The Great Consumer Reset

Repositioning Your Business to Win in the Post-Recession Era

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Bridge Strategy Group LLC

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"The current global crisis is 'vastly worse' than the 1930s"

Nassim Nicholas Taleb
Scholar and Author
May 7, 2009

Every day brings another story of economic gloom: struggling consumers or insolvent companies. In the middle of the worst recession in over 60 years, what can companies do to avoid becoming another sad headline? How can they position themselves to emerge stronger in the post-recession environment? According to research and interviews conducted by Bridge Strategy Group over the past three months, the answer is: prepare for the rise of a new consumer.

After a long and prosperous cycle of growth and wealth creation, consumers are now in the middle of an economic storm of historical proportions. This downturn is more severe and sustained than past recessions and is accompanied by a serious crisis in consumer confidence. As economic commentators begin to indicate recovery, we must not confuse the end of the economic recession with a return to previous consumer behavior.

This economic shock has the potential to create fundamental and lasting changes in consumer attitudes and values. We are entering a new era of non-conspicuous consumption that will redefine "normal."

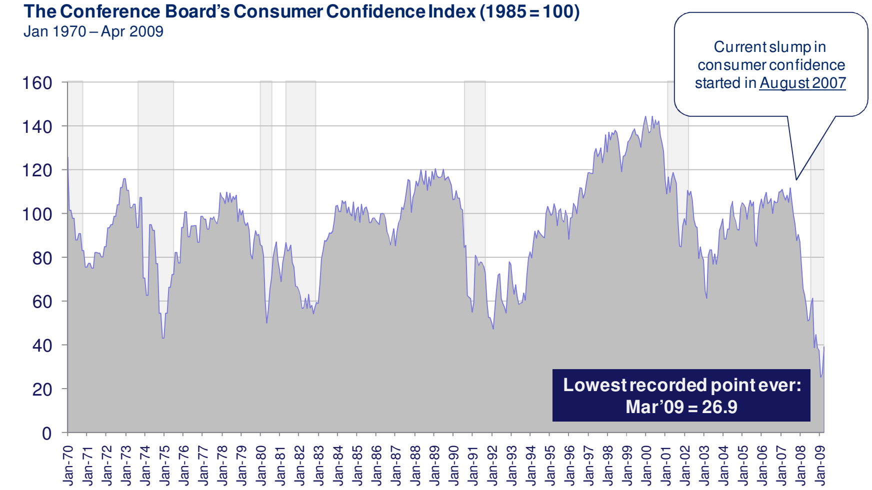
Consumer product manufacturing and retail executives must develop a clear understanding of the impact on consumers, carefully observing behavioral shifts that may become permanent. Permanent behavior shifts will have critical implications on consumer product organizations. Identifying these shifts and developing strategic responses earlier in the cycle will define winners and losers in the post-recession world.

Collectively, We Have Lost Over $10 Trillion of Our Wealth

Since the real estate market reached its peak around February 2006, consumers have witnessed a national economic and financial tailspin, which has already wiped out over $10 trillion in U.S. household wealth. The crisis has reached every corner of American financial life, from home values to 401-K and pension plans, and eliminated 22% of our collective net worth. It has precipitated unemployment rates that are the highest in 25 years and are expected to keep on rising.

Consumer confidence has suffered accordingly. Between August 2007 and February 2009, the Conference Board's Consumer Confidence Index dropped from over 110 points to a low of 25 points, the biggest retraction and lowest value in the index's recorded history. Consumer spending has not contracted as severely since the early 1980s, and the resilience of the spending reduction may be comparable only to that observed during the Great Depression.

The Conference Board's Consumer Confidence Index (1985 = 100)
Jan 1970 – Apr 2009



Source: The Conference Board Consumer Confidence Survey, March 2009
Note: Shaded areas represent periods of U.S. recession

"[…] increasing concerns about business conditions, employment and earnings have further sapped confidence and driven expectations to their lowest level ever."

