CONSUMER AND RETAIL GROUP

The Grocer’s Recession Playbook:

Five ways to turn a Downturn into an Opportunity

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How can grocers thrive in a recession?

Operating a retail business today brings a huge set of challenges. From historic inflation, to crippling supply chain disruptions, to rapidly evolving customer needs, retailers in every sector face an unprecedented set of headwinds. With the Consumer Price Index increasing over 8% from last year, consumers are feeling the pressures of escalating costs, even as the Fed takes steps to tackle inflation and forecasts more tough economic medicine in the future. Most experts concur that the writing is on the wall, with nearly 70% of economists agreeing that a recession is looming as we head into 2023, according to a recent survey cited by Fortune[1].

So, what does this mean for the retailer—and more specifically—the grocer? The good news is that people will always need groceries, and history tells us that cash-strapped shoppers will cut back on eating out in favor of home-cooked meals. The bad news is that while many grocers may have successfully dealt with recession before, the upcoming downturn will bring a new set of challenges.

In this article, our team of experts discusses how grocers can apply lessons from the past to today’s environment to not only weather the macroeconomic storm, but to thrive in it.

1. Fortune, June 13, 2022, “Over two thirds of economists believe a recession is likely to hit in 2023”

New Challenges:
This Time, It's Different!

We expect consumers to repeat many of their behaviors from the Great Recession, but grocers need to adapt their responses to today's constraints.

SUPPLY CHAIN DISRUPTION

For one, many are still reeling from the supply chain woes brought about by the pandemic, including supply disruptions and once-in-a-generation commodity cost increases. These supply chain constraints will limit grocers' ability to quickly react and adjust assortments as they have in recessions past. Being proactive and having contingency plans in place in the event of further disruptions is critical.

RECORD HIGH INFLATION

In addition, grocery prices are climbing at 13.5%, year-over-year outpacing the rest of the CPI[2], compromising consumer loyalty, and leading shoppers to trade down across categories. Retailers are already facing margin pressures, with many holding the line on price as vendor prices increase. In fact, vendor prices measured by the PPI have been above 10% since June of 2021, while consumer food prices took until March 2022 to surpass that mark. Being targeted and strategic in pricing and promotional strategies is more important than ever.

While a recession brings its share of turmoil, it also provides an abundance of opportunities for those retailers savvy enough to adapt. Grocers should be asking themselves one important question:

How can they seize the moment to turn this recession into an opportunity?

2. U.S. Bureau of Labor Statistics, year end Aug. '22

The Grocers' Recession Playbook: What to expect and how to benefit

Volatility accelerates change—it's just a question of who benefits. With that said, it is critical for grocers to proactively build their business strategy heading into what appears to be an imminent recession.

Here are the five most impactful changes we anticipate along with concrete steps to grab market share and deepen relationships with customers that will pay dividends well after the economy recovers:

	WHAT TO EXPECT	OPPORTUNITY
01	Customers will trade down	Optimize product assortment and focus on basket building
02	Discounters will gain market share	Lean on your core strengths while doubling down on loyalty programs
03	Sales will shift from fresh to shelf stable items	Heavily promote fresh to bolster reputation in the category
04	Private label sales will grow	Address private label supply risks then accelerate private label growth
05	Independent grocers will struggle	Drive expansion through targeted acquisitions

01 Customers will trade down

One tell-tale sign of a recessionary environment is when customers take stock of their spending and start to move away from higher priced items. For example, grocers are already seeing trade-downs today, like consumers moving from more expensive meats to chicken, according to a recent study by Tyson Foods[3].

Growth in Organic sales slowed during the Great Recession.

OPPORTUNITY | **Optimize product assortment and focus on basket building**

Cycle out slow moving items

Evaluate every category on its merits and ensure all items are on the table to be reviewed. The sales of specialty, niche and luxury items will likely slow; proactive retailers are already analyzing these items and beginning to cycle the lowest performers out. Now is the moment to aggressively promote those items to drive incremental sales and reduce inventory.

Optimize pack sizes

For higher priced items, customers may gravitate towards smaller sizes for lower up-front cost, while low-ticket items could warrant larger pack sizes to support bulk buying. Recent reports show some slowdown in traffic at club stores, so bulk buying is a strategy best limited to lower priced items to mitigate sticker shock.

Focus on Basket Building

Identify key basket building items like milk, eggs, chicken and canned beans. Customers buy these items most frequently and are likely to shop around for the best deals. Successful grocers build their promotional offerings around these items and, in a recession, the very best lean into them to reinforce their value proposition and build loyalty.

