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THE RETAIL: NEXT STUDIES

A series of research studies analyzing emerging trends in retailing.



Retail Formats in Transition

EXECUTIVE SUMMARY

February, 2009

This survey, conducted in Nov/Dec, 2008, captures industry opinion on the future of retail formats.

Retailers, manufacturers and other industry observers were asked to weigh in on which retail formats will prosper over the next five years – and why.

INTRODUCTION: Clouds on the Horizon

When we set out to develop the **RETAIL:NEXT** study in the third quarter of 2008, many of the economic warning signs were already on the horizon. But the fallout for consumer spending and retail sales hit in earnest in the fourth quarter. This first survey of the joint RetailWire, Dechert-Hampe series, was conducted during a three-week period in November when the economic turmoil and election excitement was in full swing. We asked the RetailWire community and other industry participants to pick the “winners and losers” among various retail formats over the next five years and to identify the factors that would drive that outcome. Considering the items most had on their plate that month - and in the midst of one of the worst holiday seasons in memory, to boot - we thought the level-headedness of the responses we received was noteworthy.

Where You Won't Shop in 2009
– Forbes.com, January 21, 2009

“While industry executives and shoppers will remember 2008 as the year the party ended, figure 2009 to be the year of the hangover. Already, Circuit City, Linens ‘N Things and Mervyns stores are going away...”

Now in the first quarter of 2009 as we write this, we have some idea of how things are going to go this year. Several major retailers have already exited the scene and others are rumored to be on the way out. Even more are closing stores and consolidating banners to ride out the storm. But there is optimism as well reflected in numerous areas of our study results. For example, some formats are predicted to experience strong growth. And half of the survey respondents expect “modest or better growth” in overall retail sales over the next five years.

There's much to learn from the data we collected and, in this Executive Summary, we've worked to extract insights that will help you with your business planning. Overall, we're impressed by the upbeat attitudes and unflagging enterprising spirit shown by these members of the retailing community. We hope you'll see it that way too.

Some Survey Demographics and Notes

- This survey was fielded in November/December, 2008 by Dechert-Hampe Consulting. This is an internet survey covering the RetailWire community and other industry participants.
- The survey results are a composite of 228 total responses. The respondent population breaks down as:
 - 32% Manufacturer/Vendor
 - 24% Retailer/Wholesaler
 - 31% Services/Research/Consultant
 - 13% Agency/Other
- This is an opinion survey of industry observers and participants. No consumers were interviewed and the survey does not purport to predict actual consumer behavior. While the survey sample is sizeable, no tests of statistical significance were employed in reporting the results and the results should not be construed as business advice or guidance by RetailWire or Dechert-Hampe Consulting.

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- **Winning formats will not focus on “what to sell” so much as “how to sell it.”**

Traditional product-focused attributes of retailing are expected to take a back seat to how – and where – the shopping experience is offered. For example, “stocking national brands” and “broad assortment within category” fall in the “much less important” tier of format attributes.

- **Winning formats will focus on consumer groups – not product groups.**

Targeting consumer groups, such as seniors, teens and ethnic, is predicted to be a format winner. Existing “category killers” are expected to continue their recent declines. And category specific formats (such as cookware stores) are not expected to be a driver of future success.

- **Unique formats will prosper – multiple chains within a format will not.**

Respondents overwhelmingly predicted continued fallout in the number of chains that can exist within a given format. But they also expect the number of unique retail formats to grow over the next five years. Much as Whole Foods and Trader Joe’s have developed as icons synonymous with organics and the treasure hunt, successful chains will own their own unique concept.

- **The current economy is having an undeniable impact on retailing, and the search for value will not go away as a retail driver – but its importance will be trumped by other attributes of the consumer’s shopping experience.**

The importance of the economic environment on shopper behavior is apparent in these results. A third of respondents said “economic trends” would be the major source of successful new retail formats. But over half said “changing consumer habits” would trump the economy as a key driver. The single highest rated factor in importance to the future of current formats was “value for the money” – but the next six are all related to the consumer experience. Looking forward, the “search for value” continues to be a top rated consumer trend – but it is joined by the “aging of Baby Boomers” and “health/wellness issues” as “extremely important”.

