

# Inflation Inflated: Part 2 — The Business Outlook



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**About L.E.K. Consulting**

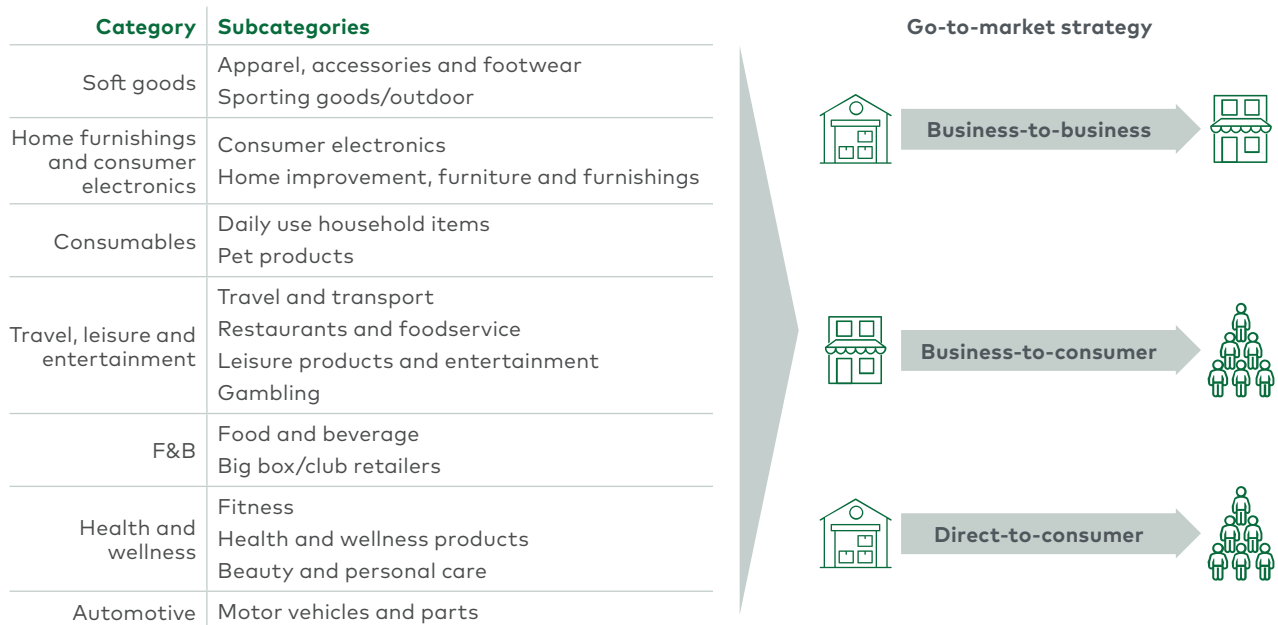
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# Understanding how consumer businesses are responding to inflation

Even with inflation backing off from the highest levels in four decades, seen in the second half of 2022, the high-inflation environment and economic headwinds remain at the top of consumer minds in 2023. L.E.K. Consulting set out to discover how businesses were responding. We surveyed more than 300 consumer business leaders across seven core categories and 16 consumer subcategories at U.S. companies, covering B2B, B2C and DTC go-to-market strategies (see Figure 1).

