

The Playbook for Successfully Managing through a Recession – Part 2 of a 3 Part Series

The Three Phases of Managing Through a Recession:

We all know that successfully managing through a recession requires fast, decisive action. Indeed, few companies sit idle, just hoping to weather the storm. Most companies take action, usually on the seemingly obvious fronts, such as cutting near-term costs and recalibrating capital budgets. In L.E.K.'s recent client work, we have observed that exceptional management teams are developing a holistic plan to ensure immediate survival and enable them to retool their business to exit the recession a stronger entity.

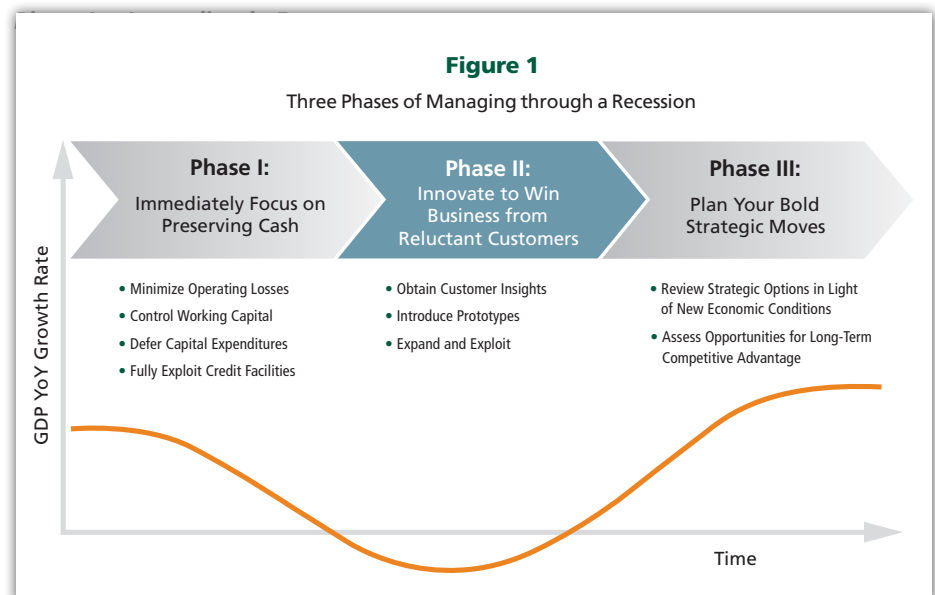
In this three-part L.E.K. Executive Insights, we explore the critical phases companies must navigate to manage through the recession and achieve strategic advantage.

L.E.K. has found that successfully managing through a recession requires astutely executing three interlocking phases (see Figure 1). In our last *Executive Insights*, which addressed Phase I, we discussed tactics companies can employ to preserve cash. In this issue, we examine Phase II of managing through a recession, which uses Guerrilla InnovationSM to persuade reluctant customers to spend. Phase III will be sent to you in the coming weeks.

Phase I: Preserving Cash

Phase II: Innovate to Win Business from Reluctant Customers

Phase III: Plan Your Bold Strategic Moves



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Phase I: Immediately Focus on Preserving Cash:

The primary goal of the first phase is to ensure near-term survival. This requires preserving cash and minimizing operating losses. While many actions may be taken, the key levers include reducing operating costs, delaying major capital projects, tightly controlling working capital, and fully exploiting existing credit facilities.

