify proper product assortment mix and cross selling opportunities
- Revisit, analyze and modify where necessary promotion and pricing strategies to ensure profit maximization
- Rationalize number of SKUs to help consumers simplifying their purchase decisions
- Build better brand portfolios - forming joint ventures or partnerships with successful established brands
- Increase private label ratio since it is easier to control costs on private labels
- Adopt a category based presentation in-store rather than a brand based presentation to improve customer purchase convenience especially in apparel
- Optimize inventories, especially in the apparel business to minimize in-store carrying costs
- Offer better bargains, but not compromise on service and convenience
- Communicate, advertise on 'value' of the solution offered and not just price
- Use better employee forecasting and labor scheduling techniques to optimize the workforce at both sales floor and back room activities.
- Improve customer service by ensuring staff is knowledgeable and helpful increase training if required. Customers would not like to be inconvenienced especially during these times
- Concentrate more on developing relationship with the customer customers developing trust during troubled times are likely to come back when times get back to normal
- Provide seamless multi-channel shopping experience for customer convenience. Drive more customers online, if not for sale, then for information.

Eventually the economy will rebound, but till that happens only the best can weather current challenging conditions. Retailers must therefore have a clear understanding of their key internal strengths, their competition, and most importantly, their consumer. Lastly, though volatile markets tend to encourage short-term focus, publicly traded companies must continue to engage in strategies for long-term development.



REFERENCES

1. Where does it go? Spending by the financially constrained from Harvard Business School
2. The reaction of consumer spending and debt to Tax Rebate: Evidence from consumer credit data, Federal Reserve Bank of Philadelphia
3. Jim Hertel and John Hauptman, March 2008, 'Whip Inflation now or at least turn it to an advantage'

ABOUT THE AUTHORS

Ravi Shetty



Ravi Shetty leads the Merchandising & Pricing center of excellence within the Retail, Consumer Goods, Transportation and Services vertical in Wipro Technologies.

- The centers of Excellence promote research and generate thought leadership in Store operations, Category management Merchandise planning, Inventory management, Assortment & Space planning.
- Besides, the COEs also support pre sales & functional consulting work, based on deep understanding of industry standards & trends to build best practices in these areas.

Kiran Singh



Kiran Singh is a Lead Domain Consultant in Retail and Consumer Goods practice. He has extensive experience in conceptualizing the solution offerings for Wipro's Retail and Consumer Goods clients.

- He has provided strategic and process consulting to leading US and European retailers and consumer goods clients in the areas of Merchandising, Demand Planning and Financial Accounting. Currently, he is engaged with leading Mass Merchandiser based in US to establish newly defined Import Sourcing Structure and provide timely and accurate financial transactions at the corporate level.

Sudhir Kumar



- Sudhir Kumar is a domain consultant with more than 6 years professional experience in IT services in Retail, CPG and Distribution domains. He has consulting experience in the areas of Point of Sale, Merchandise planning & execution and DSD. He has exposure to working with senior clientele in the mass merchandising, apparel, snack foods, and departmental retailing sectors, primarily in the US geography. He has worked with cross functional and technical teams in various engagements, as a functional or program lead and has successfully guided product development, enhancements and implementations. Sudhir is trained in SAS Merchandise Intelligence and is currently involved as an Application Consultant in a SAS implementation at a leading apparel retailer in the US



ABOUT WIPRO TECHNOLOGIES

Wipro is the first PCMM Level 5 and SEI CMMi Level 5 certified IT Services Company globally. Wipro provides comprehensive IT solutions and services (including systems integration, IS outsourcing, package implementation, software application development and maintenance) and Research & Development services (hardware and software design, development and implementation) to corporations globally.

Wipro's unique value proposition is further delivered through our pioneering Offshore Outsourcing Model and stringent Quality Processes of SEI and Six Sigma.



Wipro Technologies

Corporate Office :Doddakannelli, Sarjapur Road, Bangalore - 560 035
Phone : +91 (80) 2844 0011 Fax : +91 (80) 2844 0256