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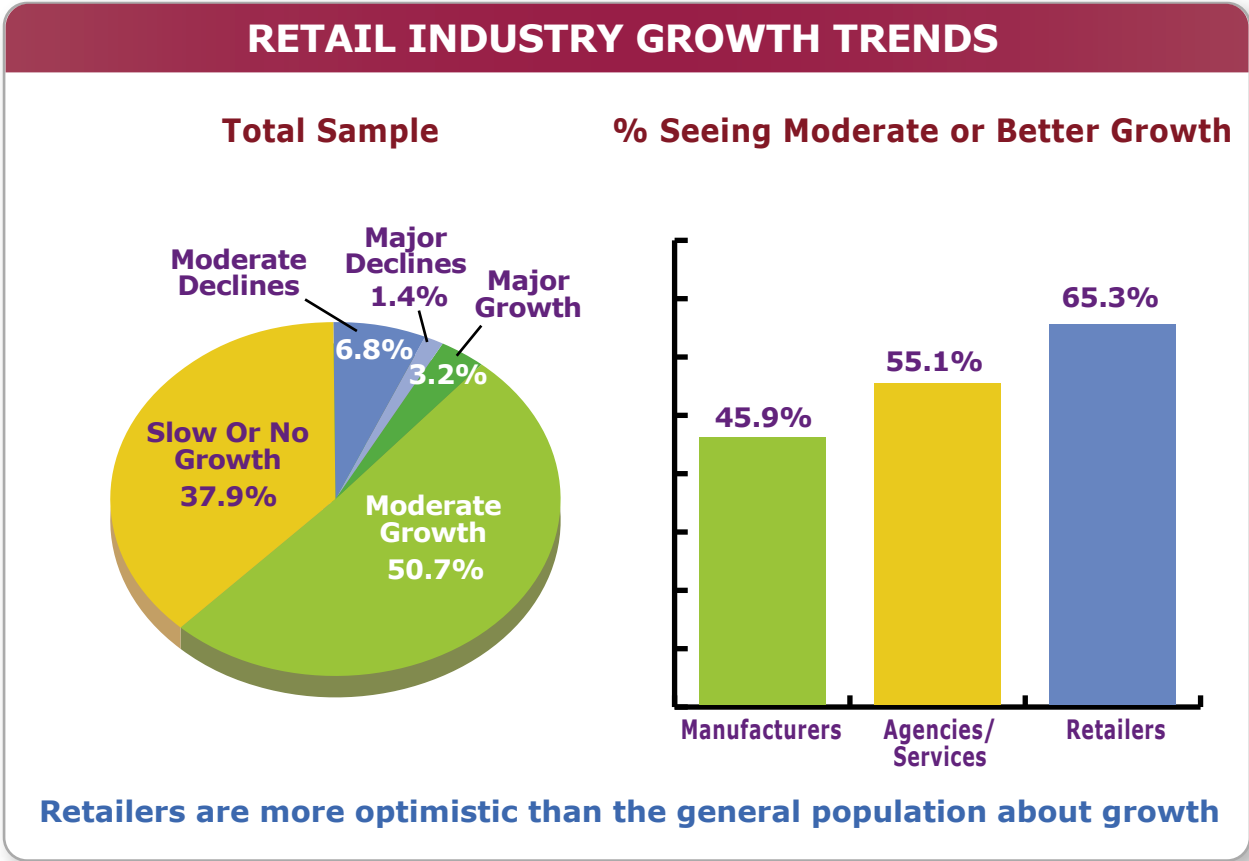
1 There is some hope for growth.

As a group, just over half (54%) of all respondents think the retail industry will experience “modest or better growth” over the next five years. Another 38% of respondents feel we will see “slow or no growth” and 8% are pessimistic enough to predict we will see retail sales retrench.

Interestingly enough, retailers themselves are the most optimistic group with over 65% confident that the industry can generate growth. Only 45% of manufacturers feel that way however, and the agencies/services group (aka “other interested industry observers” or “the pundits”) were in the middle with 55% expecting growth in overall retail sales.

Clearly, there is cause for concern in the fact that almost half of the survey respondents see no growth. And they made these predictions without the benefit of knowing how ‘08 holiday sales would shake out. We now know the NRF is reporting 2008 holiday sales down 2.8%. And the Forbes.com piece quoted above warns “...More pain is on the way...”.

But five years is an eternity in today’s volatile cycles of commodity price swings and financial surprises. We believe our respondents’ slight tilt toward guarded optimism over such a long time frame is credible enough. Let’s hope they are right.