Phase II: Innovate to Win Business from Reluctant Customers:

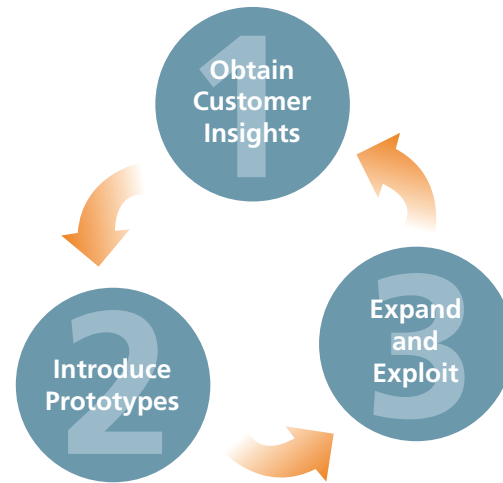
The goal here is to maximize sales and margins in the short term by persuading reluctant customers to spend by quickly adjusting a limited set of levers (marketing, pricing, promotion). Doing this requires immediate understanding of your customers' needs and behaviors, rapid prototyping and quick optimization of winning commercial tactics. Success in Phase II will require simultaneous observation and experimentation, which is not a trivial task.

Phase III: Plan Your Bold Strategic Moves:

The goal of this final phase is to take a fresh and critical look at your strategic options, considering bold moves that will meaningfully augment the business model to create strategic advantage amidst the realities of the post-recession marketplace.

Figure 2

Guerrilla InnovationSM Framework



Phase II: Innovate to Win Business from Reluctant Customers

During a recession, customers' requirements change: they buy less, they may want different products or services, they increasingly look for greater values, and they respond to different marketing stimuli. Your challenge as a consumer-based business is to adjust your near-term commercial tactics to maximize the revenue opportunity and, in turn, your profit. Just as in any ecosystem that suffers a significant disruption, what often follows is a rapid acceleration in the rate of evolution. We believe the same principle can be applied by companies to strengthen their performance during a recession; we call this approach Guerrilla InnovationSM. It employs a cascade of iterative engagements with customers to identify and test multiple tactics that can realign existing products and services to stimulate near-term spending.

Guerrilla InnovationSM is an acknowledgment that the needs of your customers have changed, but you cannot wait until your traditional innovation process sources new products to meet those needs.

Guerrilla InnovationSM focus still taps into the heart of what drives solid innovation strategy: customer engagement. But instead of applying it to developing new ideas, products and services, the immediate goal is tactical adaptations of existing offerings (see Figure 2).

1. Obtain Customer Insights.

The fundamental first step in adjusting to your customers' evolving needs is gaining information. Because customer insights must be captured and acted upon in real time, it is important to move beyond traditional customer research methods (customer surveys, store intercepts, focus groups) and leverage faster, more interactive techniques such as customer panels,

online forums and shop-alongs. Additionally, greater attention must be paid to any nuances in shopping behavior metrics (average transaction size, product mix, website behavior), as these may also be immediate sources of valuable insights. These learnings must then be rapidly distributed across your organization for immediate prototyping.

2. Introduce Prototypes.

Rapid or “micro” prototyping is another shift from business as usual because it involves introducing many ideas at once and letting the market decide the winners and losers. The key to achieving quick validation of ideas is having a strong testing program that can deliver insights in a controlled and limited-risk environment. We acknowledge that introducing many prototypes at once is risky, but you can mitigate this risk by limiting the test to a small or “micro” sample. Start by developing a plan to introduce key ideas in select locations or for select customers. Then streamline your testing plan to ensure timely response and data collection, leveraging channels that will elicit a more immediate response (for example, web sales). As part of your plan, assign metrics to gauge success (store traffic, transactions, basket size) and weigh the performance of each idea accordingly. The universe of options in Phase II may be limited, so do not abandon a prototype without understanding why it failed. It may be worthwhile to consider a modified version of this prototype.

3. Expand and Exploit.

Once you have identified the most promising tactics for attracting customer spending, these opportunities need to be immediately maximized through a rollout to relevant locations and

customers. Central to proper execution is identifying appropriate processes to manage promising projects. Progress must be measured consistently and tactics refined based on any incremental customer feedback. With market conditions changing so rapidly, a winning idea can turn into a loser if not rolled out quickly and effectively.

