BEYOND 'FRUGALITY'
Discovering Growth Opportunities in the New Normal
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In most markets during this steep recession, customers of course cut back spending and became much more price sensitive. Many observers in the business press have extrapolated from this suddenly very frugal behavior, advising that price sensitive, restrained consumption will be sustained even after economic recovery, constituting the 'new normal.' However, history does not suggest that this frugality will be uniform or even permanent. And we believe that many other major changes in markets will be less obvious yet more fundamentally important and long lasting.

The shocking, disruptive economic downturn that struck the world in late 2008 has very likely spurred and catalyzed enormously important, but non-obvious changes in the behaviors and priorities of customers (business and/or consumer), competitors, regulators, and others. The challenge for business leaders is to gain insights into these subtler but pivotal changes. Then they can re-chart courses that go well beyond acknowledging customers' obviously somewhat reduced spending power and (likely temporary) frugality. In fact their goal should be to deliver innovative new value propositions in creative new ways, anticipating and in some cases profitably accelerating major new growth opportunities as the economic skies clear.

Helping (even more thrifty) customers find new, innovative solutions

Innovative businesses will discover growth opportunities in helping consumers reallocate spending to new, smarter ways of getting the end results they still value. For example, our research indicates an intriguing opportunity for residential-interior paint. Many consumers, especially females, see great value in periodically changing the look in their homes. Many also find rich, varied colors highly appealing. However, it is expensive for a middle class household to redecorate with new furniture (let alone an interior decorator), or by remodeling the kitchen or baths. Simply repainting a few rooms, on the other hand, can make a dramatic visual impact, especially if the consumer tries bold, new colors.

Yet repainting is much less expensive than most redecorating, if consumers do the work themselves. And the social and emotional satisfaction can be powerful. Residential interior repainting could be an exciting growth opportunity in the 'new normal.' A few consumers already repaint with color very successfully, and frequently, but most consumers rarely do so. Our in-depth interviews revealed that many more of these women could be convinced to try repainting, with rich, expressive colors, if paint marketers and retailers educate and entice them, and make the task a little easier without requiring the use of a paint contractor. By showing consumers a new, smart way to achieve a great end-result, the payoff could be a major surge of vibrant, profitable growth in this old, seemingly commoditized and stagnant category.

Similarly, consumers may continue feeling less wealthy, and borrowing less than they did from 1990 to 2008. Many observers assume significantly less financial profit from consumers for years to come. However, some financial services providers should be exploring ways to help consumers adopt the 'new-normal' habits of long-term savings. How much new, profitable growth could banks and others generate by further encouraging consumers, and making it easier for them to save much more, thus spending less in total but gradually building sustainable wealth?

Nvidia – example of forward-looking insight and innovation

To capitalize on opportunities coming out of a major recession, businesses must discover *forward*-looking insights - creatively inferring new experiences customers likely *will* value, not what those customers thought they wanted prior to the crisis. Based on such insights, businesses must then develop value-delivery innovations that generate new excitement, enthusiasm and robust demand.

A current example may be Nvidia, chip-making competitor to Intel and Advanced Micro Devices. Nvidia increased R&D spending in 2009, while most others were cutting back and despite a 40-50% revenue drop in late 2008.(1) Based on Nvidia's study of end-users, CEO JH Huang foresees a new PC environment emerging from the downturn, a market with dramatically lower baseline hardware prices, differentiated by "size, battery life, and video performance." Nvidia is "prepared for that outcome... consumers will discover they don't need a high-end microprocessor…they'll get more for less by allocating their dollars toward Nvidia chips that are more efficient for chores such as watching videos."

"Personal computers as we know it, will become a 'work' station," Huang says. "Most families will have a multi-media workstation. But our 'personal' computers for accessing the internet or casual computing will likely just be a web based device…a large or small tablet - just a sheet of glass so thin and possibly translucent with a camera to augment the image in front of you with computer graphics."(2)

"What is the soul of the new PC?" Huang asks. He is betting that Nvidia has the answer.

Why deep study of downturn-catalyzed market changes is so crucial

Market changes need deep and careful study because some changes and their implications are not at all obvious, and are not revealed by simple extrapolation from trends prior-to and during a recession. Consider Japan's 'lost decade' of economic stagnation, about 1993-2001, which resulted in some very interesting but non-obvious long-term changes in consumer behavior.