2 The winners will be innovators.

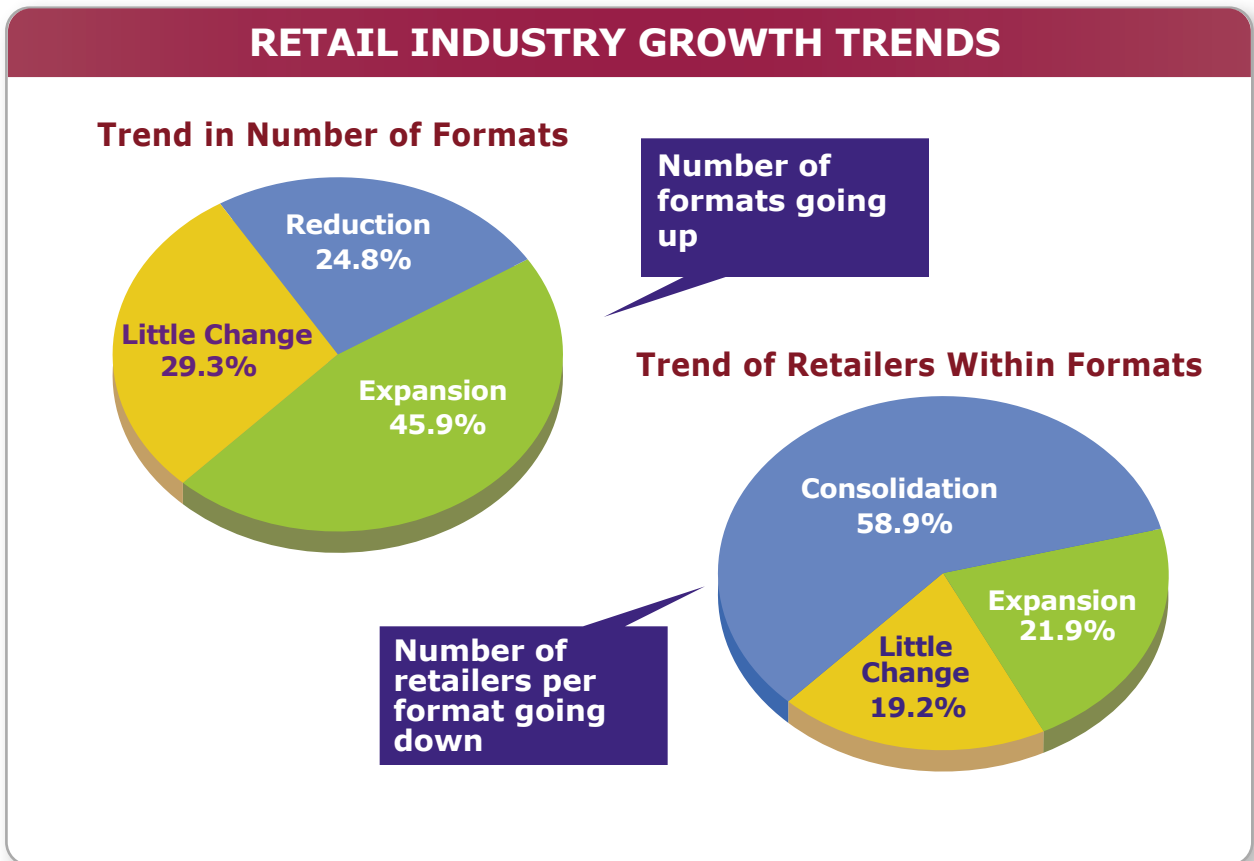
Successful retailers will be those who create new and different formats. Retailers who do not have a point of difference will continue to die. That is the clear implication of respondents' reaction to our two part question on format expansion and retailer contraction.

The number of different retail formats we see will grow over the next five years. That's the feeling of 46% of survey respondents. Only 25% see the number of formats contracting.

But the sentiment regarding the number of

different retailers who will survive within a given format was even stronger. Fifty-nine percent of the sample said we will see contraction in that number, with weaker retailers and those with undifferentiated stores falling by the wayside.

