

# The 0.3% Solution

By SPENCER L. HAPOIENU

INSIGHT OUT OF CHAOS

We seem to be entering our once-in-every-10-years recession, or economic downturn. That is, unless you count all the interim downturns, in which case this is a once-in-every-once-in-a-while downturn.

As we listen to the cable and radio yakkers jabber about whether this recession is the same or different from all the others, the one thing that seems likely is that consumers will be spending less because they just lost their retirement savings or think they might. As we've all learned, it doesn't matter if the economy is really bad; it only matters if we think it is.

Research indicates that during the last two recessions (1990-91 and 2000-01), growth in every retail sector slowed. According to the *McKinsey Quarterly*, 93 percent of retailers surveyed experienced slowing revenue growth in one of the recessions and 59 percent found it true in both.

Unfortunately, it also takes retailers longer to benefit from the turnaround when it does happen. The average retail growth rate in the year of recovery in both 1991 and 2001 was just 0.3 percent.

Most of us start to hunker down and take a defensive approach to a recession. Obviously cutting costs where possible is common sense. But when it comes to marketing at retail, cutting back is a self-fulfilling prophecy to 0.3 growth.

## DECILE REPORT

Decile	No. of HHs in Decile	Store Sales	%	Avg. Ticket	Avg. Days between Visits
top 30	1,432	\$744,109	78.6%	\$23.86	27
10	478	\$437,863	46.3%	\$26.04	13
9	477	\$189,109	20.0%	\$21.94	28
8	477	\$117,138	12.4%	\$20.37	41
middle 30	1,431	\$156,693	16.6%	\$18.71	86
7	477	\$75,155	7.9%	\$18.95	56
6	477	\$49,142	5.2%	\$18.54	85
5	477	\$32,396	3.4%	\$18.43	117
bottom 40	1,907	\$45,625	4.8%	\$12.92	228
4	477	\$21,388	2.3%	\$16.70	163
3	477	\$13,827	1.5%	\$13.95	200
2	477	\$7,765	.8%	\$11.27	257
1	476	\$2,646	.3%	\$4.63	291
Total	4,770	\$946,427	100.0%	\$21.96	125

Chart 1: Customer accounts divided into equal tenths ranked by sales.

## In good times or bad, a customer database is a license to do business.

During previous recessions, advertising, promotion — and most of marketing — were always the first to be cut. But this time, retailers with customer-specific databases are pushing ahead because they know who their customers are and what they buy.

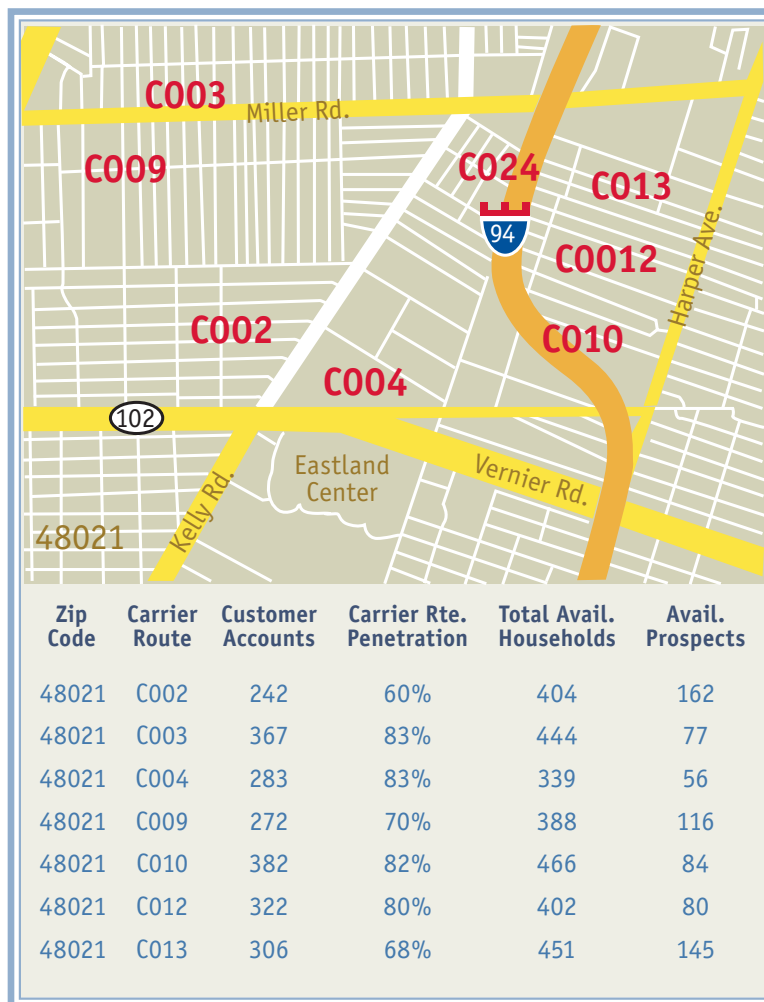
Consumers still have to eat, buy clothes, maintain their homes and cars, and stay healthy. They will still buy gifts for the holidays, buy music for their iPods, and jewelry for their celebrations. Some people will buy less, some people will buy cheaper, and some will spend more in one category and eliminate another entirely.

