Capitalizing on Consumer Agony

Understanding how consumers react to a recession is the secret to survival

"Luck is what happens when preparation meets opportunity," said the Roman philosopher Seneca. Companies will be better prepared to secure business if they understand consumers' true needs and desires, and adjust their business models to capitalize on new global realities. Consumers still want all the luxury they can afford.

Whether you're at a four-star restaurant or a corner coffee shop, you'll no doubt feel the fallout from the global financial crisis. Nearly every business sector has experienced depressed sales and fewer orders. Fast-moving consumer goods (FMCG) retailing is no exception. Compared to other industries, however, there seems to be less pain. For example, while revenues are down 20 percent or more in the automotive industry, retailing has taken a much lighter hit.

The reason is clear: People don't want to starve. A lot of goods, especially food products, are an integral part of our everyday lives. Consumers can jettison the ski vacation, postpone the spa weekend and delay purchasing the case of estate-bottled Bordeaux for another year, but will continue to acquire basic food, clothing and housing. This does not mean, however, that FMCG retailing will come out of the recession unscathed. Although activity appears to be holding up quite well, consumers are in a completely different state of mind compared to before the crisis.

Indeed, distressing media coverage, rising unemployment and sharply reduced housing values have all shaken consumer confidence. The resulting "consumer agony" is a serious factor that will reshape FMCG retailing for years to come *(see sidebar: The Agony Gets Personal on page 2).* However, do not believe that a recession simply propels consumers toward cheaper discount products. It might appear this way at first glance, but people do not intrinsically crave discounts; the recession forces this upon them. This is where their agony originates. And understanding the impact of this consumer agony is the secret to surviving the recession.

Maslow Speaks

When we analyzed the impact of past economic crises on the consumer nondurables business the picture is basically the same as today. Compared to other industries, the consumer nondurables industry is least affected by economic crises, and is affected later than most other industries.

To understand why, we turn to what psychologist Abraham Maslow termed the hierarchy of human needs.[1] We must feed and clothe our children and ourselves regardless of what is going on around us. In a recession, we are often forced into purchasing cheaper, more affordable products. These decisions are not based on making positive healthy food choices, or making a commitment to more sustainable consumption. We are more interested in affordable products and services because we are forced there and it is not a true reflection of deeper cravings or convictions. Very few consumers aspire to be frugal or "discount hounds."

Consumers will continue to fulfill their needs as they did before the crisis, but now decisions are often influenced by a filter of consumer agony. The distinction between true consumer needs and consumer agony is important as it will influence purchasing decisions and how consumers evaluate different retail offerings. This is the real challenge: How will consumer agony affect trends in the FMCG retailing industry?

The Impact of Consumer Agony

Although economic conditions are still in flux, we can examine systematically how consumer agony is likely to affect the dynamics in the FMCG retailing industry.

For example, let's review the ongoing trend in developed markets such as the United States,

The Agony Gets Personal

The global economic crisis will not just sail by the FMCG industry. On the contrary, something very fundamental has changed from a consumer perspective, something that will shape the FMCG retailing business and leave its mark for many years. To understand this, let's look at what consumers are experiencing at a personal level from the global crisis.

Consumers are inundated with media coverage of the global economic and financial crisis. Thanks to global media and advancements in technology, we now have a 24/7 onslaught of dismal news about the economy. The latest unemployment figures in Russia? Check. The latest news on a failing bank in the United States? Check. Coverage of how the construction industry in Spain has come to a halt? Check. At a minimum this will create some anxiety in consumers and it certainly does not lift their spirits.

Adding to this anxiety is the fallout from firsthand experience. Rising unemployment is something very close to home for many of us. As the unemployment figures go up by hundreds of thousands and even by millions in many countries around the world, people in our circle of friends or family will likely experience the agony of unemployment. In the United States, the number of unemployed increased by 851,000 to 12.5 million in February 2009 alone. The European Union is expecting a 4.5 million increase in 2009 to 9 percent, up from 7 percent the previous year. The United Kingdom foresees a more than 50 percent increase to 3.2 million in the second half of 2010, a potential unemployment rate of 8 percent.

Falling housing prices also have a direct impact on consumers. Many find themselves in a squeeze as their net worth has taken a substantial hit, in some cases to such an extent that their mortgage exceeds the current value of their house. The average price for a house in the United Kingdom, for example, has dropped more than 12 percent in the first quarter of 2009 compared to just a year before, and the average U.S. house price has fallen more than 15 percent over the period from 2007 to 2008. All of this has seriously eroded consumer confidence, with few signs of an early restoration.