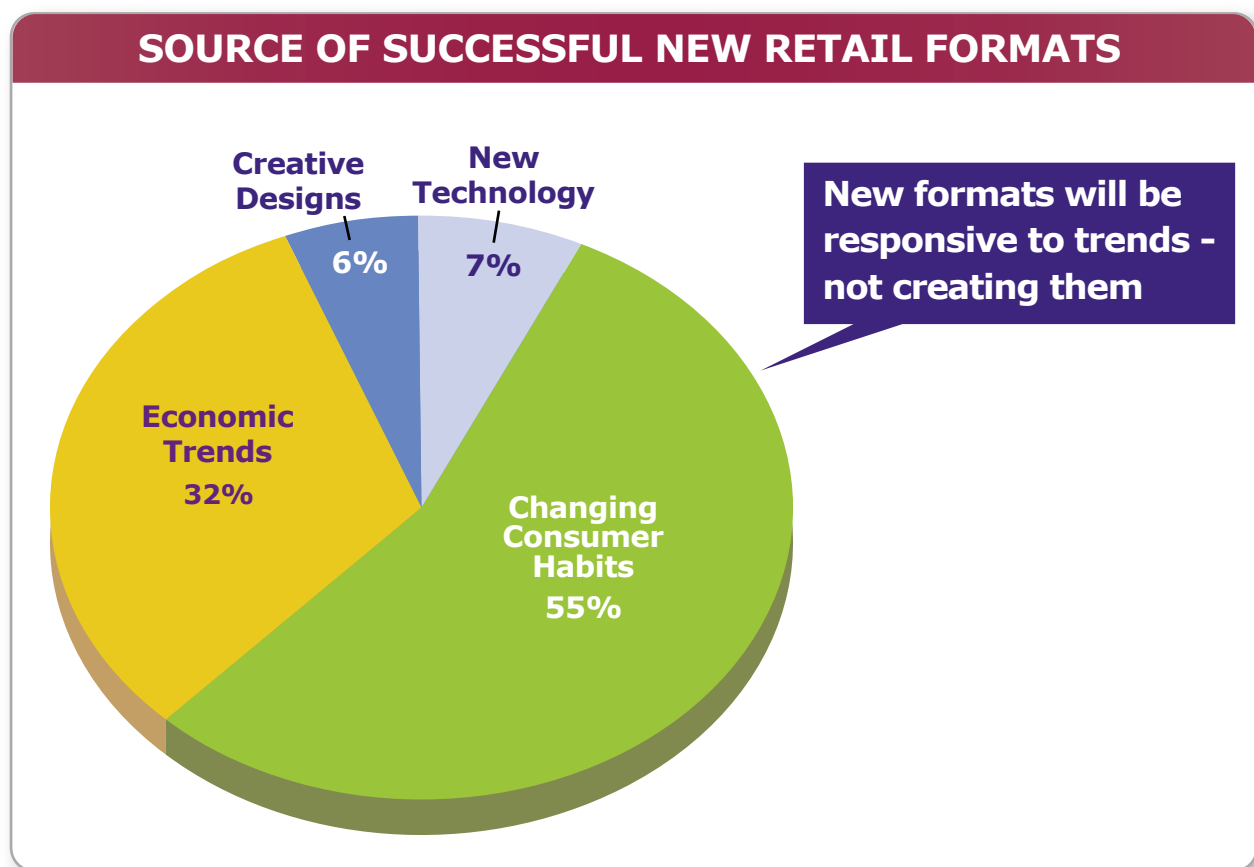
This seems like a safe bet, as we have seen that happen already in saturated formats like grocery and drug. Merger and acquisition activity – along with outright closings -- have taken chains like Eckerd, Long's and Albertson's (as we knew it) off the retail map.



3 Consumers will drive change.

We often talk about “driving change” in retailing with new technologies and creative store design. But this group of industry experts feels these efforts are of little consequence

in a vacuum. Instead, the innovation that has impact is that which recognizes and addresses changing consumer habits – not that which tries to shape them.



Not surprisingly given the current recession, economic trends will be a big influence on the success of new formats as well. Of course, these two factors are difficult to separate in the current environment. As we drill down on this subject it becomes apparent

