Winning with Durables
Through the Current Economic Cycle and Beyond

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With its high share of big-ticket discretionary products, the durable goods sector has been hit particularly hard in this recession. Although some consumers are trading down for necessary purchases—or taking advantage of promotional offers—research by The Boston Consulting Group indicates that many are simply opting out of the market for now, which has reduced sales volumes in many durables categories by 20 to 60 percent from recent peaks. Industry analysts believe that the U.S. market has probably reached bottom, but sales of durables in Europe are likely to see further deterioration—not only because the economy will continue to contract there, but also because the downturn has yet to be fully translated into reduced consumer demand. Consequently, most companies are facing significant levels of overcapacity. Many have initiated aggressive “rightsizing” actions—but further moves will be necessary to restore profitability.

Such a grim outlook might suggest that the durables sector is in serious trouble. Actually, this is a hopeful—even exciting—time for some companies, because they are seizing the opportunity to reinvent product categories as their customers reinvent their spending habits. Executive teams at these companies are rethinking long-standing assumptions about consumer behavior and developing new insights into how spending on durables will change through the current business cycle. To stay steady in the storm and position themselves to profitably capture new share, they are pursuing answers to such questions as the following:

- How have consumer attitudes and behaviors changed in the current economic crisis? What new attitudes and behaviors will persist through the next cycle?
- What tradeoffs will consumers make in order to reconcile what they want with what they can afford? Which drivers of spending behavior will rise to the top?
- Which market, product, and channel segments will rebound faster than the overall market?

The insights offered in this White Paper are drawn from many years of working with durables companies, as well as from proprietary data in BCG’s annual Consumer Sentiment Survey of more than 20,000 consumers around the world, conducted most recently in late 2008 and early 2009.1

A Sea Change in Consumer Sentiment

With unemployment reaching record levels and minimal relief in sight, everyone is concerned about the future. When we asked consumers in March 2009 whether they thought the economy would get even worse in the next 12 months, 56 percent of respondents in the United States agreed or strongly agreed that it would—an increase of 24 percentage points since October 2008. In Europe, 60 percent of consumers felt the same way, an increase of 11 percentage points since 2008.

But consumers aren’t reacting only to reductions (real or anticipated) in disposable income. What makes this crisis so different from previous periods of economic constraint is that in addition to financial anxiety—which manifests itself in all downturns—a fundamental change in attitudes toward spending seems to have occurred, and it is having a significant impact on purchase behavior in many categories.

One indication of this shift in the United States is that the consumer savings rate has skyrocketed from barely zero to 5 percent in only a few months. More than half of U.S. and European survey participants

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said that the crisis is, in part, a consequence of “overconsumption.” Consumers around the world have told us that basic and simple necessities are all they can afford for now—almost everything else must wait. In fact, 82 percent of U.S. survey participants (and 74 percent of Europeans) said that they plan to defer nonessential major purchases because of the current state of the economy.

A few years ago, escalating housing prices guaranteed good returns on renovation projects, and exceptionally attractive financing and refinancing offers put significant amounts of cash into consumers’ pockets. Those enticements to spend are now gone and unlikely to return for several years. Whereas fewer than half of U.S. and European consumers reported reducing their spending on groceries, a whopping 76 percent in the United States (68 percent in Europe) said that they would spend less on durables for the home in the next year. Most of that decrease comes from delaying purchases or not purchasing at all.

The New Durables Demand

Tighter budgets are forcing consumers to repair rather than replace older appliances and to make do with dated but still-functional kitchens. But at some point—when confidence and financial stability revive—consumers will start spending again, and previously delayed purchases are likely to be at the top of their shopping lists. Our survey clearly indicates that for big-ticket discretionary durables, such as home furnishings, fixtures, decorations, and kitchen appliances, consumers with reduced incomes are more likely to forgo or delay purchasing until they can afford the features they want—rather than settle for lower quality.

That helps explain why the average price paid in several categories of durables has held up better than in consumable categories. It also suggests that large-scale demand for higher-quality premium durables will return. Therefore, as consumers opt back into the market, companies must be ready with a product portfolio and distribution footprint that can serve consumers’ continuing demand for high-quality products. Durables manufacturers and retailers that focus on low prices and low-end products as a way to stimulate demand could find themselves fueling a trade-driven race to the bottom, with significant margin erosion.

A Road Map for Thriving After the Downturn

Many companies in the durables sector are continuing to look at ways to improve their top and bottom lines as the downturn continues. One positive outcome of the economic crisis is that it has helped companies take unpopular, but necessary, actions—such as reducing or rebalancing production capacity and exiting unprofitable businesses or low-value-added activities. By implementing their managing-in-the-downturn plans, companies are protecting themselves from uncompetitive cost positions.

But it is now time to move beyond these “disaster control” measures. Although the crisis has been (and continues to be) a major challenge for day-to-day operations, it also presents a tremendous opportunity for companies to leap ahead of competitors by understanding shifts in consumer and customer behavior and by gearing up to win a disproportionate share of profitable market segments. We offer the following suggestions for securing a pole position when the recovery arrives.