After little-to-no growth for nearly a decade, the Japanese economy recovered well (until 2008). Yet, long after the recovery began, some surprising new behaviors persisted.(3)

During the boom years prior to stagnation, Japanese felt wealthy, and many engaged in conspicuous consumption – wearing foreign fashion, drinking Scotch Whiskey, driving luxury cars. Sales of such items dropped sharply during the lost decade, but by 2007, after six years of recovery, volumes were still down – e.g. Whiskey at -80% since its 1980s peak, and auto volumes at -50% versus 1990. "I'm not interested in big spending," said one college student. "I just want a humble life." And remarkably, a poll by news daily Nikkei found that the percentage of men in their 20s who said they wanted a car had dropped from 48% in 2000, to 25% last year.

This reduced desire for a car corresponds to many Japanese spending less time driving cars and more time commuting by public transportation. That behavior feeds into another phenomenon – growing demand for wireless access to broadband-oriented information and entertainment. In about 2000, Japan rolled out 'Third Generation' (3G) wireless telecomm technology.(4) 3G supports Video On Demand (VOD) technology (where consumers can view any movie, etc., on demand, anytime) on a cell phone. Japan now leads the world in adoption of VOD.(5) And who watches VOD on their cell phones? Those Japanese commuters. On a train for over an hour, they highly value a quality entertainment experience on their cell phones, and they're getting it.

Only insightful understanding of these consumers' changing behaviors and attitudes could anticipate this scenario. Extrapolating from prior trends and assuming a return to 'normalcy' (or even a 'new more frugal normalcy') would have missed this train.

So we urge businesses to adopt a realistic, systematic methodology for creative market-exploration and strategy reformulation. We believe such a methodology must include in-depth engagement with customers (business and/or consumer), and other analysis of shifting behaviors of customers, competitors, regulators, and other influential entities. This exploration must discover forward-looking insights, translated into value-delivery innovations that can generate major new demand.

OK, customers want to spend less…but what else (more fundamental) is changing?

While recovery has begun, significant headwinds may persist. Some sectors, such as high-tech and health care, look reasonably good, while much of the 'old economy' continues to struggle. Housing is likely to recover slowly, weighed down by foreclosures, while commercial construction has largely collapsed. Profits and the stock market are up strongly from crisis low-points, but business investment has generally not followed suit. Consumer demand, a primary engine of the economy, may remain anemic for some time.

As Reuters reported from the American Economist Association's annual conference in early January, many economists expect US GDP to grow less than two percent per year over the next decade. Consumers' balance sheets are sharply diminished versus 2007, and heavily debt laden. Unemployment, and associated anxiety, may remain high, at least in the US, for several years. Meanwhile, the collapse of commercial construction continues. Bank lending remains weak, whether because companies are paying down existing debt, or because banks have tightened their terms and conditions. Even in information technology, which has been showing relatively strong signs of recovery, research firm IDC's April survey of IT buyers[6] projects only flat IT spending over the next 12 months.

This environment has no doubt produced a retrenchment in spending habits, both by consumers and industrial buyers. The business press is full of predictions of the 'new normal' – a 'permanent frugality' with more modest consumption. However, to assume that this change covers the full extent of the recession's impact would be a failure of imagination.

Discovering major lasting changes and the greatest innovation opportunities

Perhaps most crucial to emerging from the downturn as a long-term winner, businesses need to devote attention now to imaginatively and deeply studying changes in their markets. These changes include the new 'frugality,' at least until the economy returns to robust growth, but many of the most important changes will involve factors beyond price and total spending levels. These additional changes will likely be major, long lasting, and yet not very obvious to spot or easy to predict. Discovering and understanding these changes is not likely without a fresh, deep exploration of current/potential customers and other key players in the market.

For example, the Depression of the 1930s, far more than our current recession, reduced people's ability to spend. But the long-term impact of that era was not, at least primarily, a propensity to spend less. The more important long-term changes, with implications for business strategy and growth opportunities, were about new priorities, tastes, and behaviors, partly catalyzed or stimulated by the Depression, and usually by simultaneous technological and other innovation.

In fact, the economy's ultimate recovery from the Depression was led by major innovations which responded creatively to changing values and habits, much more than by trimming the cost of the same old products and services. Thus, entertainment soared in popularity in the thirties, the movies providing an affordable escape, and became a key US industry. And people were on the move, on the road, so the motel became very popular and then a lasting fixture of the American scene. Without waiting for 1950, one could have foreseen some of this by deeply exploring the changing habits and mindset of the US consumer by the early-to-mid 1930s.

Today, Cisco is betting on the replacement of much business travel with teleconferencing and related technologies. Cisco is trying to innovatively capitalize on behavioral changes spurred by the current cost-consciousness but which may have major long-term potential.

