

November 2008

# Retail Trading Strategies

*Strategies during Tough Times*



# Retail Trading Strategies

## *Strategies during Tough Times*

Although the economy has yet to be officially in recession, (defined as two consecutive quarters of negative GDP) the majority of Australians believe this is almost inevitable. At the very least, we have a sense of those industry sectors that are displaying recessionary indicators and the retail sector is at the forefront of these trends. Recent retail store closings and growing vacant retail space are clear signs that the sector is in for some tough times.

In the Kimberley region of Western Australia, the retail sector is estimated to be valued at around \$345m<sup>1</sup> and employs 1,104 people (representing 8.6% of the Kimberley workforce<sup>2</sup>). This ratio is marginally higher in Broome, where the retail sector employs 10.76% of the employed population.

This paper has been prepared with the intention of taking account of lessons learnt over times of previous economic downturns. It is not intended to be alarmist but rather provide retailers with some alternative strategies to deal with a changing economic environment.

## Consumer Behaviour

---

The basic economic concept of consumption smoothing<sup>3</sup> can help to understand what we might expect in the developing economic climate. Consumption smoothing refers to how individuals behave to maintain a certain standard of living. All things being constant, this means that individuals will use savings to compensate at times when income is low but save when incomes are high, therefore “smoothing” their consumption patterns to achieve a balance. This doesn’t suggest that spending increases or decreases with changes in income but rather that the peaks and troughs will be less dramatic. The theory suggests that consumers won’t spend a dollar less with each reduced dollar earned or vica versa. Evidence of this is clear when we look at credit card debt and the increase in this debt during tough times. As much of an individual’s expenditure (consumption) is

---

<sup>1</sup> Source: Department of Local Government and Regional Development

<sup>2</sup> Source: ABS 2006 Census

<sup>3</sup> An economic concept which refers to balancing out spending and saving to attain and maintain the highest possible living standard

fixed and doesn't vary with income, shortfalls are made up by dipping into savings or increasing personal credit card debt to maintain living standards.

While consumption smoothing explains individual choices for saving and spending, it does not explain the consumer decision making process. During times of economic downturn, consumers are often forced to make tough decisions which involve tradeoffs. Often this is apparent through substitution or "trading down". Trading down is also a type of consumption smoothing where a house brand may be purchased versus a national branded product, allowing consumption to be maintained at a lower quality and cost. Trading down is not just about substitution but consumers actively look for other places to shop or eat.

In light of consumer behaviour there are some clear strategies that retailers can adopt.

### Managing Inventory

1. During tough times, retailers must focus on liquidity over profits and margins
2. Retailers need to analyze inventory and determine must have products and then actively reduce the stock of non-essential stock
3. Retailers need to set limits for ordering new stock and plan for its management, presentation and selling strategy
4. Retailers must try to have as many months of cash reserves as possible that will pay basic expenses such as rent, utilities and wages. Cashflow is the key to surviving times of trading downturn

### Managing Costs

1. The objective for retailers from clothing to restaurants is common in that it is to generate profits and with rising input costs, there is a natural inclination to increase retail costs accordingly. However, retailers need to be clear on the price elasticity of a particular product or service.<sup>4</sup>
2. Developing pricing strategies during tough times based on elasticity makes good business sense. Examples of inelastic products are petrol and water where there are no good substitutes. Examples of highly elastic products are eating out, new cars and clothing and groceries

---

<sup>4</sup> Price Elasticity describes how strong the response of the consumer is in the quantity demanded of a product or service when the price changes

3. The lesson for retailers is not to raise the price on those goods or services that your customer could live without or find a less expensive substitute
4. Think about the choices your customers might/could make and develop pricing strategies accordingly

### Managing Employment Costs

1. As input costs increase and structural rigidities affect a retailer's ability to maximize income, labour costs becomes an obvious path to reduce costs. These are tough decisions.
2. There are many options available before laying off staff and all should be considered as any downturn is short term and trained staff will again be required. (eg Fewer staff per shift, reduced hours by reducing trading hours)

### Eight Principles for Retailers

---

1. Just like consumers shouldn't use debt to finance purchases, nor should retailers. Financing stock through debt because it is being offered at a discount price does not pay off in the long term
2. Offer consumers substitutes at lower price points. Lower price point options or substitutes will keep customers in your store or restaurant
3. Be aggressive about moving inventory and offer specials or discounts where necessary. These economic downturns don't last forever but retailers need to keep customers in their store or restaurant and build that long term loyalty. You might not be making the profits you would like but you are making sales and building customer relationships
4. Don't assume that raising prices will keep your revenue stream stable. Price elasticity of products you sell will determine whether or not you can increase prices. You can't raise price on goods that have high elasticity as this will reduce demand
5. Be obsessive about your stock/inventory. Keep detailed records of what you sell most, at what price and to who. Pay close attention to competitor activity and their pricing strategies
6. Look at low to no cost options to reinvigorate your retail space. This might be as simple as changing the layout
7. Be prepared to make tough decisions. Be clear on where you want to be after the down time turns and work towards that strategy
8. Listen to your customers. They are still your single greatest asset