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The new retail reality

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Call it “trading down” or the “new frugality,” but most observers agree that the current economic crisis has made consumption suddenly out of fashion.

Coincidently, environmental considerations had many consumers questioning their consumption even before the recession reared its ugly head.

While no industry is immune to these trends, **retail** is arguably the hardest hit. The industry is undergoing a “structural break” that will force many companies to dramatically alter their business models. While some discount retailers may thrive, other retailers will struggle to adjust to the new reality. In this challenging environment, four key principles will be critical to success.

Making everything lean

A return to value will require retailers to make their **operations leaner**. Operational excellence took hold in grocery and mass merchandise segments years ago. Now, companies in many other retail segments will be forced to adopt similar practices to protect margins as their pricing power evaporates.

Among the changes we’ll see: Stores will be fewer and smaller. Retailers will have to manage capacity across the supply chain more carefully. Companies will make capital expenditures based on rigorous ROI measures and quantitative testing, rather than on gut feel. Product will be moved less, packaging will be rationalized, and new product introductions will be heavily scrutinized. Value chain collaboration will become critical for ensuring the long-term profitability of suppliers and retailers.

Leveraging new channels

Retail storefronts will decline in number but virtual **channels**, still in their infancy, will develop at an accelerated pace. Consumers, aided by increasingly ubiquitous and mobile information technology, will gain leverage and be able to exercise their demand for better value.

Sustainable business practices will lead to the emergence of a more highly developed reverse channel as a means of liquidating used materials at the end of their lifecycle. Some big box retailers are already accepting electronics items difficult to dispose of, and have established reverse logistics processes across thousands of stores.

Consumer-to-consumer channels will become more important as well. Durable long lifecycle products will increasingly find new homes via online personal resale services like eBay, Craigslist, and Free Cycle—rather than ending up in a landfill. Some retailers have already decided to play an active role in this market. Other retailers will soon follow.

Trading up for innovation and service

In this environment, full price sell-through will be more challenging without the freshest retail concepts and products. Increasingly demanding consumers and multi-cultural demographics will create smaller market segments with specific needs. In short, competition for the consumer's dollar will require that retailers refocus to provide innovative and quality products and services. Retail companies will also be forced to shorten product development cycles and create stronger linkages between their **product development** and supply chain operations.

Growing globally

While consumer spending will inevitably rebound, it may never see the levels displayed in the past. We believe global expansion is one source of future growth. So far, however, retailers that have expanded overseas have experienced limited success. Realizing ROI from such efforts depends on understanding local demand and developing the capabilities to meet it. Each of these markets has its own complexity and risks that must be addressed—with profound implications for channel strategies, real estate, labor management, product development, and supply chains.

No one knows when consumer spending will improve. It seems likely, however, that the retail future will look significantly different from the retail past. Only companies that act now to develop the right capabilities will thrive in that new environment.

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