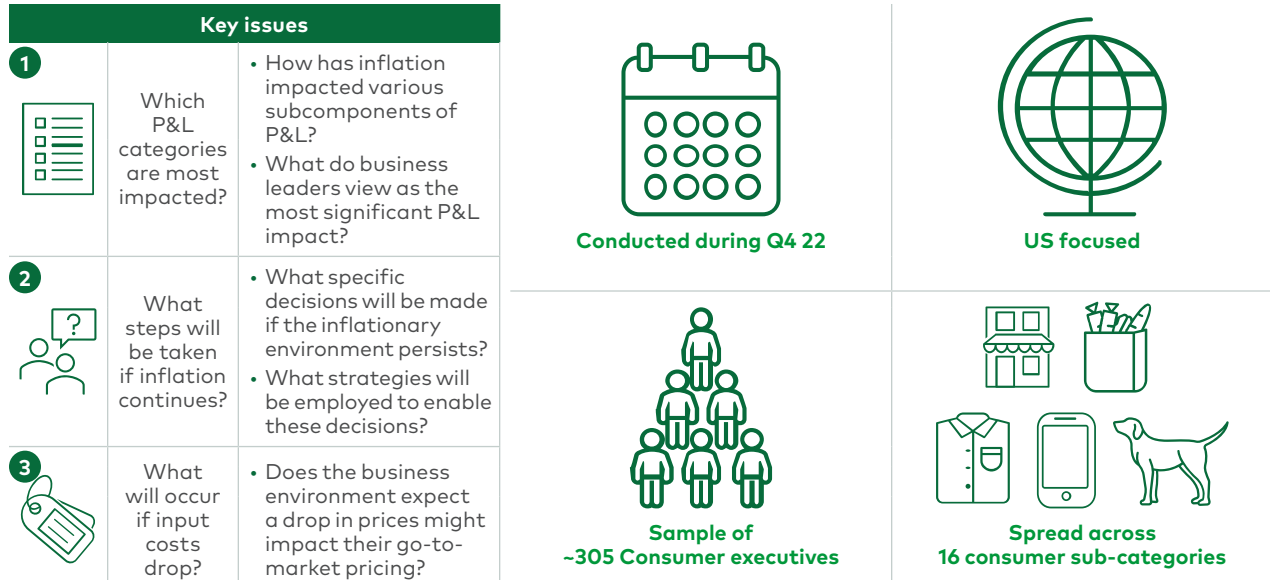
**Figure 1**  
Survey among 300 executives on 16 sub-categories and all go-to-market strategies



Note: F&B=food and beverage  
Source: L.E.K. survey and analysis

The survey focused on three key issues: how the profit and loss statement is being impacted by inflation, the steps business leaders plan to take if inflation continues and how they plan to amend their go-to-market pricing if input prices start to fall (see Figure 2).