[1] *Abraham Maslow (1908-1970) was an American psychologist who postulated that humans seek to satisfy their needs in progressive levels from the most basic (food, water, sleep) to the most elevated (creativity, morality).*

where people want everything, everywhere and at any time. People become more demanding and more diverse in their needs over time as they move to higher levels of Maslow's hierarchy of human needs, and no longer struggle to satisfy basic physiological and safety needs. This has already made consumers less predictable, but in combination with the global crisis, it has made them downright fickle. Consumers actively avoid having to trade down within Maslow's hierarchy. They might be forced to by circumstances, but they will not enjoy it.

In our ongoing research into how FMCG manufacturers and retailers can respond to this situation, we have come to three conclusions:

- People have zero tolerance for a manufacturer's poor performance and operations.
- True differentiation will become apparent in the extended value chain as diverging consumer needs go beyond what one-size-fits-all value chains can deliver effectively.
- Consumers are looking for true fulfillment of their increasingly diverse needs.

The following sections elaborate on these three conclusions.

Zero tolerance for poor performance. Efficiency has always been important, but postrecession, it will be essential to survival. The reason is simple. Consumers are more aware now than a year ago that they can spend their money only once. They are seeking maximum value and propositions they perceive as efficient and effective. This doesn't necessarily mean people want the lowest-cost products, but that they want full value for their money.

In the United States, Wal-Mart is among the most efficient companies in the world. A well-controlled supply chain, fully aligned IT systems, powerful management of stock assortment and attractive prices make Wal-Mart ideally positioned to take advantage of consumer agony. Indeed, Wal-Mart is one of the few retailers that has seen a marked increase in sales since the global crisis took off in earnest. Its sales for the three months ending April 30, 2009 were up 3.6 percent compared to the year before—something many other retailers can only dream about.[2] Also, the retailer just announced the hiring of 22,000 more employees and plans to open or extend between 142 and 157 stores in the United States during fiscal year 2010.

Whatever you thought your customers wanted before the crisis, they want something different now.

Albert Heijn, the largest supermarket chain in the Netherlands, was considered an expensive and upmarket supermarket. Over the past few years, however, it has started to flex its economies of scale muscles, triggering very public price wars in the Dutch FMCG market. Albert Heijn has created a new persona—that it is an efficient retailer where the consumer pays for high-quality products, not for any operational inefficiencies. Its 2009 first-quarter identical sales rose almost 5 percent over the year before. Sales at true discounters Lidl

[2] *U.S. same-store sales, excluding gasoline sales.*

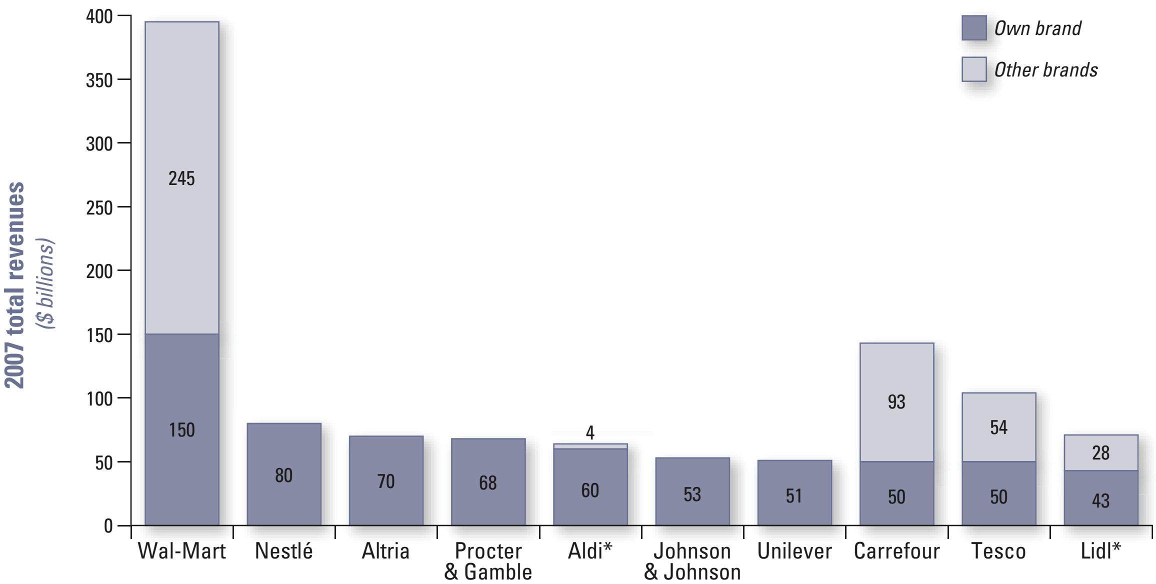
and Aldi also rose as a result of the crisis, but not all discount supermarket chains enjoyed the same results. Apparently, consumers not only consider price but also value for their money *(see sidebar: Shopping for Speific Value)*. For retailers and manufacturers in traditional FMCG value chains this has a number of implications.