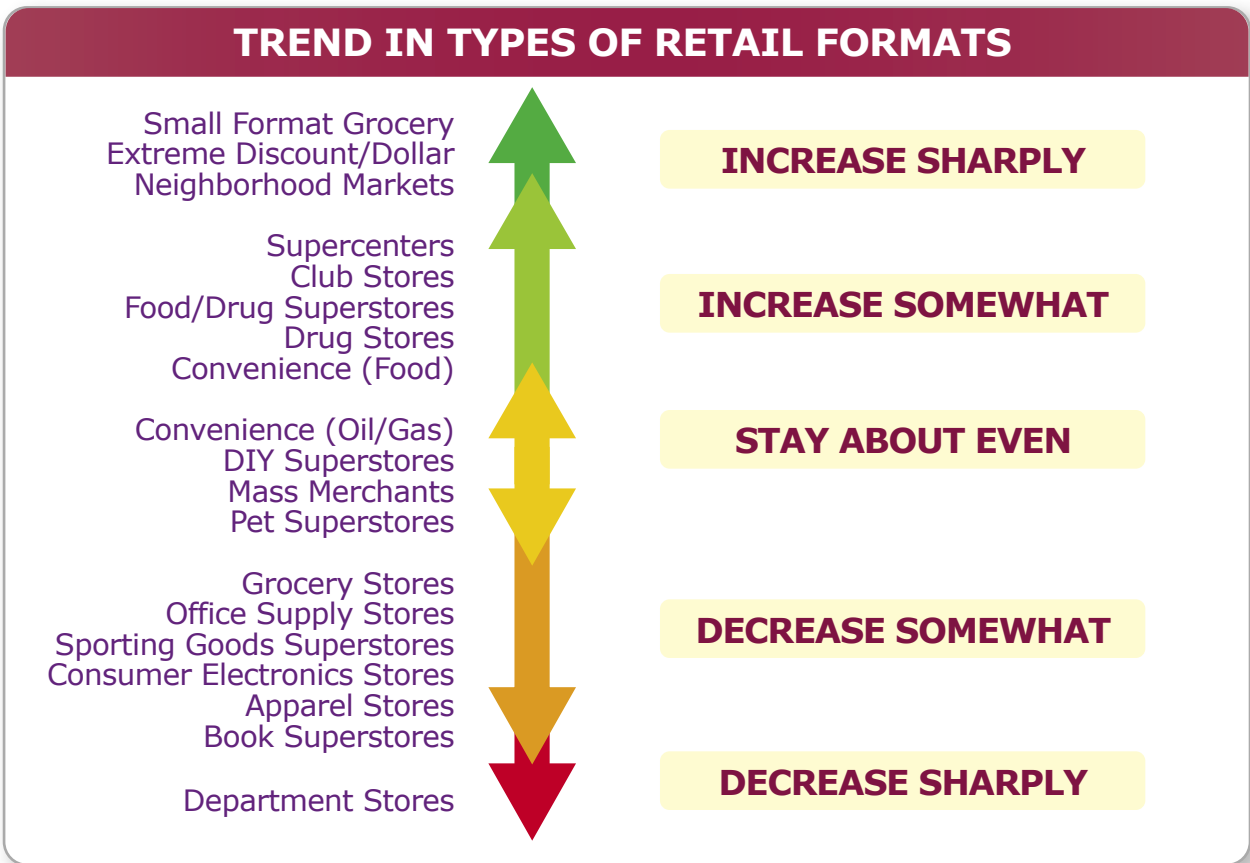
respondents feel that the economy is going to be a key factor in format success over the next few years – but not the only factor. And in many cases other consumer trends will trump economic concerns in driving where consumers choose to shop.

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4 Small format grocery and dollar stores will be big winners.

For the foreseeable future, department stores will be the big loser and, in short, what is winning today will continue to win. Not a horribly bold prediction – but that is what we seem to think as a group. The

convenience and ease of shopping afforded by neighborhood markets and other small format grocery is predicted to have continued appeal to consumers. And we believe the current economy has breathed renewed life



into the extreme discount/dollar store format. Both very reasonable predictions given what we were seeing in Q4 of 2008.

Other formats predicted to prosper are supercenters, club stores, food/drug combo stores, drug stores and convenience stores

focused on food and food service. Interestingly, most of these formats embody some form of convenience and value. The supercenters, club and food/drug superstores offer “one-stop shopping”, with the supercenters and club adding price/value to the offering. Drug stores are the original “high penetration”

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format – seemingly offering consumers shopping opportunities from every busy urban and suburban corner in America. And c-stores that focus on food/food service instead of oil/gas are generally in high traffic urban locations as well.

