EFFECTUS

ECOSYSTEM OF PRODUCT: MONTHLY UPDATE AND OUTLOOK

May, 2020

EFFECTUS
STRATEGY PRACTICE

May Newsletter

Over the last month, COVID-19 has continued to add new twists to our daily routines and the societal norms we've grown so accustomed to. Although we've begun to see the light at the end of the tunnel with The White House and Center of Disease Control and Prevention's (CDC's) plan to reopen the country, our teams continue to work around the clock to turn these burdensome obstacles into opportunities for our people (both internal and external) to come out of this stronger and more equipped to navigate uncertainty and volatility that accompanies times such as these.

Market Watch Summary

Over the last few months, we have seen retailers temporarily close doors as a means to appease shelter-in-place mandates and long-term shuttering being simply a worst-case scenario. Today, that possibility is becoming a reality for many retailers across many categories. According to UBS analysts, upwards of 100,000 doors are expected close over the next 5 years with apparel, consumer electronics, and grocery representing 24%, 12%, and 11% of those closures, respectively.

While many retailers are finding themselves in fight-or-flight mode and considering bankruptcy options, players such as Walmart and Target are less exposed to these possibilities. There are several insulating factors at play with both, but it is safe to say their e-Commerce platforms and diverse product catalogs have played a major role in keeping them above the proverbial death-line of their category-focused counterparts.

With that being said, e-Commerce is experiencing tremendous throughput. Not only are the transactions more convenient, but the contact-free nature of those purchases is a means of mitigating some of the risks that consumers are becoming more cognizant of. According to the aforementioned UBS analysts, these platforms are currently performing at a 15% penetration rate, but over the next 5 years forecasts suggest that number could be as high as 25%. In today's environment, it is never too soon to begin having these conversations. In some cases, the reality is that placing such bets may not be in the best interest of your business, but it remains proven that a systematic and disciplined approach to topics like this can safeguard the business from the downstream impacts that new elements can have on an existing model when executed hastily.

On the flip side, as the country starts the reopening process, we are seeing safety measures put in place as a means of protecting patrons and employees beyond the standardized use of protective masks. Some establishments are adding hand sanitizer dispensers where they normally would not have them. Other organizations are mandating temperature checks at the beginning and end of a workday along with capacity constraints everywhere from restaurants, to stores, and even breakrooms and lounges. While the rate of change varies across the country, many offices are not expected to reopen until September. With so many businesses having already adjusted and embracing the realities of working from home, employers like Twitter are empowering their personnel to continue working from home as much as they like. As managers have become comfortable with leading teams remotely, they are also increasing employee allowances to create a workspace that suits them best which can be conducive in reducing overhead and freeing up funds for other areas of operation.

SBA Paycheck Protection Program (PPP)

These funds are still in high demand. If organizations have applied in previous rounds, there is no need to reapply as many lenders are still processing loans, but we can expect that process to speed up as more funds become available. Once they do, however, it is especially important to make sure those funds are used appropriately – which is defined as at least 75% for payroll and no more than 25% on other utility expenses – and within 8 weeks of the issuance to benefit from the loan forgiveness. It is also important to note that failing to maintain employee headcount can lead to owing money as well.

Upon reviewing the data provided by the SBA, a few conclusions can be made with regards to how this capital is being deployed, but the waitlist for prospective borrowers is still largely speculative. Bearing that in mind, it is unclear when business owners can expect those funds or how much they can expect, but according to the data, the average loan size was approximately $79K, with more than 1,400 approved loans being more than $5MM. Although many are in a crunch for cash, some needs are more severe than others. If this is the case, there are other alternatives worth considering. In an effort to keep employees on payroll, the Employee Retention Credit may be a suitable option. This program was launched as a tax credit equal to 50% of eligible employee wages of a business that has been hurt by COVID-19. A business is considered “hurt” if operations were fully or partially suspended by the government or if quarterly earnings took a 50% hit.