For one thing, efficiency and economies of scale are even more important for success. Fortunately, many retailers and manufacturers can achieve economies of scale through consolidation. If they have not already done so, this will have to be implemented with some urgency to create a true source of operational competitiveness.

Consolidation of retailers in many markets has fueled growth of private labels (distributors' own brands). Retailers can manufacture the precise product for their own conditions. Especially in Europe and North America, private-label penetration is 20 to 25 percent and growing fast. In fact, growth in private labels has been so substantial that if we consider private-label sales as the "manufacturing" volumes of the retailers, five of these retailers would be in the top 10 of global FMCG manufacturers *(see figure)*. Wal-Mart's private-label sales exceed the total revenues of Nestle, Altria and Procter & Gamble. This makes the argument about how to deal with private labels from a manufacturer's perspective (or even stronger, how to counter private labels) somewhat beside the point. Private label now represents a well-established class of

Figure

Half of the largest food manufacturers are also retailers



Note: Dollar figures are based on U.S. exchange rate during each company's fiscal year; the retailer value-add and margin are not included for the non-private-label products.
**Aldi figure includes Aldi Sud; Lidl figure includes Schwarz-Gruppe and Kaufland.*
Sources: Planet Retail, 2007; Fortune Global 500, 2007; A.T. Kearney analysis

competitors. The stakes have been raised considerably for manufacturers to improve efficiencies, for that is what this new class of competitors brings into the game.

Now manufacturers not only compete with each other, but also with their customers. This is especially the case since private label is no longer just a segment positioned below branded products. Some private-label products are as differentiating and innovative as the A-Brand products.

This highly competitive environment also sets the tone for how to compete in this space. The following checklist should be considered.

Understand consumers' needs. Use all available information to understand what consumers need in light of the global crisis. Insights from before the global crisis concerning assortment composition and consumer preferences, for example, should be considered suspect and be properly reevaluated. In fact, you could argue that whatever you think your customers wanted before the crisis, they want something different right now.

Match channels and formats. Tailor products and services to consumers by matching channels and formats. Consider regionalization and localization of the assortment so that it optimally reflects local needs.

Reconfigure supply chains and store operations. Design configurations that perfectly match these tailored assortments and channels and that are as efficient as possible. This means having zero tolerance for cross-subsidization and the weakest links, truly capitalizing on economies-of-scale potential, and ensuring no excess complexity is being dragged along.

Communicate with consumers based on true strengths. Consumers will still pay for value but no longer for inefficiency. Company reputation is critical.

Many retailers are working on these sorts of issues and making breakthrough progress. Product assortments based on the overall category strategies and positioning can often be streamlined to such an extent that the number of individual

Shopping for Specific Value

The current economic climate will make consumers more open to explore alternative products with more value. What feeds this need for diversity? First, consumers themselves have become more diverse. The aging population in many developed countries creates new consumer segments with specific needs. Many societies are also increasingly multicultural, creating a multitude of specific needs in the process. Some McDonald's fast food restaurants already sell halal products to satisfy the needs of their Islamic consumers. In addition, consumers have become more demanding and expect much more than even a few years ago. In the United States, 73 percent of consumers shop in five or more channels (out of the eight available).

People do not just want a product. They have become sensitive to attributes such as authenticity, well-being, sustainability and the experience that the product provides them. Perhaps the biggest contributor to the creation of specific consumer needs, however, is that consumers don't stay in their segments anymore and have become their own "assortment integrators." Travelers happily fly business class across the ocean when their company pays. On their own dime, they fly discount, boarding by group and paying for checked luggage and food and beverages on the plane. Supermarkets also experience this, as consumers evaluate value at their full-service supermarket compared to the discount supermarket in the same afternoon.

products can be reduced by more than 40 percent. This has obvious consequences for sourcing, supply-chain and in-store efficiencies.

Tailor value chains to meet consumer needs. The growth of private label is more than just an interesting story. It also shows that alternative value chains can meet specific consumer needs. Private labels represent a number of deviations from the traditional manufacturer-retailer value chain, prominently the absence of the manufacturer-retailer interface. Instead, products are manufactured specifically by the retailer for a solid fit with consumer needs and single-point optimization from the retailer's perspective *(see sidebar: The Tailored Value Chain)*.

This trend of creating tailored value chains to meet explicit consumer needs had taken off well before the economic crisis. Consumer needs have been and are still diverging so that they can no longer be met with a single value chain. Another reason is that consolidation has created retailers with sufficient scale to pursue private-label strategies effectively.