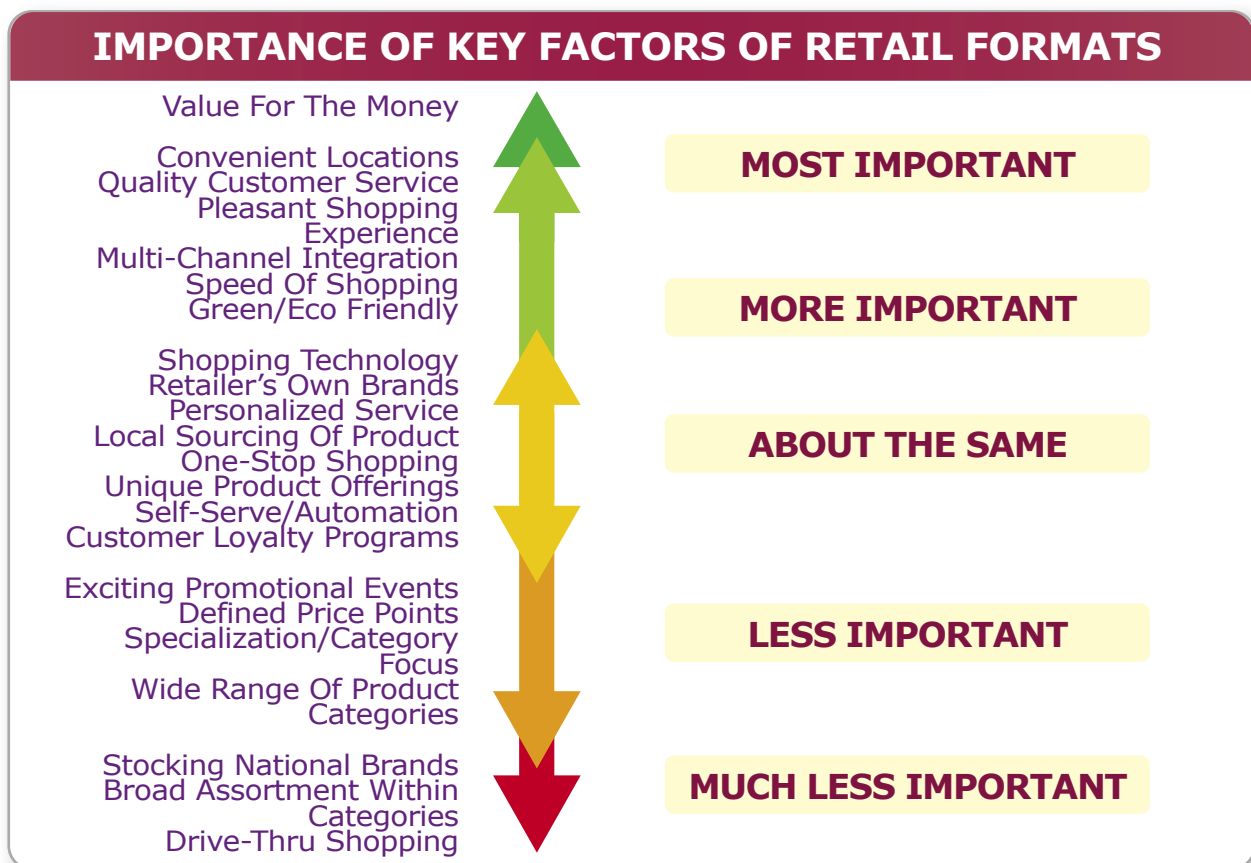
Our respondents definitely expect the decline of the department store to accelerate. This format, originally damaged by fading

relevance and perceived high prices, has been further injured – perhaps fatally – by the failing economy and falling foot traffic at suburban malls. The rollup of many of the grand old names by Macy’s is just one example of weakness in department stores in general. The well-chronicled woe of Sears Holdings is another. And the recently announced Mervyns exit is widely expected to be a sign of things to come.

5 The importance of “value for the money” will not go away.

Survey respondents made “value for the money” the single highest rated factor in driving the success of retail formats in the future – not a surprise in the current

environment of course; but, the importance of “stocking national brands” may be. We think it is very telling that the next six attributes, all rated as “more important”, are related to



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an enhanced shopper experience.

Certainly there is a logical tie between respondents' choice of the extreme value/dollar format as a winner and the selection of "value for the money" as a key factor in future format success. But the parallel correlation of also choosing small format grocery/neighborhood markets as a winning format and attributes like "convenient locations", "quality customer service", "pleasant shopping experience" and "speed of shopping" is equally strong.

Other influential attributes include "multi-channel integration", a factor closely allied with convenient shopping, and "green/eco-friendly". This group does not feel that consumers are going to abandon their quest for greener living just because the economy is bad.

The biggest news in our question on what attributes will drive future retail format success may well be in what respondents predicted will NOT be important – like "stocking national brands" and having a "broad assortment within categories". Respondents placed these attributes in the

"much less important" tier, along with "drive-thru shopping". This is certainly not good news for national brand manufacturers.

Rated as "less important" were traditional retailing standbys such as "exciting promotional events" and, for some extreme value retailers, "defined price points". The message here seems to be that consumers' definition of "value" going forward will consist of more than hot promotional pricing and price point gimmicks. Instead the more holistic definition of "value" including price, quality, service and utility is what consumers will be looking for.

Survey respondents seem to have mixed emotions about the importance of product mix to future format success. They don't think a "specialized category focus" is a guaranteed winner, but neither do they think handling a "wide range of product categories" is the path to glory. If we look at this question in the context of the overall survey – the theme seems to be "it won't be so much what you sell as how – and where – you sell it."

6 We are very focused on the aging Boomers and their health.

But we are not at all worried about slow or no population growth, overall. As expected, we also find, in the recurring theme of the survey, that the "search for value" is going to be an extremely important consumer trend over the next five years.

