

## **The hard sell**

*Jena McGregor*

*How retailers are fighting for the hearts and minds of the new consumer.*

By U.S. consumers at nearly every income level and spending stratum have pulled back over the past year, trading down from department stores to discounters or delaying purchases altogether. According to one poll, 60% of Americans say they're wearing clothes several times between washes to cut cleaning costs. And 72% say they now haggle before they buy some items, up from 56% two years ago, says C. Britt Beemer, chairman of America's Research Group.

That frugality has retailers running scared as they near the all-important holiday season. Even if the economy picks up, some retail veterans think it could be 10 to 15 years before pre-bubble abundance returns. "They're looking at a new era," says Allen Questrom, a former CEO of J.C. Penney (JCP), Barneys, and Neiman Marcus who is now an adviser at Lee Equity Partners.

So smart retailers are starting to rethink their approach. Instead of just slashing stock levels, slowing expansion, and discounting deeply, they're getting creative about managing inventory, adjusting product lines, and dumping their addiction to promotional pricing. A few risk-takers are even adding stores or raising prices. Over the coming weeks they will find out whether those initiatives will set them up to thrive during another tough season—or at least survive. Here are a few strategies they're using in this year's brutal sales battle:

**Creating Scarcity:** One of the biggest changes shoppers may notice this holiday season won't come on their first trip to the mall but their second. That size 6 sweater you were going to buy for your sister? It may be out of stock. "Retailers are not overcommitting on anything," says retail consultant Walter Loeb. "They can't afford to take the chance."

CEOs such as Myron E. Ullman III at J.C. Penney remember last year's pain all too well. "They didn't have to use the heart paddles on me, but it was a jolt," he says, recalling how the Plano (Tex.) chain missed last year's sales projections by \$2 billion. This year he's holding back about 60% of inventory—both finished products and fabric—in warehouses, far more than the 20% held back last year, says Deborah Weinswig, a retail analyst at Citigroup (C). She calls Penney's efforts particularly sophisticated and aggressive. With more in warehouses, goods can be sent quickly to stores in need or cut into apparel styles that are selling well, avoiding the pile-ups that lead to heavy discounting or the empty shelves that result in lost sales.

Gap (GPS), too, heightened its focus on inventory management as it introduced a redesigned jeans line this fall, an ambitious effort to offer premium denim for \$60 to customers used to paying up to \$250 for boutique and department-store jeans. The line—which includes six women's styles, two to four "washes" (or shades), and six men's styles—meant rolling out a vast array of choices without knowing what would sell. So Gap North America President Marka Hansen and her team sought fabric that could be dyed into any of the shades and cut more of the denim after seeing which jeans sold best. Says Hansen: "We wanted to leave ourselves as much flexibility as humanly possible in reacting to what the customer voted for."

**Kicking the Discount Habit:** Retailers sideswiped by the recession last fall were left with little choice but to slash prices or cope with excess inventory. "There really was a bloodbath of markdowns and such an erosion of margins that it has created scar tissue" for executives, says Arnold Aronson, managing director of retail strategies at Kurt Salmon Associates and a former Saks Fifth Avenue (SKS) chief executive.

Instead of just holding sales, Container Store CEO Kip Tindell moved this summer to permanently cut prices on a tenth of the chain's entire stock by an average of 16%. The lower prices, he hopes, will keep customers buying even when big sales aren't being pushed. But Tindell still anticipates the need for promotions. "Next year we're going to have to wean ourselves," he admits. "I don't know how we're going to do it."

Saks has also made moves that are leading to lower average prices. While the luxury chain's brand is still built on high-end merchandise, it's boosting its mid- and entry-level offerings, resulting in average prices that are down approximately 10%, says Citi's Weinswig. Saks CEO Steve Sadove says designers were initially hesitant to create more lower-priced goods. "The vendor community [in Europe] perceived this as very much an American problem." But now everyone from Gucci to Prada is using different fabrics and embellishments to lower costs. "The world has changed," he says.

Even promotions are different. Retailers are making them more targeted. Neiman Marcus' "Midday Dash" sales, launched this summer, lure customers via e-mails or Facebook alerts about deep discounts on select items. They are only available online for a two- to three-hour window, such as during the NFL Monday Night Football debut, when fashionistas might have extra time on their hands. The promotion follows the launch of popular luxury sites such as Gilt.com, which operate like invite-only online sample sales, selling goods for a 36-hour window at steep discounts. Neiman CFO James E. Skinner won't reveal sales data but says results have been better than expected. The recession, he says, "is forcing us to experiment."

**Simplicity and One-Stop Shopping:** Having the right array of products is critical in a world where stealing market share is crucial to growth. Neil Stern, a partner at retail consultant McMillan Doolittle, predicts that consumers will limit temptation by shopping under one roof. So chains are moving into new product categories.

Sears added permanent toy departments to 20 of its stores in August for the first time since the mid-1990s. While the chain has set up seasonal toy sections in the past, the permanent area is intended to bring back a recession-proof staple. Meanwhile, this year Best Buy (BBY) tried out new categories such as patio furniture and electric scooters and is testing the sale of used video games in about 40 stores. "We've learned over time that our brand can go into more places than it used to," says Barry Judge, Best Buy's chief marketing officer, who speculates that one day the chain could "eventually end up [selling] electric cars."

While some retailers are broadening their offerings, others are dumping fringe products to help make store operations more efficient. Home Depot (HD) has cut back on styles of paintbrushes, grills, and even outdoor holiday products such as artificial Christmas trees and blow-up snowmen. Walgreen (WAG) and Kroger (KR) have done the same, taking a page from Costco (COST) and Trader Joe's, where more selective product lines have helped the chains thrive.

**Going Against the Grain:** Risk-taking hasn't been a part of most merchants' strategies over the past year, and it isn't hard to see why. "Retailers live by daily sales, which tends to drive a mindset of living in the present," says Madison Riley, a senior partner at Kurt Salmon. But a few opportunists are pushing forward as others pull back. In an effort to reap higher margins and interact directly with customers, wholesaler VF Corp. (VFC) is opening more of its own outlets. By 2012 the owner of such brands as North Face and Seven for All Mankind plans to get 22% of sales from its own stores, up from 16% last year. Competitors such as Jones Apparel Group (JNY), meanwhile, are closing stores. VF CEO Eric C. Wiseman says he does not expect a big recovery. But if it happens, "we'll be in a position to chase demand."

Furniture emporium Restoration Hardware also is taking risks. Instead of slashing prices, CEO Gary Friedman has hired artisans to take his furniture even more upscale. "If you're going to battle with the same goods you did in the last economy, you're probably going to lose," he says.

Friedman's idea, hatched after the crisis hit, has led him around the world four times in five months seeking unique designs while cramming product development into six months. The collection's debut this fall includes a \$2,995 Italian chandelier and a \$1,295 coffee table. "Am I nervous? Absolutely," he concedes. But he's willing to make the bet. "It's not what happens to you that matters. It's how you respond to it."

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