**Figure 2**  
L.E.K. 2022 US Inflation Study Methodology

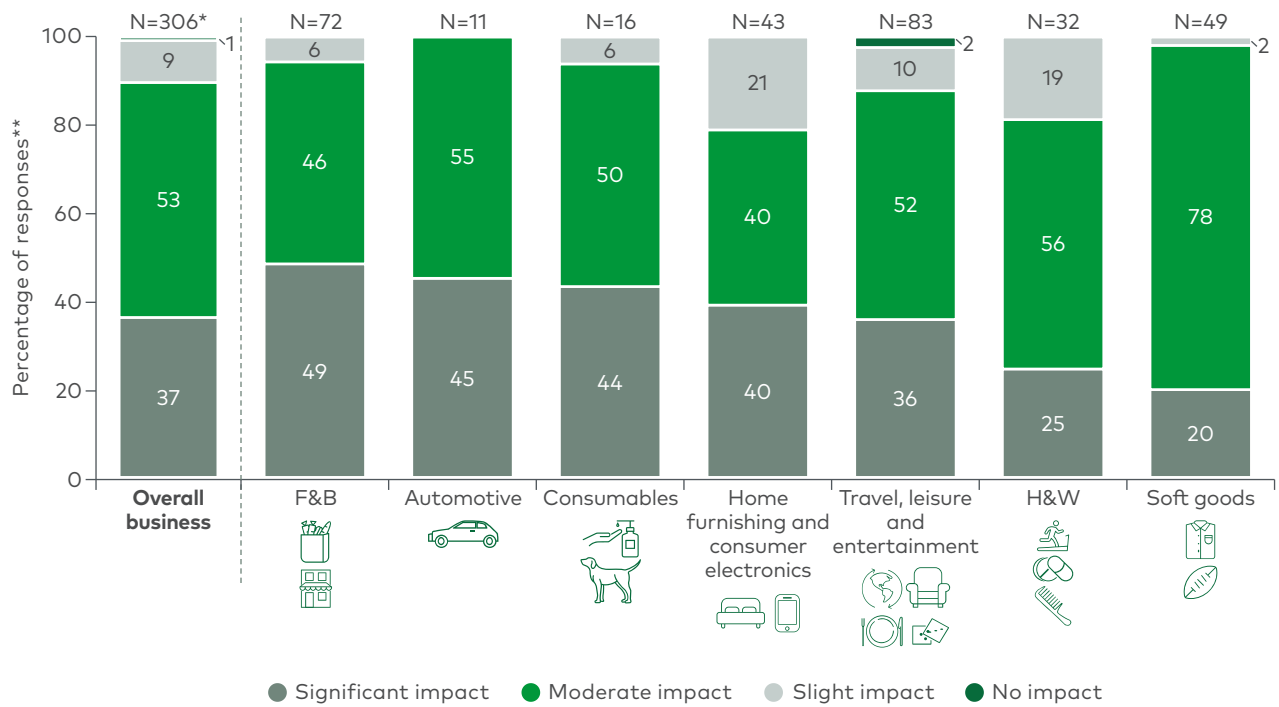


Note: Categories examined in pt. 2 differ from pt. 1 in that rent and utilities are excluded, and big box retail was added as a category  
 Note: P&L=profit and loss  
 Source: L.E.K. survey and analysis

# Inflationary business impacts to date

Of the consumer business leaders surveyed by L.E.K., roughly 90% said they were experiencing material inflationary