3. CNN, Aug. 8, 2022, "Steak's off the table: Inflation-weary shoppers are switching to chicken"

02 Discounters will gain market share

During the Great Recession, discounters were there to capture newly budget-conscious shoppers. As the former Dollar Tree CEO put it: “In 2008 folks lost jobs…and they found us[4].” Fast forward to 2022, and it’s clear that history is poised to repeat itself. Dollar players are shifting into growth mode, Lidl’s US entry is set to accelerate, and, of course, Walmart has the discount credentials and financial muscle in place to be aggressive. With the discounters chomping at the bit, how can grocers defend market share and more importantly, where can they go on the offensive?

Aldi had one million new householders shop through September, with foot traffic up 10.5% since last year[5].

OPPORTUNITY | **Lean on your core strengths while doubling down on loyalty programs**

Lean on your strengths

Customers are generally less loyal in a recession, so a two-pronged approach is needed: protecting loyal shoppers and targeting cross shoppers. When targeting these cross shoppers, leaders should be mindful not to throw the baby out with the bathwater. Whether their differentiation is anchored on superior brands, store layout and ease of shop, or service and experience, retailers must continue delivering on their value proposition or risk alienating their customer base.

Maximize loyalty programs

Loyalty programs should reward just that: loyalty. These are the customers already in your store, supporting your brand. As customers look for better deals and promotions, use this opportunity to maximize their spend by truly delivering value to your most loyal customers through “Members Only” perks and benefits. Simultaneously, invest in onboarding efforts through in-store associates, digital channels and sign-up bonuses.

4. Former Dollar Tree CEO, Gary Philbin, quote by Reuters, May, 28, 2020, “Dollar chains expect robust demand as shoppers brace for recession”
5. Placer.ai

03 Sales will shift from fresh to shelf stable items

Fresh food sees the sharpest drops in consumer spending as incomes fall.

Fresh is another category to watch, where the premium price tags can cause consumers to shy away when money gets tight. In fact, a 2021 study at the Agricultural and Applied Economics Association[6] revealed that fresh food categories see the sharpest spend drops as incomes fall.

However, this behavior will also prompt a decline in competition, as other retailers pull back from these categories. If approached the right way, this is the perfect time to aggressively promote your selection, but it needs to be done thoughtfully. Consider bucking the trend and investing in fresh to build a reputation that will extend well past the recession.

OPPORTUNITY | Focus on fresh to bolster reputation and build loyalty

Optimize the assortment

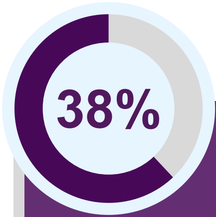
In addition to basket building in the fresh category, there is a golden opportunity to be aggressive: upgrade the fresh assortment as others pull back. Agricultural producers will have excess supply as demand for these items declines. Knowing that a recession is not permanent, grocers should approach their fresh vendors and propose a solution which can be beneficial to all.

Aggressively promote

The retailer invests in promotional spend to offer fresh items at competitive prices and build their brand strength in fresh, the vendor provides volume-based discounts and is able to keep supply levels consistent, and finally, the customer gets well-priced, high quality fresh items that they would not typically be able to access.

Lean into local

“Swimming against the tide” in this respect is a long-term strategy. And with increasing competition in fresh—as evidenced by the 38% of respondents in a recent FMI study[9] who consider big-box stores their biggest competitor in perimeter sales—it has never been more critical to drive differentiation. Supporting local producers will pay dividends well after the economy recovers.



38% of respondents in a recent Supermarket News survey[7] consider big-box stores their biggest competitor in perimeter sales

6. Lusk, J.L. and B.R. McFadden. 2021. "Consumer Food Buying during a Recession" Choices. Quarter 3
7. SN 2022 Fresh Food Trends Report

04 Private label sales will grow

With private label promising better value, consumers have shifted spending towards these products as they feel pressure on their wallets. According to a study at Chicago Booth[8], store brand sales grew 10% during the last downturn. This trend has continued in recent years, with 56% of grocery shoppers purchasing private label according, to an April study conducted by the A&M Consumer & Retail Group[9]. Fast forwarding to the most recent quarter, both Walmart and Kroger reported that store brand sales spike[10], foreshadowing what could be a perfect opportunity to expand in private label.

