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HOW DO SUCCESSFUL RETAILERS DEAL WITH ECONOMIC UPS AND DOWNS?

By Bennett E. McClellan with Karen Schwichtenberg

OVERVIEW

Consumer-focused companies, such as retailers and consumer packaged goods (CPG) companies, experience good times and bad times. Yet some companies seem to consistently outperform their peers regardless of economic conditions. Recognizing this anomaly, HighPoint InSights posed the following question to HighPoint's retailing expert Karen Schwichtenberg:

What do high-performing retailers do well, regardless of economic conditions?

Schwichtenberg responded by outlining three simple, yet profound principles:

1. Recognize that no company controls the external environment. Winning retailers outperform their peers in spite of changes in the environment.
2. Develop a crystal clear understanding of who their customers are. Regardless of the economic climate, successful retailers know the customers they serve and what those customers value.
3. Enable leadership at all levels to act responsively as customers adapt to changes in their environment. The executive team sets the direction and the front-line staff converts this direction into sales.

In this article, Schwichtenberg elaborates on each of these themes. She asserts that the wisdom of high-performing retailers applies generally across most industries. If you have customers, these principles should apply to you.

WHEN THE ECONOMY IS UP, THEY'RE UP. WHEN THE ECONOMY IS DOWN, THEY'RE STILL UP RELATIVE TO THEIR PEERS

UK retailer Harrods reported a 15% profit increase in 2011. According to *Retail Week* writer Alex Lawson, the iconic retailer's double-digit profit did not come as a surprise. In good times and bad times, year in and year out, Harrods has generally outperformed its retail peers. Even though the store itself was sold in 2010, the key to Harrods' success remains embedded in its motto: *Omnia Omnibus Ubique*, "All things, for all people, everywhere." Harrods has long been referred to as "the store where you can buy anything."

Apple stores represent the opposite end of the merchandising spectrum. Their retail operations sell only one thing: Apple and Apple-related products. However, Apple stores also offer repair services, training, user advice, and a good vibe. How well has this approach worked for Apple? Apple stores are the most productive retail spaces in the US. Generating over $6,100 per square foot, they beat electronics retailer Best Buy by a factor of 7 to 1. According to a report published in the *Financial Times*, the Apple store in London is the most productive retail space in the UK.

In case you are thinking these are the outliers, consider Macy's Inc. In spite of a difficult 2012 US holiday retail environment, Macy's reported a 4.1% gain in year-on-year, same store sales in the month of December. The National Retail Federation cited that December retail sales overall (excluding automobiles, gas stations and restaurants) grew at only 2.1% year-on-year. The 850-unit chain also tracked a 52% increase in online sales over the same period. When asked about its above industry average performance, Macy's executives credited their company's success to following changing customer preferences in multi-mediated shopping: wherever, whenever, however.

Harrods, Apple and Macy's face the same retail conditions as every other retailer. They have no more control over the economy than any other retailer. They have no special insight into future events. They do not do a better job of shaping consumer confidence levels. They cannot beat unemployment. The 2008 recession happened to them, as did Hurricane Sandy.

High-performing retailers deliver consistently better results than their competitors, regardless of whether the economy is good or bad. The question remains, how?

YOU DON'T CONTROL THE EXTERNAL ENVIRONMENT

Schwichtenberg stresses that it is not the vagaries of the economy that differentiate one competitor's performance from another's. She asserts that it doesn't make sense to blame the economy for a company's poor performance, nor does it make sense to take credit for improved performance in a booming economy, unless a company had something to do with making the boom happen.

Therefore, the first principle for high performance in retail is taking responsibility for outcomes. Top performing companies take responsibility for their performance, whether the economy is good or bad. High-performing retailers make it their responsibility to deliver superior results regardless of economic conditions.

Michael Crooke, former CEO of Patagonia, illustrated this point vividly when speaking to a group of business students at the Claremont Graduate University. Michael described Patagonia as a company known for the quality of its outdoors wear, particularly its low-temperature fleeces. When asked by one student about the seasonal effects on profits, Michael responded, "Cold weather makes us look really smart."

Michael explained that Patagonia's choice to be in outdoor wear put them in the risky position to ride seasonal trends – both up and down. Michael went on to explain that regardless of hot or cold weather, he considered it his responsibility to deliver his company's performance goals. If the weather happened to send more customers his way, then he considered that a bonus. His point was clear: Sometimes luck brings you a windfall, but don't count on luck for making your profit targets.