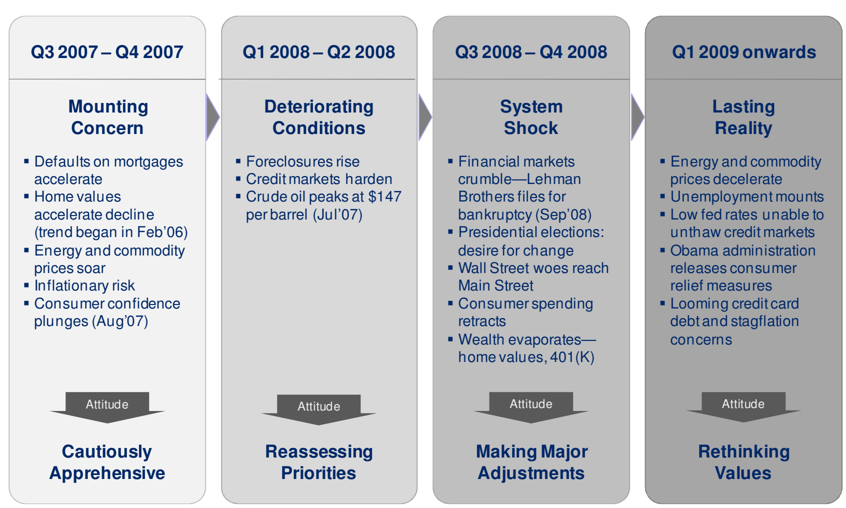
Lynn Franco
Director of Consumer Research
The Conference Board
February 24, 2009

CONSUMERS ARE CHANGING RITUALS AND RETHINKING VALUES

As conditions began to deteriorate rapidly in 2008, many consumers quickly reassessed priorities and made major adjustments to their purchasing behavior. They cut back severely on durable goods, while prioritizing spend on essentials categories. This has had a tremendous negative impact on mass merchants like Target.

Consumer rituals are also changing drastically. According to a recent survey of 1,000 consumers by Time Magazine , 56% are eating out less at non-fast food restaurants, 46% are going to fewer movies, and 20% have not filled a prescription because of the cost. Several similar studies confirm these changes throughout the population.

Consumer attitudes toward consumption have evolved with the deteriorating economic conditions



Source: Bridge Strategy Group LLC analysis

Heightened awareness of value and affordability is driving shoppers to experiment with and trade down to less expensive brands, and explains the recent spike in private label sales across product categories and retail formats. The longer this downward experimentation takes place, the less likely it will be that consumers return to previously favored brands.

Channel shifting is also evident, as more consumers are switching to the stores that they perceive as less expensive. Consequently, discounters and supercenters have gained share of grocery sales at the expense of mass merchants and specialty stores. In addition, as people cut back on driving, consumers are taking fewer shopping trips and shopping at stores closer to home.

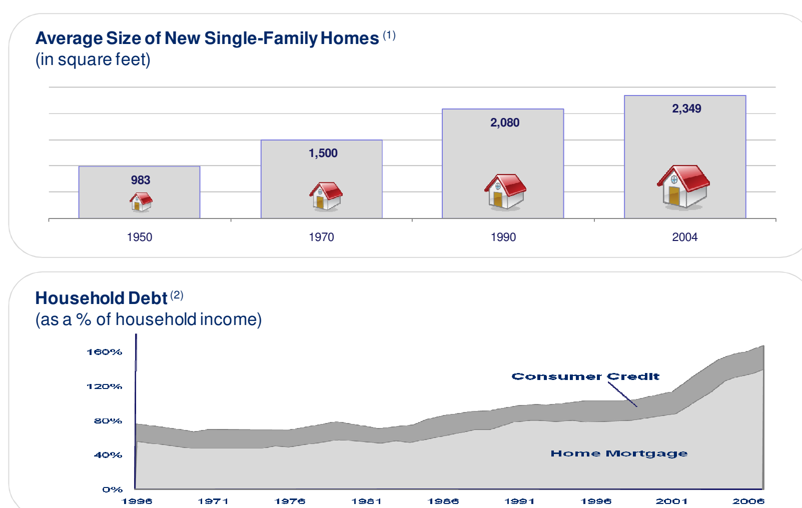
"The shopper is in crisis and is now focused on long term survival."

Thom Blischok
President
IRI Consulting & Innovation
December 12, 2008

This newfound frugality has affected consumers across the board. According to IRI, 50% of shoppers with annual household income above $100,000 even agree that price has become a more important consideration than convenience. These more affluent shoppers have demonstrated a measurable increase in price sensitivity, which suggests that even upper income consumers are attempting to extend their lifestyles at a lower cost.

A more fundamental question is: are any of the observable changes in consumer behavior and attitude going to become permanent? Are we witnessing an enduring shift in how we shop, buy and consume? We believe the answer is yes.

An emerging thesis suggests that we are entering an era of non-conspicuous consumption



Source: (1) National Association of Home Builders; (2) Federal Reserve

Targeting the "New Consumer"

We are entering a new era of non-conspicuous consumption. The "new consumer" will emerge from this economic cycle with different values and concerns than in the past. The recession has resulted in

"This economic crisis doesn't represent a cycle. It represents a reset."