And, as in other survey questions, all of the other consumer trends expected to have greater than average importance are long term trends like "aging of Baby Boomers",

"health/wellness issues", "convenience/time starved families" and "growth of the Hispanic population".

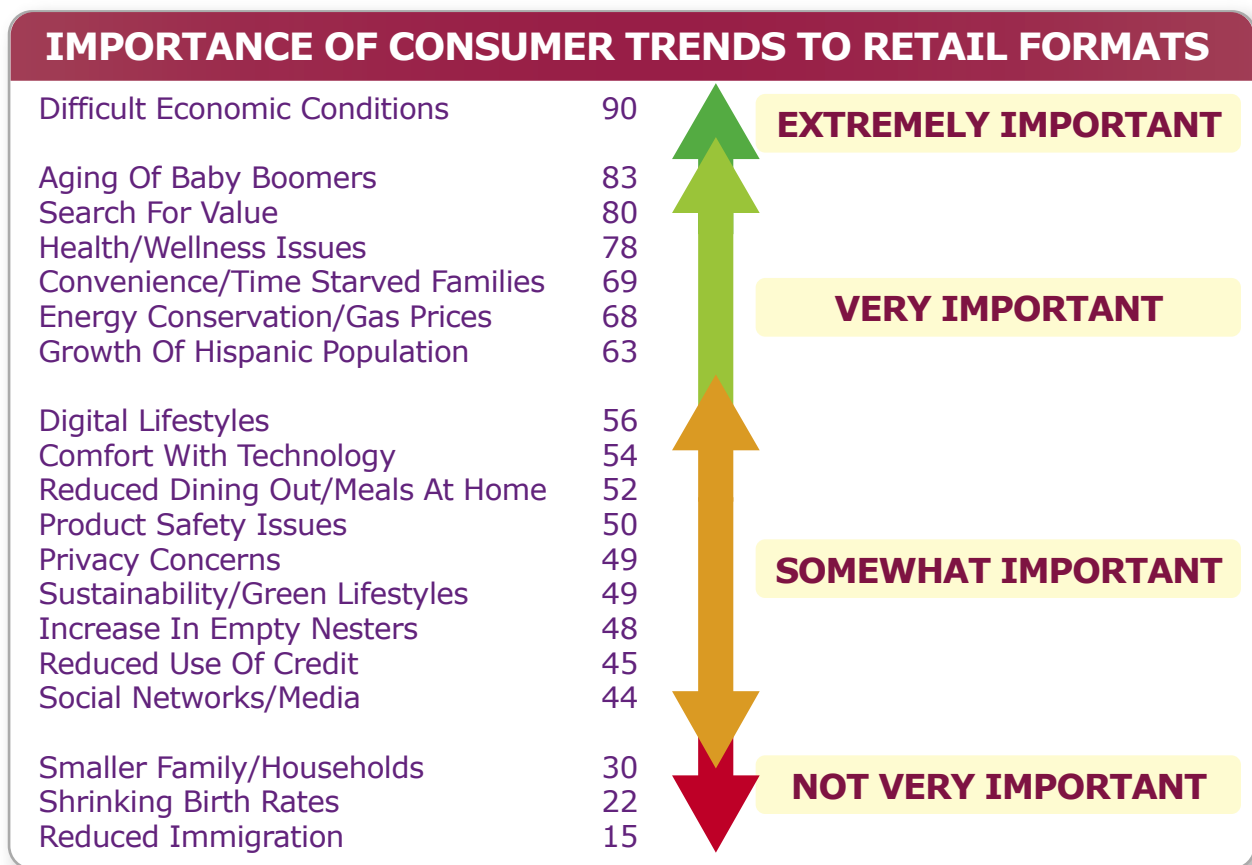
The last trend making the top tiers, "energy conservation/gas prices", is difficult to interpret as it could be either a long-term environmental issue or a reaction to oil prices and economic conditions in Q3/Q4 of 2008. We suspect it to be more of the latter, however.

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Slow or no population growth is of little consequence to the future of formats according to this group, regardless of the source. Evidently the growth in the Hispanic population cited as “very important” is not assumed to be coming from immigration, as “reduced immigration” was the lowest rated

factor on the list.

Similarly, “shrinking birth rates and smaller family/households” are of little concern – even though they would seem to be a favorable trend for the smaller format stores predicted to prosper.



At first blush, the respondents’ dismissal of population as an important factor is surprising. Especially in light of conventional economic wisdom that population growth is a key driver of the overall economy.