Organizing for Guerrilla InnovationSM requires immediate and tight coordination between multiple stores, marketing vehicles, and functions of your business. You may lack the resources or expertise to do this, so consider allocating a dedicated command and control team. This team will oversee customer insight management, the testing program and evaluation of results. Centralizing this effort will not only ensure rapid responses to any market fluctuations but also keep your marketing, sales and operations teams working efficiently and in concert. Once you have embarked on this process you will find that Guerrilla InnovationSM typically focuses on changes to pricing, product mix, promotions and/or messaging. You can glean a number of lessons in each of these areas from companies that have successfully demonstrated strong customer engagement and a direct response to their customers’ evolving needs.

Pricing

Publicized shifts in product pricing can change the value perception and drive revenue gains

Sonic launched its first value menu in December 2008 in recognition that value-based options are driving incremental growth in the quick-service segment during the economic downturn. Traditionally,

Sonic has relied on an array of signature menu items and its brand strength to drive sales, but it has recently turned to strategic pricing to stem the tide of the recession. Sonic expects its EverydayValue Menu, which includes ten items priced under one dollar, to increase store traffic by providing broader options for budget-conscious customers.

Product Mix

Changing product mix to appeal to shifting consumer needs can drive sales growth

Family Dollar has evolved its product portfolio and shifted its in-store product mix to skew more heavily toward everyday necessities and consumables (e.g., food, detergents). The company also invested in equipment (coolers) to support increased food and beverage sales. Consumables now account for over 60% of sales and Family Dollar is reaping the benefits of this change in product mix.

Walmart recognized that private-label products mark some of the greatest opportunities in this recession, as consumers in the food and beverage category (and beyond) are showing great interest in trading down. Walmart has responded by relaunching its “Great Value” brand to increase the share of lower-priced private-label offerings in its stores, replacing slower-moving branded products.

Promotions

Launching time-sensitive promotions with perceived value can increase customer loyalty during the downturn

Kroger, Food Lion, and Albertson’s were quick to offer value-add promotions for cashing in economic stimulus checks.

In Kroger's case, customers could benefit from a value increase of 10% for immediate conversion of checks into Kroger gift cards. The benefits of this were twofold: Kroger captured 100% of the value of the stimulus checks and it strengthened its perception among consumers as being a value retailer.

Hyundai recently began offering consumers the ability to return a purchased car if they lost their jobs within a year. This promotion speaks directly to the finding that consumers were so worried about making payments that traditional rebates and incentives were not stimulating sales.

Dollar General also targeted consumers' anxiety over the economy by kicking off 2009 with its "Fresh Start New Year Sweepstakes." This promotion, which did not require purchase for eligibility,

included over \$180,000 in cash prizes, such as a \$100,000 grand prize to pay your mortgage and various other cash awards to pay car, credit card, and utility bills.

Messaging

Simple tweaks can make your marketing message align more closely with your customers' most immediate concerns

Staples recently shifted the message of its iconic "Easy Button" campaign. When the campaign launched in 2003, the "Easy Button" was created to demonstrate ease of shopping. Amid poor economic conditions, Staples' advertisements have been repositioned to convey that shopping at Staples makes it easy for consumers to save money, acknowledging the importance to consumers of savings over convenience.

Conclusion

Persuading reluctant customers to spend money during a downturn is challenging and will require your company to utilize new and unprecedented commercial tactics that speak directly to their evolving needs. Guerrilla InnovationSM is one way to identify and deploy these tactics through rapid learning, prototyping and adaptation. If you can successfully embark on a Guerrilla InnovationSM strategy, you should be able to find tactics that stimulate consumer behavior within a three-month period.

L.E.K. Consulting is a global management consulting firm that uses deep industry expertise and analytical rigor to help clients solve their most critical business problems. Founded more than 25 years ago, L.E.K. employs more than 900 professionals in 20 offices across Europe, the Americas and Asia-Pacific. L.E.K. advises and supports global companies that are leaders in their industries – including the largest private and public sector organizations, private equity firms and emerging entrepreneurial businesses. L.E.K. helps business leaders consistently make better decisions, deliver improved business performance and create greater shareholder returns. For more information, go to www.lek.com.

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