impacts on their businesses, and this is true across the consumer economy (see Figure 3). Of the seven core consumer categories surveyed, discretionary durables (i.e., home furnishings and consumer electronics)

**Figure 3**  
Inflation impact, across overall business



\*Survey question: Where are you feeling the impacts of inflation across your business?

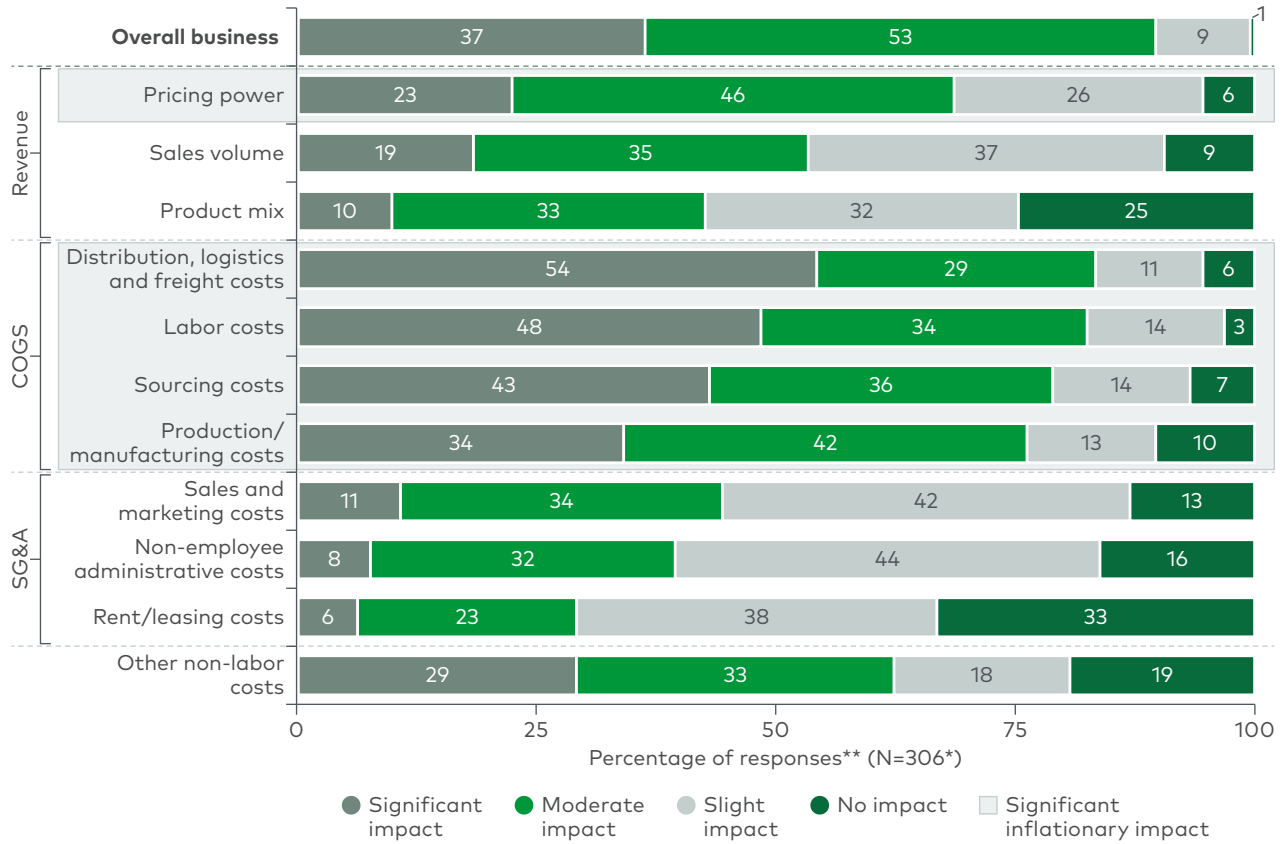
\*\*Percentages may not add to 100 due to rounding