Another alternative to the PPP is a traditional SBA loan. These funds are more widely available, with very reasonable interest rates, but it still leaves borrowers at the mercy of lenders’ ability to process these loans, so contacting your provider before setting those plans in motion is strongly encouraged.

COVID-19 Challenges Create Opportunities to Pivot

Out of necessity, businesses have been cornered by reactive decision-making, thus limiting their ability to take proactive measures. According to research conducted at MIT’s Sloan School of Management, there are 3 strategies that can enable organizations to become more proactive during these challenging times.

The first strategy is defined as "Same Products, Different Channel." In short, digitize your offline operations. Beyond retail, we see this done with universities across the country: brands like Nike have applied this practice as well. Earlier this year Nike closed 71.4% of their directly owned and partner-operated China locations. This afforded an opportunity to place more digital bets and maximize their online activity.

The next strategy MIT observed was referred to as "Same Infrastructure, Different Products." Organizations are repurposing their production lines for products that are in higher demand. In light of the global scarcity of hand sanitizer, companies such as Pernod Ricard have begun making hand sanitizer to help meet that demand. Beyond the CPG-space, organizations such as Ford and GM were able to pivot their inactive lines to help meet the healthcare industry's need for medical devices like ventilators. Changes like these exist in the Hospitality industry where chains such as Hilton have begun offering their rooms to hospital staff and COVID-19 patients in the UK.

The third strategy that has been identified is "Same Products, Different Infrastructure." This pivot pertains most to organizations struggling to meet demand and are willing to collaborate with external partners and take action to bridge gaps in capacity. This is being seen with organizations like Walmart, Dollar Tree and 7-Eleven who are planning to hire a combined 200,000 new employees and Amazon planning to add 100,000 new positions across the country. In light of this hiring initiative, Amazon has partnered with Lyft as a means of directing potential hires to warehouse, delivery, and grocery shopper positions in order to meet the increased demand related to more homebound shoppers.

Addressing Consumer Sentiment in a Weak Economy

Companies of all different shapes and sizes are being challenged by the rapidly changing conditions of COVID-19. This new reality is far from ideal, but smaller, more resourceful firms are leveraging their lean operations to give them an edge over their larger competitors. Finding innovative ways to gain market share, maintain a strong cash flow, and embrace the concept of continuous improvement (from both a cost and process perspective) will not only help businesses mid-pandemic, but will also better position organizations once the dust has settled. Although innovation can mean many things to many people and organizations, there are 2 major components of innovation that are extremely relevant right now: messaging and product quality.

According to a media consultant at Forbes, during the 2008 recession, ad spending in the U.S. dropped by 13%. It's natural for businesses to recognize advertising as an area to "trim fat" since consumers tend to buy less in a weak economy. While there may be some truth to that, the reality is that consumer focus on value and quality are heightened; under the right conditions though, they are still willing to purchase. By avoiding clever, momentary attention-grabbers, and instead crafting a message that emphasizes the quality and benefits of products in a clear, direct way, organizations have a more meaningful interaction with the consumers. For some companies, this means ramping up advertising activity, for others that are more present in the advertising space this could be as simple as maintaining that activity: shifting the message and capitalizing on the less congested ad space. Whatever the case may be, monitoring the competitor's advertising efforts will help indicate whether or not there is an opportunity to take advantage of the "lack of noise" and maximize the return on that spend.

The second component, product quality, is just as impactful as messaging. The messaging of a product's superior value offering must be backed up by the actual quality of the product or service delivered. The adage "put your money where your mouth is" rings especially true when it comes to quality. During times like this, when the "careful consumer" is your target audience, and product messaging focuses on quality and value, the concept of "critical-to-quality" is escalated and widens the gap known as "cost of poor quality". According to Global Data's 2018 Q3 global consumer survey, 43% of consumers said high quality products/ingredients define good value for money, followed by multi-benefit/multi-functional at 33% and low price/cheap at 30%. When the goal is to strengthen market positioning, the products you sell should be in-line with your messaging strategy and at the very least meet consumer expectations. Alternatively, the temporary increase in market share will pale in comparison to the damage done to brand equity and reputation.