Current conditions are making consumers rethink their ingrained habits. They are much more open to new types of offerings and propositions. Amazon.com, for example, had its best year and its best end-of-year holiday sales in its entire history, despite the fact that the full force of the global crisis discouraged consumers during their holiday shopping sprees. EasyJet experienced a similar sales boost during the fourth quarter of

The Tailored Value Chain

The fresh meat category of a supermarket provides a good example of a tailored value chain. Such products are typically packed in a plastic tray sealed with a clear cellophane film. The sealed tray makes a protective environment that keeps the meat fresh for longer periods. Standardization of the size of the plastic trays is a quite common practice for several different reasons. Having fewer sizes makes them easier to source and creates efficiencies in packaging lines. However, the size (especially the height) of the average tray has become quite large, based on the average thickness of a slice of packaged meat (about 20 millimeters). The height also ensures that the film sealing the tray does not contact the packaged meat. This would reduce the shelf life and negatively affect the appearance, which puts off consumers. Within the existing business context this practice can be considered optimal. One packaging company, however, showed that considerable room for innovation exists when considering the extended supply chain. The packaging company developed a packaging configuration that allows for much flatter trays. A strengthened tray allows for higher pressure inside the sealed package, which prevents the clear film from being pressed on the packaged meat.

The benefits of doing so are profound. All transportation steps along the chain benefit. Much less volume needs to be transported, much less material is needed to manufacture the trays, and the packaging becomes more durable and easier to handle. This benefits the retailers as well: with smaller packaging, more varieties can be stacked on shelves. The reduced height also means that packaging can be tilted, providing the consumers with a clear view of the contents, something that could only be achieved when looking at the meat from above with traditional packaging.

Such optimization opportunities should be seen as necessities. Not only retailers, but also manufacturers (both branded and private label) should search for what is possible along the chain and how suppliers can be involved in innovation efforts in order to ensure they can compete in a more streamlined competitive environment.

2008—10 percent more passengers than a year earlier with many new users, and 14 percent more revenues per seat on a constant currency basis. Both companies have significantly tailored value chains compared to their respective traditional setups. Amazon.com doesn't make use of physical stores and EasyJet has an exclusively Internet-direct sales model supported with call centers.

A recession is a good time to create tailored value chains that focus on specific consumer needs and fulfill them in new and superior ways.

Aligning extended value chains around specific clusters of consumer needs is not a short-term proposition. However, formulating such strategies can provide essential insight on where to take a company and how to ensure it can emerge from the crisis as a winner. In the current situation, many competitors will be distracted as they explore solutions. Above all, companies must seek to attract consumers who are actively looking for fulfillment of their needs.

The following can serve as guidelines for thinking about aligning extended value chains with specific clusters of consumer needs:

- Decide on the type of real value you want to pursue. This requires understanding the true needs of your customers and which of those needs you can fulfill.
- Match this value focus with operational specialization. This requires determining the ideal way to deliver the value, and formulating a resources shopping list.
- Identify the type of collaboration you need and the players that need to be involved. Here, we turn the resource shopping list into a functioning extended value chain.
- Create appropriate arrangements to lock in the value, thus capturing an attractive part of the value created.

Consumers will seek true fulfillment. As argued earlier, consumer agony will significantly influence consumer behavior and preferences, but consumers do not intrinsically crave discounts. Most would probably rather hold on to their pre-crisis spending patterns if they had a choice.

A logical result of this will be that wherever possible, consumers will try to find fulfillment for their needs and will only seek economy or discount solutions where they have to or where it interferes least with their intrinsic needs. This creates plenty of room for value- and premium-focused innovations.

> Consumers don't crave looking for discounts or being frugal.

The recipe for success in meeting consumers' increasingly diverse needs is fairly straightforward. Understand the needs of the consumer, then satisfy them in appropriate and innovative ways. Be aware that preconceived ideas about what to do can quickly cloud well-grounded decision-making. Consider the following advice:

- Don't believe that the only answer to the crisis is cost-cutting. Many great things have originated in previous recessions and some of them required investing.
- Don't believe that consumers only want discount and economy. They would rather be able to escape the agony induced by the crisis.
- Make sure you stay in touch with your consumers and customers. Do not necessarily believe

what is written or commonly believed about them (we accept the risk of undermining our own argument here).

Nothing Is Easy, Still

Clearly the crisis will not make fast-moving consumer goods retailing easier but it does provide opportunities to innovate and grow. The crisis represents challenges that can create winners and also-rans. A few things need to be in place to take advantage of the dynamics in the retailing industry induced by the crisis. True efficiency must occur in the traditional manufacturer-retailer setup. Differentiation must occur at the value-chain level instead of at the product level. And real consumer needs, rather than consumer agony, must drive the retail industry forward to a more secure future.

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