Having said that, putting the blame for poor results on the economy seems to be a common ploy for struggling companies and nervous politicians. Consider the following headlines from 2012:

"BT (British Telecom) blames European economy as Q1 2012 revenues drop 6%" (*Computer Weekly*)

"Caesars blames slowing economy for nasty second quarter" (*Forbes*)

"Caterpillar Cuts 2012 Outlook, Blames 'Economic Weakening and Uncertainty'" (*Wall Street Journal*)

"McDonald's blames economy for weak July" (*CBS News*)

"Tiffany lowers profit forecast, blames economy" (*Reuters*)

"Weight Watchers down, blames economy" (*Reuters*)

"Xerox blames economy for low profit" (*Wall Street Journal*)

A Google search of the words "blames economy" produces more than 16 million references. Of course, not all of these links are business related, but a surprisingly large number are. It seems that some corporate executives are unwilling to take responsibility for the performance of their companies in bad times.

Still, some US retailers have "beat the economy" in the past few years. A sample of these high performers includes Costco, Nordstrom, PetSmart, TJ Maxx, Pier1 Imports, Victoria's Secret, and Whole Foods. Those merchants cover much of the retail spectrum. Yet, the economy does not seem to have stopped them from outperforming their rivals. What do they do differently?

Schwichtenberg determines that what makes the difference between average performing retailers and outstanding retailers is how well they address factors they can control. She says, "There are many internal drivers or levers a company can focus on in any environment. The two critical areas of focus, regardless of the environment, should be knowing their customers and effective leadership." She sees these factors as the twin drivers of many other critical internal processes.

UNTIL YOU TRULY UNDERSTAND YOUR CUSTOMERS, IT IS DIFFICULT TO DETERMINE HOW TO EFFECTIVELY SERVE AND ENGAGE THEM BETTER

Schwichtenberg explains that when she looks behind the performance differential among retailers, the first thing she typically finds is a fanatical concern for understanding customers. Customers of any given retailer can have different buying motivations, shopping patterns and usage profiles.

She asserts that high-performing retailers differentiate themselves by investing more in customer understanding. She says, "Many retailers still refer to *the customer*, as if their customers were all the same. This is obviously not true." Any exercise to understand customers should quickly prove that not all customers are created equal.

Taking the time to understand the nuances of customer behavior is essential for focusing efforts on serving the most attractive segments. Determining which segments to prioritize, and what shape the efforts directed toward those segments will take, are key retail investment choices. While such segmentation efforts may seem burdensome, they are necessary to develop the kind of deep customer knowledge high performers use to distance themselves from their peers in both good and bad economic climates.

Schwichtenberg sharpens the point by stating: "It's not really an approach as much as it is a foundational philosophy. For high-performing retailers, knowing your customers becomes a way of life. It is infused in the way the organization thinks and acts at all levels."

She offers the following five simple questions as starting points for developing deeper customer knowledge.

1. HOW DO CUSTOMERS PERCEIVE YOUR BRAND?

Every retailer has a view of how they present their brand promise to the public. But customers may or may not see them in the way they want to be seen. In fact, it is almost impossible to have a consistent brand image across different customer segments. This discrepancy is something that must be acknowledged and managed.

Retailers are often shocked when they map the images they have of themselves against how customers perceive them. Companies must realize that spending money on advertising does not necessarily communicate their desired brand image. The only way to understand how customers actually perceive your brand is to ask them.

Since brand perception drives expectations, retailers need to clearly understand customer expectations. What promises do customers associate with your brand? How do those expectations vary by customer segment? How well are those expectations being fulfilled? How consistently are those expectations being reinforced? What opportunities exist to help improve customer perceptions?

2. HOW DO YOUR CUSTOMERS VARY BY CHANNEL?

The advent of ecommerce has opened new doors to retail. The Internet has become an informal communication tool, an advertising medium, an order entry service, and a place to vent discontent. In other words, the Internet has created a host of opportunities and dangers for retail. One thing that appears to be true is that ecommerce customers have different behavior patterns from in-store shoppers.

Do you truly understand how your brick and mortar customer differs from your online customer? How are online customers different from mobile customers? Many retailers still assume that these three sets of customers are the same or similar. This is most often not the case. Once you understand and acknowledge these differences, you can then effectively serve your customers, however they shop.

3. WHY DO YOUR CUSTOMERS SHOP YOU?

Shopping is an experience. What experience do various customers seek when they shop your store versus when they go elsewhere? Imagine yourself walking through the front door of one of your locations. What do customers experience when they enter your store? Hint: It’s not just about the merchandise.

Most retailers have many competitors that offer similar merchandise at similar price points. Think of Best Buy’s stores - they sell the same products that the Apple store does and at the same prices. Why buy from Apple versus Best Buy?

What is the experience you want to create for your customers? How can you do that more effectively? How can you make that experience unique for your customers?

4. WHO DO YOUR CUSTOMERS SEE AS YOUR COMPETITORS?

Many retailers define their competitors using a narrow perspective. Executive teams continue to focus their energies only on retailers that compete with them directly in terms of offering and price. But from a customer’s perspective, competition is defined as a series of choices about who gets their money. Unless you truly understand this idea, chances are someone you have not identified is taking share of wallet from you. If you don’t identify *all* of your competitors, you have no chance of competing with them effectively.