Jeff Immelt
Chairman & CEO
General Electric
November 6, 2008

trade-offs that have forced consumers across income levels to reassess life priorities, rethink their attitudes towards consumption, and reevaluate fundamental values. Jeff Immelt, CEO of GE, has pithily summarized this shift: "This economic crisis doesn't represent a cycle. It represents a reset."

In addition to the economic downturn, two other forces are influencing and molding consumer values: environmental sustainability, and health and wellness. In combination, these forces are creating new approaches to lifestyle and community. This "new consumer" will live in an age where "less is more" and an emphasis on "quality" will replace a desire for "quantity." In this age, the pursuit of enjoyment, community, and fulfillment will supersede the quest for material success and professional achievement.

While the repercussions of these changes are not yet fully understood, they do provide enormous opportunity for companies to rethink and redirect their strategies in order to meet the emerging needs of the "new normal" consumer. Projecting how the shift in consumer values will impact your business is a task that should begin now.

For many organizations, avoiding insolvency by conserving cash and boosting liquidity is still the top priority; without a sound balance sheet and a robust cash flow position, any strategic initiatives are vulnerable to further market instability. For organizations whose market positions are painfully exposed as a result of the downturn, strengthening the core business is warranted in order to minimize share losses that may prove costly to recover.

However, for companies with a strong balance sheet and stable cash flows, this is a great time to position for growth. It is an environment rich in possibility and highly conducive to disruptive change. We have truly hit the "reset button," so basic customer loyalty is up for grabs.

In a market environment and competitive landscape that is likely to be fundamentally different from the past, we have been advising our clients to focus on five critical activities in order to prepare their organizations for the next phase of growth:

1. Know your consumer/shopper

This is definitely the time to develop superior consumer/shopper insights, and to consider the specific strategic implications for the organization: what segments to focus on, what channels/stores to prioritize, how go-to-market efforts should be organized, where resources should be allocated, and what organizational capabilities will be critical for success. This requires companies to go beyond the generalities of syndicated data and broad-based consumer surveys. In-depth customer/shopper knowledge will be critical for devising ways to target the "new consumer" with products and services that will meet their recession needs and post-recession values.

"There's evidence that there will be some good values coming free within the next year or two … We have a balance sheet and we're not afraid to use it."

Doug Conant
CEO
Campbell Soup Co.
February 19, 2009

2. **Understand the specific implications for your organization**
   With a clear, in-depth understanding of consumers/shoppers informed by original research, executives should ask themselves: Is our long-range strategy still valid? What aspects of our plan should be modified? Do we have the right portfolio of products and services to address changing market needs? Are we structured in a way that will allow us to respond most efficiently and effectively to market opportunities? Do we have the right resources and capabilities to succeed?

3. **Plan for the uncertain**
   Of course it is virtually impossible to predict with a reasonable level of accuracy how long the recession will last and how deep the downturn will take us. In the face of uncertainty, executives should model alternative scenarios and develop contingency plans in order to create an early and shared perspective on critical trigger points and alternative courses of action.

4. **Define the meaning and role of innovation**
   Empirical evidence shows that recessions are a great time to make customer-centric investments, particularly in innovation. In fact, many lasting product and service innovations have happened during recessionary times. Companies should think beyond vanilla product innovation and learn to incorporate partnerships and external networks. The external relationships create value-added differentiation by encouraging smart investment in areas where others may be cutting back.

Many lasting product and service innovations happened during recessionary times

1929-1933	• Snickers bar • Birds Eye frozen food • Montgomery Ward – Shop by phone • Miracle Whip – low cost mayonnaise • Fortune magazine
1973-1975	• Stove Top dressing • McDonalds Quarter Pounder • Starbucks • IRA's and discount brokers • People magazine
1980-1982	• Generic brands • Diet Coke • Loyalty Marketing – American Airlines • IBM PC into the office • CNN, Cinemax, Weather Channel

Source: AdvertisingAge, "Downtime Opportunity", December 2008

5. **Leverage the power of your balance sheet strategically and opportunistically**
   Organizations with the right vision and sense of direction can make strategic and opportunistic investments, taking advantage of depreciated asset values in order to obtain greater scale, increase market coverage, diversify their portfolio, and/or acquire valuable assets and capabilities.

The economic downturn has certainly created a challenging and environment for consumer product companies. It is also an opportune time to recalibrate brands and product assortment in order to capture the attention of the post-recession consumer.

BRIDGE STRATEGY GROUP LLC

Bridge Strategy Group is an experience-led general management consultancy committed to helping our clients rapidly improve their business performance.

For more information, please contact us at 312-357-6740 or visit us at: www.bridgestrategy.com