Note: F&B=food and beverage; H&W=health and wellness

Source: L.E.K. survey and analysis

and health and wellness (H&W) have seen a somewhat lesser impact, but even there the vast majority are seeing an impact on their business. Across businesses, distribution, labor, sourcing and production costs were, in that order, the most impacted line items, although over two-thirds of consumer businesses have also found themselves with more pricing power regarding their customers (see Figure 4).

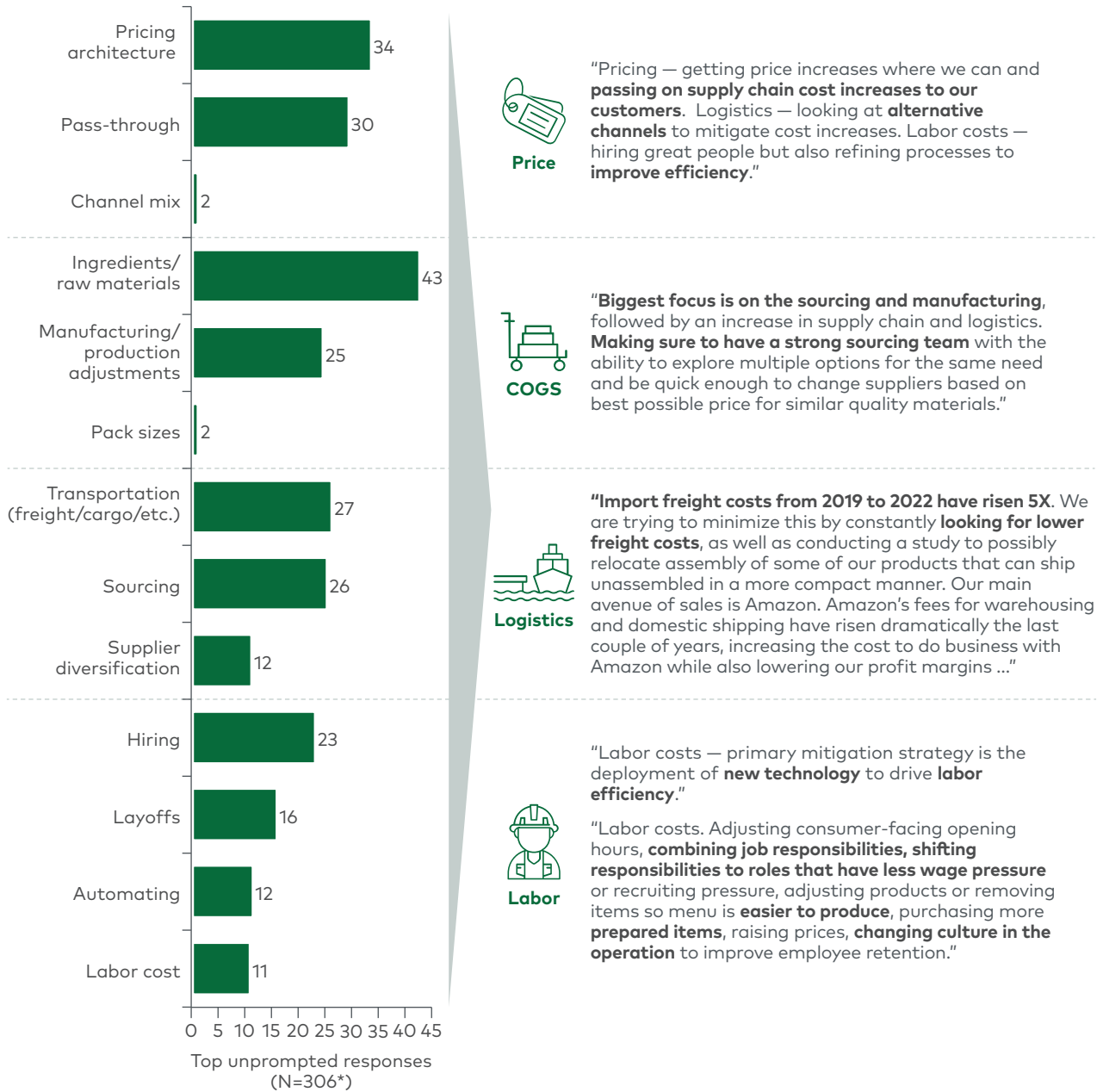
**Figure 4**  
Inflation impact, by P&L component



\*Survey question: Where are you feeling the impacts of inflation across your business?  
 \*\*Percentages may not add to 100 due to rounding  
 Note: P&L=profit and loss; COGS=cost of goods sold; SG&A=selling, general and administrative  
 Source: L.E.K. survey and analysis

Reflecting the inflationary pressures being faced, over 20% of businesses (on an unprompted basis) indicated their primary concern was either passing through cost increases or adjusting pricing architecture to maintain profit margins (see Figure 5). In tandem, executives have been proactively addressing the rising cost of goods sold (COGS) by exploring new and multiple sourcing options to secure supply. They've also been looking at alternative ways to offset the rising cost of freight and labor through technology, job redesign and shifting of business models.

**Figure 5**  
Key inflationary impact (unprompted)



\*Survey question: In what aspect of your business are you most focused on managing inflationary pressures? What strategies/tactics are you employing to do so? (Free response)