In the US, residential housing is slowly recovering, but perhaps not in the same form of recent years. Many homeowners may come out of the recession disillusioned by the guaranteed wealth-building formula they were taught was a home. Rising oil prices will again make long commutes expensive. Are some segments of homeowners becoming more interested in 'sustainable living?' Conceivably, might these and other changes combine to start changing where and in what kinds of structure homeowners are interested in living? Deeply studying their evolving attitudes could reveal much new insight to businesses in this changing market.

Businesses should be studying their markets to learn, 'what changes are percolating in the lives and businesses of customers and other key players, stirred by the economic turmoil? What experiences do those changes imply that customers, going forward, potentially *would* value, if our business could deliver them?' These potentially valuable new experiences are not usually discovered by asking customers what they will now want as a result of various changes; customers do not yet know. Rather, a business must deeply study the changes, and creatively *infer* the potential innovations in value delivery.

Albeit not usually easy, the *biggest* opportunities for value-delivery innovation often involve restructuring how a business and its customers operate. This principle applies strongly to both business-customers and consumers. The tumultuous environment may facilitate such restructuring moves that can redraw the competitive landscape, e.g.:

- Are there changes in business-customers' operations that would allow the business to convince customers that now is an opportune time to outsource various processes to that business? Bundling the traditional product with those outsourced processes could redefine the value delivery systems of both the business and its customers.
- Are there new opportunities emerging for the business to help customers enter new markets, or to compete more effectively in current markets?
- Is the downturn, combined with changing technology, undermining the value distributors or other intermediaries deliver, between a business and end-users? Do such changes create opportunity to initiate more direct relationships to end-users?
- Though shell-shocked, might the construction industry be riper than ever for major supply-chain restructuring, such as expanded use of pre-fab materials?

We don't propose that businesses select from neat recipes of specific solutions, in a downturn. *The point is that businesses should not assume they already know what strategy is right for markets undergoing the hard to predict transformations brought about by a severe downturn. Instead, they should deeply and imaginatively immerse themselves in customers' changing businesses and lives, to understand and creatively interpret changing behaviors and priorities, likewise analyzing the behaviors of other key players in the market, including intermediaries, competitors, and regulators.*

A realistic, market-focused methodology for charting a new course, as skies clear

We urge that a business follow a two-part methodology for rethinking strategy in light of the fast-changing environment. First, market-exploration should include analyzing:

- The behaviors, priorities, and values of current and potential end-users and other customer groups - what they will likely want and be willing to pay for it
- The structure and dynamics of the relevant value-delivery chains, including changing roles for various intermediaries, complementors, and others
- Competitor behaviors, objectives, capacities, and limitations – which competitors are likely to be vulnerable, or aggressive? Should include current competitors, plus potential threats from different technologies or regions (e.g. China, Japan, Europe)
- Regulators' and other governmental bodies' priorities, and thus the incentives, support, and constraints they may bring to the market

Essential to our suggested approach is studying what current and potential customers are actually *doing* today, then creatively inferring what experiences those customers will likely therefore value in the near future. This approach fundamentally differs from methods that rely on having customers tell us what they think they want. It is also forward-looking – not a discovery of what customers *used to* value just before the economy melted down. This methodology is actionable, not an elaborate exercise in observing and characterizing groups by academically interesting categories, without surfacing concrete hypotheses for possible value-delivery innovations.

Consumers are not difficult to engage in detailed discussion of what they are doing and thinking. Plenty of money can be wasted by over-intellectualizing this task. But managers can engage directly with consumers, especially in individual in-depth interviews, often useful to conduct at home or otherwise in the consumer's world. In this way, businesses can efficiently gain invaluable insights into behavioral and attitudinal changes.

Large business customers are a different challenge, and they may seem uninterested in any topic beyond pricing. However, businesses badly need supplier innovation and now may actually be a better time than usual for real strategic dialogue. Such dialogue should entail multi-functional joint team projects, led by senior managers on both sides, with concrete goals and deadlines for co-discovery and pursuit of major new business initiatives of mutual benefit. In this environment it may make sense to experiment with very different terms, such as greatly expanded sharing of risk and accountability.

Based on such deep engagement with customers, and correspondingly careful analysis of other key players – intermediaries, competitors, regulators – a business should then creatively reinvent its business strategy. What new or greatly improved value propositions should the business deliver, in what new innovative ways?

The deep recession has likely caused important, lasting, but not always obvious, changes in behaviors, priorities, and capabilities of key players in most markets. Reticence to spend is an impact, at least for now, but it is unlikely to be the only or most important and long-lasting change. Some of the less obvious changes present major opportunities to innovatively generate new growth, for businesses willing to invest in creatively discovering such opportunities, and then capitalizing on them with value-delivery innovations. Well beyond frugality, the new normal can present major growth opportunities for businesses willing to explore for them.

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