Retailers who can identify best customers and what they respond to can help their best customers navigate through these troubled times with appropriate messages and offers to maintain their share of business from their best customers.

For example, let's take the home-improvement category. The big-box retailers like Home Depot, Lowe's, and Wal-Mart practice EDLP and mass advertising. It's likely that they will cut back on advertising in general, increase their price promotions, and their television advertising, to gain more awareness.

They'll probably cut back on anything that doesn't reach as broadly as possible, (magazines will likely take a hit). Or, they will cut back on everything and discount even more. Their margins will go down and their awareness and status in the customer's considered set will decrease.

On the other hand, hardware retailers like True Value and ACE, both of which have loyalty programs with customer databases built on transactions, have a huge opportunity to not only protect their businesses, but also to increase share. While the big boxes are watching the tumbleweed roll down their aisles, the independent hardware retailers are targeting their best customers with relevant offers and increasing their foot traffic. Their share-of-voice among selected customers is



**Chart 2: Penetration of customer accounts within each zip code and carrier route.**

increasing, as the big boxes are cutting back.

True Value and ACE retailers know what each customer segment spends, on average. The top 10 percent of customers might spend \$26.04 while the next two deciles spend less than \$22.00. Sending an offer for \$5 off \$30 will increase the average ticket among the top 10 percent and sending \$5 off \$25 offer will stimulate response from the next 20 percent. The average ticket will go up during this recession even if the customer is cutting back, because the customer will cut back on that trip to the big box (see Chart 1).

The independent hardware retailers also know

## True Value

While Home Depot and Lowe's are pulling back on their expansion plans, True Value "is on track to add 1.5 million square feet between 2006 and 2009. That is the equivalent of opening about two new, remodeled or expanded stores a week both this year and next."

Compare that to Home Depot, which "plans to close 15 underperforming stores and halt development plans for 50 others in the U.S., some of which have been in its pipeline for more than 10 years. Lowe's is delaying opening of 20 stores this year and hasn't unveiled 2009 expansion plans yet."

True Value's expansion meanwhile defies a report from Harvard University's Joint Center for Housing Studies, which "suggested spending on home improvement could drop as much as 9.2 percent in 2008, compared with a four percent decline in 2007."

This is partly because True Value's numbers were not included in the Harvard study. But it's also because, in a bad economy, more people are buying what True Value is selling. What True Value is selling is "core hardware for routine maintenance and repair." Hey, that toilet is not going to fix itself.

Despite its surprising resiliency, "it will be tough for True Value to reach its goal of boosting revenue 7 percent between 2006 and 2009," because of "macroeconomic pressures."

But True Value CEO Lyle G. Heidemann says its member stores are not struggling, and sees no reason why they won't move forward with their expansion plans.

[SOURCE: Mary Ellen Lloyd, *Wall Street Journal*, 7/23/08]

how often their customers shop. Typically, their best customers shop every 30 days, while the average hardware customer shops every 90 days. The big boxes know that, too—they just don't know who those customers are. The True Value and ACE retailers can increase their frequency of messaging to their high-transaction customers to potentially gain an extra visit, while the big boxes are reducing their advertising to everyone.

The big boxes will decrease their prices and reduce their margins, while the independent retailers can increase their marketing to their best customers, eliminate marketing to their low-margin customers, and increase their overall margins.

Perhaps there's an opportunity to remix merchandise or bundle items into pricing pods that fit the customer's inclination to reduce spending. In home improvement, customers who stop shopping can be recaptured with special offers on necessity items, like fertilizer for lawns, shovels and salt for snow, batteries and light bulbs. Retailers can also step up customer recognition in the store by having store associates identify and pamper best customers with more service than usual.

It can be an even bigger win for the independent retailers if they prospect for new customers who will

feel less inclined to visit a big box. That's because a database of customers not only tells you who your customers *are*, but also who they *aren't*.

Within geography where customers have shown a high degree of responsiveness, it is possible to prospect specifically to households that have not become customers and have not joined the loyalty program. It's best to reach out to those prospects most likely to become customers with a hotter-than-normal offer (*see Chart 2*).

The margin for those who respond might be lower than usual, but picking up new customers for the long haul will provide a boost towards beating that 0.3 percent growth during the turnaround—regardless of whether the market is up 400 points, or down 400 points. ■



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