Rather than act on expectations for aggregate volume, acquire a deeper understanding of how spending behavior is likely to change. Planning for a successful future is less about predicting exactly when consumers will resume purchasing and how large the volume uptick will be, and much more about understanding the motivations that will drive the spending behavior of consumers after the recovery. Which product categories, price points, and channels will consumers be most attracted to? Will certain features become more desirable than in the past? For instance, will a product with “green” energy-saving features be more popular than one that has a flashy appearance? Investing in categories and segments (or even subcategories and subsegments) that promise to outperform the overall market will help to refocus the organization on the right products, pricing, and distribution plans and ultimately lead to profitable growth in market share.
Don’t get trapped in a descending spiral of lower prices and quality. Manufacturers and retailers are cutting prices to new lows in order to stimulate consumer demand for durables. In many cases, such promotions fail to generate sufficient incremental volume to offset the margin reduction on sales that might otherwise have been made at the regular price. What’s more, these tactics can simply pull demand forward from the future—at much lower margin levels—rather than create new demand. Although it may be necessary to temporarily pursue aggressive volume generation, companies should not lose sight of the fact that most durables consumers want “better or best.” They would rather “go without” than purchase lower-quality products with fewer desirable features. Therefore, short-term efforts to attract consumers through lower prices shouldn’t come at the expense of neglecting products that returning consumers will want. Beware of starving (or abandoning) premium segments in the product portfolio or sacrificing their location on the sales floor to lower-priced offerings.

Be your customers’ go-to brand of choice. Many durables retailers are simplifying their product assortments around one or two go-to brands to serve as the major rungs of their price-benefits ladder. Retailers hope that this tactic will permit supplier consolidation (some suppliers will be “in” and others “out” of their retail-customers’ businesses) and drive lower costs, better terms, and greater efficiencies. Another reason for this shift comes from the consumer side. Over the past decade, increasingly powerful retailers, supported by a rising tide of consumer demand and retail consolidation, have introduced a proliferation of brand and SKU choices in their aisles. But the unintended consequence, especially with higher-ticket products, has been consumer confusion over too many choices. And as retailers have discovered, a perplexed consumer is not a consumer who will readily close a deal, let alone trade up to higher-priced products.

Many retailers are therefore eliminating superfluous choices and positioning their leading brands to cover all or most of the benefits ladder without introducing unnecessary brand choice in consumers’ trading-up process. This has meant higher average realized prices along with sales conversion rates that are 10 to 20 percent better than those of their competitors. Durables brands not selected for these go-to positions are relegated either to being used to attract consumers into the store or to playing a niche role in the assortment. In either case, the retailer isn’t gearing up to sell a lot of those brands. Leading brands with broad product and service offerings are best positioned to emerge successfully from this shift, and they will enjoy a better balance of power with retailers. For that reason, manufacturers should anticipate this trend, approach their customers with a compelling offer, and focus their distribution strategies around the channels and customers for which they can play a significant role.

Understand the private-label threat and opportunity. Companies fear that more and more consumers will turn to private-label products during the recession and then continue purchasing them after the recovery. This risk is particularly high in categories for which private labels offer an attractive range of products and to which consumers have little brand loyalty, as well as for products with short development lead times. The risk is much lower, however, for big-ticket durables with long development cycles and the branded features that consumers value.

Moreover, given the current economy, retailers are taking a closer look at the true profitability of their private-label businesses—especially with regard to more complex, big-ticket categories, in which costs previously hidden or less visible to buying teams had not been fully factored into the total profitability equation. These costs include the cost of often-inferior product quality and of working capital tied up in extended supply chains, as well as the opportunity cost of less productive SKUs with me-too designs. Several large retailers are now recognizing that the total cost of their private-label business is offsetting their supposedly higher private-label gross margins. This realization has created opportunities for brand-ed suppliers to win new segments of business by focusing on the overall economics that their product portfolios and supply-chain capabilities offer.

Help take the pressure off consumers and their budgets. There are several ways companies can help consumers cope with financial anxiety or reduced incomes when considering discretionary purchases of durables:

- Companies can educate consumers about how going “green” can help reduce both the real and perceived costs of product ownership. A powerful example is the significant savings that come from...
replacing older appliances and home fixtures with items such as energy-efficient windows and insulation or washing machines that have water-saving cycles. Consumers reap the benefits of upgrading to new, better-performing products that also pay for themselves over time.

- Companies can revise pricing models to eliminate charges for “extras” that offer little perceived value for consumers. Several retailers are also offering extremely low financing rates—often no more than 1 or 2 percent and even as low as zero—as well as delayed payment dates to encourage purchases.

- Companies can help mitigate the risk consumers face in a volatile job market through such “altruistic” offers as promising to cover payments or accept returns from customers who lose their jobs within a specified period after a product purchase. Sears, for example, recently launched a home appliance campaign that would cover Sears Card payments and, ultimately, the entire repayment amount if a Sears customer lost his or her job after purchasing a major appliance. Although it is too early to assess the impact of those campaigns, analysts anticipate that they will be a significant factor in consumers’ purchase decisions, especially for big-ticket items.

Be ready to take advantage of sudden windows of opportunity in the competitive environment. Your “company radar” must be able to recognize unexpected opportunities that are likely to arise in today’s marketplace turbulence. These might include regulatory changes, new government-stimulus programs created to drive demand, and M&A opportunities emerging from weakened competitors. Make sure your organization is capable of a fast response when necessary and that it has the right triggers in place to allow for quick action when opportunities present themselves.

Give your business the fuel it needs. Overly zealous cost cutting shouldn’t undermine the “gems” in your portfolio. Even when working with a tight budget, you must continue to fund long-term investments in R&D and new-product development. You should also give sufficient support to short-term opportunities for gaining market share, such as competitive promotions or product launches. The winners through the next cycle will differentiate themselves by the strategic product and market investments that they make in today’s challenging environment, rather than solely by the cost-cutting measures that most other companies are aggressively pursuing.

It will take time and a string of good news for the anxiety of today’s consumers to ease and their purse strings to loosen. For durables manufacturers with the right approach, however, the economic crisis can have an upside. Strong players can gain an advantage over weaker competitors through superior consumer insight to drive planning and resource allocation, the ability to work with retailers on win-win propositions, and the agility to pursue opportunities quickly as they arise. Such actions will lay the groundwork for a rapid advance once the economy turns around.
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