OPPORTUNITY | **Address private label supply risks, then accelerate private label growth**

Address supply risk

Demand is going to rise for these products, and retailers need partners that are ready. Engage suppliers to assess risk in key categories (e.g., frozen, canned goods, cooking oils). Being agile and adaptable also applies here: replenishment teams need to be ready to place orders quickly when supply becomes available in tight markets; otherwise, competitors will pounce.

Accelerate private label growth

Go on the offensive by launching new SKUs, expanding into new categories, or launching entirely new store brands. Focus on gaining market share from mid-tier brands to whom customers have traditionally shown less loyalty. According to the same Chicago Booth study mentioned above, customers remained loyal to top national brands even as prices increased during the Great Recession, prioritize and be thoughtful with which items you target. Strong private label programs are built on customer loyalty, so use the current economy as an opportunity to build a following for your brands and reap the rewards for years to come.

8. Chicago Booth Review, December 1, 2015, "How the Great Recession Changed US Shopping Habits"
9. A&M CRG, "Store Brands: Driving Growth and Building Loyalty"
10. Forbes, June 30, 2022, "Why Private Label Brands Are Having Their Moment"

05 Independent grocers will struggle

Between 2005 and 2015, the share of independent grocery stores declined over 40% in the U.S.

It's no secret that small grocers have struggled for decades. A study by the U.S. Economic Research Service[11] found that the share of independent grocery stores declined over 40% in the U.S. from 2005 to 2015. Without the scale to effectively negotiate with vendors or enact large-scale process efficiencies, this is no surprise. During the pandemic, these retailers were given new strength, as restaurant closures caused consumers to turn to their local supermarkets. As these tailwinds fade, we expect their struggles to return in full, with many teetering on bankruptcy.

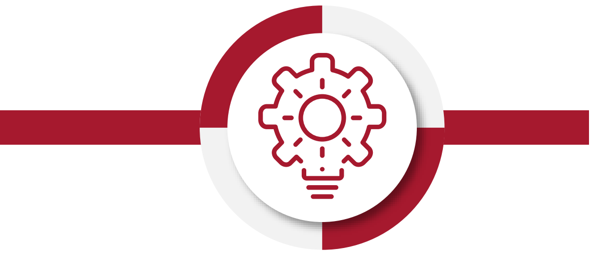
Even the largest players are focused on building scale. Kroger's stated motivation behind the recent move to acquire Albertsons is to leverage consolidation and bring down prices with suppliers. Smaller players who have enough capital should aggressively seek growth.

OPPORTUNITY | Drive expansion through targeted acquisitions

This environment provides fertile grounds for M&A, so if the balance sheet is healthy enough to pursue deals, an aggressive acquisition strategy can be transformative during a downturn. Acquisitions can be motivated by a range of strategies—from building capabilities to increased economies of scale to what is likely the top priority on the minds of acquisitive grocers in a recession: geographic expansion.

Utilize M&A

Design a strategy



Being prepared to move quickly can make all the difference. In addition to other retailers competing for deals, Private Equity funds are also active in this space. So, what can your team do to be ready? In short: make a plan. Work with your team to align on strategic objectives and shortlist potential targets to monitor closely. Taking proactive steps like these will enable the team to move quickly and with clear purpose as opportunities arise.

11. Economic Research Service: USDA, November 2017, "Independent Grocery Stores in the Changing Landscape of the U.S. Food Retail Industry"

What Does All This Mean for the Grocer?

Tailor tactics to each situation.

Whatever actions you take for your shoppers, keep in mind that one size does not fit all stores. Assess how different variables like demographics and competitive intensity should shape your strategy. For example, areas with higher earners who have not been as impacted to date may require less promotional activity. Conversely, stores in close proximity to discounters will warrant more aggressive promotional strategies.

And most importantly: Don’t panic!

The successful grocer will lean on and pull from their strengths to weather this next recessionary storm. Think of this playbook not as a total revamp of your strategy but rather a deliberate adjustment to meet the ever-changing needs of the market. Grocers who act decisively and make the right decisions during this volatile period will plant the seeds that their business can sow for years to come.

At A&M, we have the experience and resources to support you during these turbulent times. We are passionate about helping companies achieve their maximum potential and be on the right side of disruption. We look forward to connecting.

David Ritter, Managing Director
dritter@alvarezandmarsal.com

Jeremy Levine, Director
jeremy.levine@alvarezandmarsal.com

John Clear, Director
jclear@alvarezandmarsal.com

David Schneidman, Director
dschneidman@alvarezandmarsal.com

Conor Gaffney, Associate
cgaffney@alvarezandmarsal.com