One plausible interpretation of these results is that absolute population may well impact total sales growth – but that it has little impact on which formats will capture the growth there is to be had.

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7 When asked to forecast the future, the importance of the consumer experience leaps to the fore.

In contrast, the current economic woes seem to fade in importance. Respondents continue to favor “quick/fresh stores” like Tesco’s Fresh & Easy and Wal-Mart’s Marketside concept. Clearly, they do not expect consumers’ interest in freshness and convenience to dissipate any time soon.

Also predicted to fall in the “most successful” camp for retail concepts are “experiential stores” such as the Apple Store. This is very much in keeping with other survey results predicting an enhanced consumer experience to be the key to new format and concept success.



Respondents followed the theme of “consumer experience” as they selected other retail concepts destined for success. “Mission focused stores” – most notably those designed

to address consumers’ “quick trip” needs ranked highly. This is very much in keeping with the importance placed on convenience throughout the survey.

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Consumer-centric concepts (Best Buy as a cited example) also ranked highly.

One consistent theme is that concepts focused on the consumer – or consumer segments – are favored to do well while concepts focused on the category are not.

Concepts targeting ethnic groups (Black, Hispanic), age groups (seniors, teens) and lifestyles (Outdoor World) are predicted to be winners while concepts targeting category

specialties (Cookware, Party Stores) are near the bottom of the list.

Concepts driven by technological innovation are not expected to do well either. The consumer's quest for convenience notwithstanding, this group had little good to say about pop-up stores, automated merchandisers, virtual stores or drive-thru stores. And in case we hadn't gotten the message already, malls are dead – even "extreme malls".

It's a lot to take in, but here's our best "high altitude view" interpretation.

Consumers make retail format choices based on a complex set of interrelated attributes or "utilities". The relative importance of any one of these utilities is influenced by the environment the consumer is presented with on any given shopping occasion. Some of these environmental factors are quite compelling – but also quite temporal. "I'm hungry"; "I'm in a hurry" and "It is easier to reenter the highway from this corner" are examples. Other environmental factors are much more global and enduring. "Aging population"; "sustainability" and ethnic population shifts all have a lasting impact on who we are and how we shop. "The economy" is tougher to categorize as an influence on shopper behavior – particularly as it relates to choosing one format over the other. It certainly has a big influence in times like these. But it also tends to take a back seat to the more stable trends like aging and health over the longer term.

In response to this set of utilities and environmental factors, retailers offer shopping formats and manufacturers offer brands. Typically both groups strive to satisfy the broadest possible set of utilities and environmental factors possible in order to attract the most traffic and sell the most products. But consumers may demand a different posture going forward.

Our survey respondents certainly seem to feel that "who you are selling to and how" is going to trump "what you are selling" in the future. This means formats like "the teen store" or "the senior store" might make more sense than "the shoe store". Even if we don't get that far down this road in our survey horizon of the next five years, we expect to see movement in that direction. Some of the nearer-in manifestations might be a reduction of variety and assortment within categories. And the respondents clearly feel that stocking national brands is going to take a step back in importance to format success.

Another manifestation of these trends is that "me-too" retailers within a format are quickly losing their reason for being. Regardless of what attribute or set of attributes a retailer embodies, it needs to be a unique concept – and the retailer needs to own that concept in shoppers' minds.

- Aldi = Limited Assortment
- Trader Joe's = Treasure Hunt
- Apple Store = Cool Lifestyle
- Wal-Mart = Lowest Prices Everyday
- Victoria's Secret = Sex Appeal

Perhaps the surest interpretation of this survey is that change will continue apace on the retail horizon. That is why we plan to do this again soon.

Thank you for reading.

About RetailWire

RetailWire is a unique online news analysis and discussion forum, which launched in February 2002. RetailWire goes beyond conventional headline news reporting. Each business morning, RetailWire editors pick news topics worthy of commentary by its “BrainTrust” panel of industry experts, and the general RetailWire membership. The results are virtual round tables of industry opinion and advice covering key dynamics and issues affecting the retailing industry.



Membership to RetailWire is free to all qualified retail industry professionals. Over two-thirds of members are in top executive or senior management positions, representing a broad cross section of retail channels and the companies that supply them. RetailWire is supported via sponsorships by leading retail suppliers and service organizations.

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Dechert-Hampe & Company is an independent management-consulting firm specializing in Sales and Marketing services. DHC works to help clients succeed through Sales & Marketing solutions that result in tangible change, measurable results, a competitive advantage and a return on their sales & marketing investments.



Our primary service areas include: Strategy, Structure & Planning; Productivity & Performance Improvement and Research, Analytics & Insights.

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