5. HOW CAN YOU SERVE YOUR CUSTOMERS BETTER?

The retail landscape is crowded. Most customer needs are already being satisfied in some form. As a result, you need to continually focus on how you can enhance the customer experience. How can you make it more convenient for the customer? How can you raise your standard of service? How can you provide more variety? How can you offer what you provide at a lower price point or increase its perceived value? Great retailers worry as much about creating needs as fulfilling needs.

Another set of questions focuses on how you can create new categories, new formats, and new kinds of experiences. Entrepreneurs are always thinking about the next new thing. Are you?

Schwichtenberg summarizes the importance of customer understanding by stating, "Regardless of market conditions, it is critical to know your customer. Retailers that truly understand their customers significantly increase their chance of succeeding in all economic climates."

Understanding customers is one thing. Satisfying customer needs is another. This brings the discussion to the second driver she believes differentiates high-performing retailers: the role of leadership.

SUCCESSFUL LEADERS RELENTLESSLY FOCUS ON SATISFYING CUSTOMER NEEDS

Schwichtenberg explains that behind a true understanding of customers are leaders who are fanatical about serving them. Leaders set the tone for their organizations. They take responsibility. They hold themselves accountable for the company's success in any environment. In bad markets their job gets tougher, but it is still their job.

Once you know who your customers are, what they think, want and need, how they buy and why they buy, then the leadership team has to act on that information. They need to develop and fully embrace strategies to improve loyalty and expand share of wallet with their customers. They must also potentially have the courage to cut off customers that are not profitable.

In tough markets as well as in good markets, successful leaders need to be laser-focused on customer strategies and ensuring accountability for their execution. They need to continue to invest in the development of internal infrastructure and tools to support front-line accountability of everyone who comes into contact with customers.

It is obviously not sufficient for top managers to act alone in this devotion to customers. Fanatical attention to customers typically pervades all levels of the most successful retail organizations. Customers rarely see top managers. Instead, customers see and interact with the folks on the store floor. They judge customer orientation by the way they are treated by these valuable team members.

It is therefore important that sales associates embody and convey the retailer's commitment to satisfying customer needs. Sales associates are also ideally positioned to gather critical customer knowledge as they are on the front-lines every day. Schwichtenberg states, "One of the most undervalued sources of information a retailer has is its associates. They are a wealth of knowledge, however few retailers have done a good job of determining how to effectively tap into these insights."

Successful leaders constantly challenge themselves and their associates to better serve their existing customers. They are constantly looking to attract new customers as well. Leaders don't allow themselves to become complacent in good markets.

Schwichtenberg points out that self-congratulatory behavior can easily emerge when companies are "winning" in up markets. She says, "In such cases, the leadership team begins to think, 'We must be doing something right!' Such companies also tend to blame external factors, for example the economy, when markets soften. In retail, complacency in any kind of market can work to the competition's advantage."

Leaders must be willing to acknowledge when there are issues. Sometimes the economy goes south, as the US economy did in 2008. In such cases, the organization needs to understand that it is no longer business as usual. Leaders need to communicate such messages clearly and persuasively. Leaders fail when they don't recognize the need for change, or more likely, when they do not clearly communicate the need for change within their organizations.

Schwichtenberg says, "Leaders don't sugarcoat tough messages. Rather, they use tough messages to stimulate higher performance from their organizations." They adopt the attitude, "Damn the economy, retail ahead!"

Effective leaders also believe that nothing is set in stone. They question everything. Schwichtenberg asks, "Why settle for maintaining, when you can focus on winning? Remember, winners strive to excel under whatever market conditions. Instead of having change happen to you, you need to make change work for you."

Finally, the executive team must be willing to take calculated risks and move quickly. Sitting still is not an option in today's competitive environment; but taking risks means that sometimes you fail. When leaders fail, they acknowledge the failure, and move on. They learn what didn't work, and what did.

Schwichtenberg closes by saying, "Leaders should not be afraid to do their jobs. Too many leaders fear failure and seek to play it safe. In an up market, safe bets yield average returns. In a down market, failing to take risks is almost always a formula for failure."

ECONOMY UP OR DOWN, WHAT DO WINNERS DO DIFFERENTLY?

The short answer to the question *InSights* posed to Karen Schwichtenberg is that winning retailers, and more generally winning companies regardless of sector, behave in pretty much the same way whether economic conditions are good or bad. As a rule they:

- Accept responsibility for their performance against their competitors
- Clearly understand their customers' needs and differences
- Make serving customers with creativity and commitment their number one priority at every level of the organization

It all seems pretty basic, but the sheer complexity of coordinating those three tasks can become overwhelming. In down markets the complexities multiply.

Winners understand that whether the economy is good or bad, it takes every ounce of effort, every ounce of managerial capability, and every ounce of leadership tenacity to achieve an edge over the competition. After all, even if the competition appears to be sleeping, can you really assume they are asleep?

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