Experts at CRG Partners give retailers examples of how to survive a recession without sacrificing too much of your company.

BEST PRACTICES

Survival Strategies for *Retailers in a Recession*

Back to school, the second biggest shopping season of the year, is typically when consumers splurge on clothing. But this year, vendor orders have dramatically decreased because many retailers are worried about the season ahead.

Despite modest improvements in consumer confidence, the outlook is grim, and back-to-school sales are predicted to be 4% to 5% lower than 2008, according to Strategic Resource Group. Whereas in prior recessions customers still made purchases but traded down, today many are abandoning stores altogether, leaving malls partially vacant. Luxury retailers have been particularly hard hit as they are selling in an environment where it is not fashionable to spend money, even for those who can afford it.

The following are some key survival strategies for retailers trying to weather the storm as they approach the upcoming season:



A Sales Focus

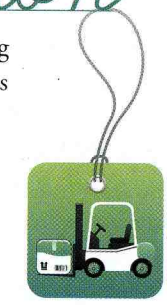
Over the past decade when the luxury goods market was booming, high-end brands became a permanent feature in stores. But today, consumers are only purchasing the necessities. This is evidenced by the 2.3% rise in denim sales while total apparel sales are down 6.3%, according to the NPD Group.

Although basics are selling, traditional, full-service retailers are struggling. Same-store sales at Saks Fifth Avenue, the luxury department store declined 27.6% in Q1 2009, reiterating that consumers are cutting back on nonessentials. Tiffany & Co., the iconic jeweler, is also experiencing negative same-store sales, and analysts predict this trend to continue through the fall.

Facing increased competition, traditional retailers must play to their strengths. Retailers need to make consumers feel like they are getting top-quality goods, a high level of customer service, and an overall sense of value. It is increasingly important for brands to leverage a distinct service or characteristic. Nordstrom's reputation of offering "personalized service, compelling merchandise, and a pleasant shopping environment" has helped it remain competitive during the recession, according to analysts at Barclays Capital. Nordstrom's loyal customer base will continue to spend their apparel dollars on a name they trust.

Despite low consumer confidence, designer discount stores have emerged as one of the few successful retail segments. TJX Companies, owner of TJ Maxx among other brands, reported impressive Q1 2009 results, and analysts predict a strong Q2. TJX plans to open 80 to 85 new stores in FY 2009, indicating optimism about the discount retail market. Sales also remain healthy at other discount chains, such as Nordstrom Rack, which plans to open nine new locations this year. These examples of strong sales and robust expansion confirm that shoppers are value-conscious and actively seeking lower-price merchandise.

In this environment of decreased sales, many retailers are faced with cash-flow issues. To save money, some are cutting back on payroll, which can disrupt customer service and cause a downward spiral that could result in further sales declines. Although the impetus to reduce overhead is valid, to do so at the risk of sales volume is precarious. It is important to maintain sales during a recession because without a sales base, other strategies for improved performance may fail.



Freight and Distribution

With consumers and retailers purchasing fewer products, the trucking industry has become highly competitive. Trucking firm failures are at unprecedented levels—42,000 trucks, or 2.1% of the nation's capacity, idled in Q1 2009, and nearly 1,000 companies went bankrupt. The domestic truck freight tonnage index in April fell 13.2% below the levels a year ago, the lowest point since 2001, according to the American Trucking Association.

As retail chains expanded over the last few decades, it was cost efficient to manage inventory by bringing large shipments to a central distribution center, storing the goods and/or distributing to stores directly. Retailers also quickly learned that establishing chain-wide purchase orders resulted in volume discounts. For years, retailers followed the central distribution center concept and bought or leased trucks to perform store deliveries, assuming that this approach was less expensive and offered better service than hiring an outside carrier.



But today, with decreased sales, high carrying costs, smaller store orders, and less merchandise on the outbound trucks, the current freight and distribution model should be reassessed. Retailers do not want or need the extra inventory, yet the costs remain the same: the lease of the truck and/or warehouse, truck fixed costs, running costs of the truck, and variable expenses. To determine the most effective freight and distribution strategy, retailers should reconsider the realistic benefits of running a private fleet, leasing versus owning, and outsourcing.

Cutting costs now is important, but a longer-term strategic approach is the best way to prepare for economic recovery; if retailers make deals with carriers today, they will lock-in advantageous prices and, when the recession ends, be able to meet increased demand at lower distribution costs.

Bankruptcy

Real estate is the biggest factor in retail chain bankruptcies. Over the last 15 years, the rate of retail development has drastically outpaced the jump in consumer spending. Mall vacancies are now at their highest in almost a decade, with a vacancy rate of 7.1%, up from 5.8% at the end of 2007, according to Financo. An estimated 150,000 stores closed last year, while only about 110,000 opened. The same is expected in 2009, leading to a net loss of 40,000 retail locations each year, according to the International Council of Shopping Centers.



As bankruptcy filings skyrocket, landlords fear more vacancies, and many are unlikely to negotiate a deal with retailers ready to close their store, unless compelled by a bankruptcy filing. While using the bankruptcy process to close store locations may be beneficial, it is important to remember that closing a store or group of stores may be a short-term solution that could ultimately cause a dangerous domino effect.

Customers may flock to the liquidating stores, cannibalizing the remaining stores in search of deep discounts, or turn to the competition. In many cases, the remaining open stores in the smaller chain will not generate enough revenue to cover the established infrastructure costs or corporate overhead. When considering bankruptcy, the costs and benefits of keeping stores open versus closing must be weighed individually by market and the entire company.

Many stores, particularly in a specific market area, share the costs of support functions like advertising and retail management. It may actually be beneficial to close all locations in a market rather than leave a single store open. To determine which stores should be remain open, sophisticated retailers use well-devised econometric modeling and analysis by retail location (e.g. regional customer demographics and competition). This analytic methodology becomes even more important while in bankruptcy, as real estate decisions are evaluated by multiple constituencies and form the fundamental basis of a successful retail turnaround.



Modifications in the bankruptcy code have also altered retailers' strategies for filing. Rather than filing in January, directly after the busy holiday shopping season, when retailers have the highest cash balances, retailers are now filing in the summer or fall. This gives retailers the time to implement a court-approved store closing strategy prior to the holidays to maximize yield on the sale of liquidating inventory.

Despite gradual improvements in consumer confidence, the back-to-school season will undoubtedly be tough for retailers. The weeding-out process for many, even big name chains, is anticipated. To address the current market challenges, it is critical for retailers to take a more strategic approach to decisionmaking, keeping in mind the tremendous value of smart inventory management, strong balance sheets, a tight back-office, low overhead, and outstanding customer service. Companies with these attributes will likely avoid store closings and bankruptcy and will be best positioned to weather this storm.

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