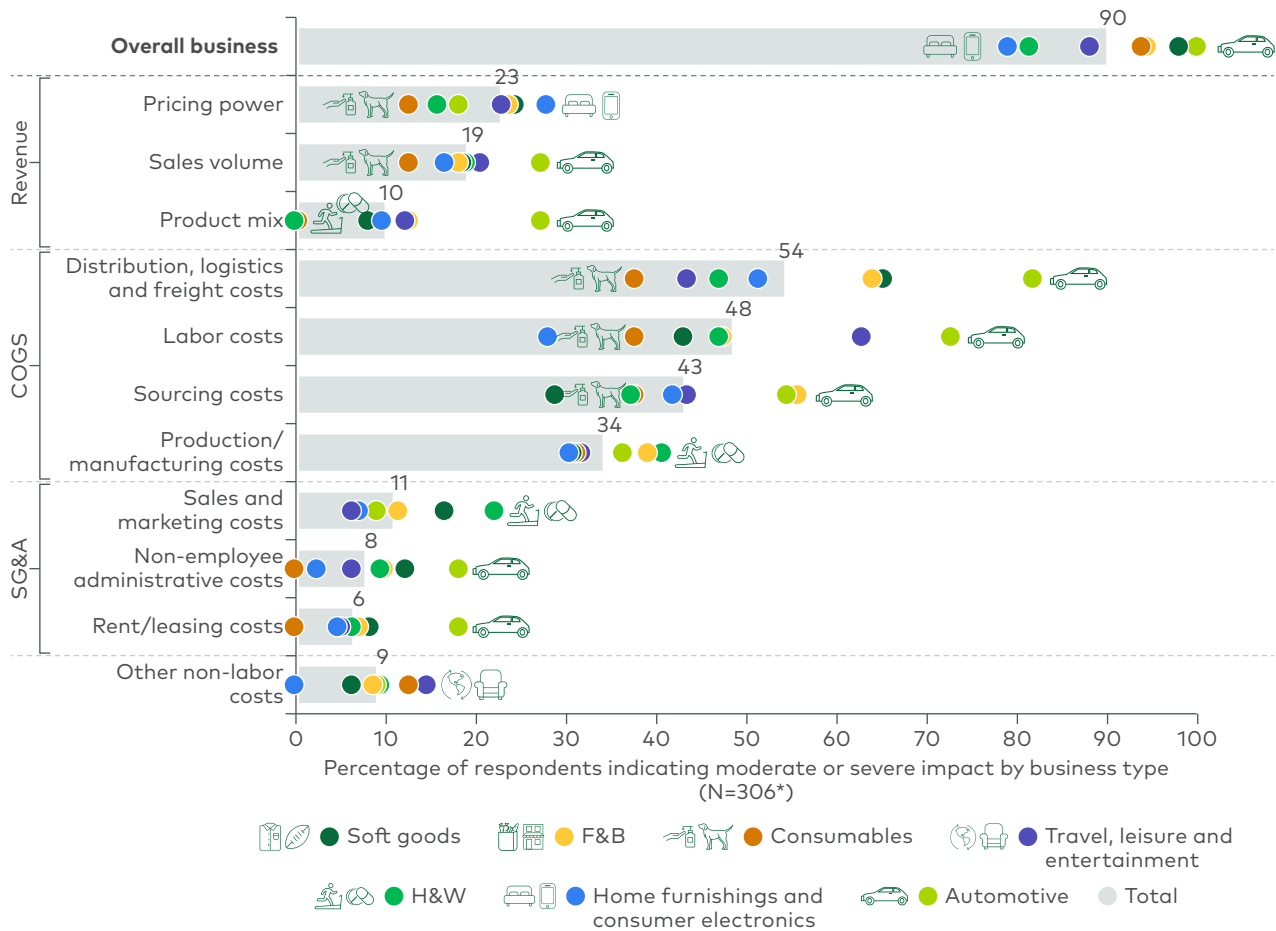
Note: COGS=cost of goods sold

Source: L.E.K. survey and analysis

# The impact of inflation across categories

Inflation is not impacting all types of businesses equally. Broadly, outsized inflationary impacts were cited by the gas and automobile executives surveyed by L.E.K., especially around major COGS elements, reflecting widely reported difficulties in sourcing parts and exposure to commodity prices. On the other hand, nondiscretionary categories, like pet products and H&W, are seeing relatively less impact across revenue, COGS, and selling, general and administrative (see Figure 6). Consumers within these categories appear more willing to absorb price increases, which helps reduce the impact of sourcing, distribution and labor constraints being felt within COGS.

**Figure 6**  
Inflation impact, by P&L component



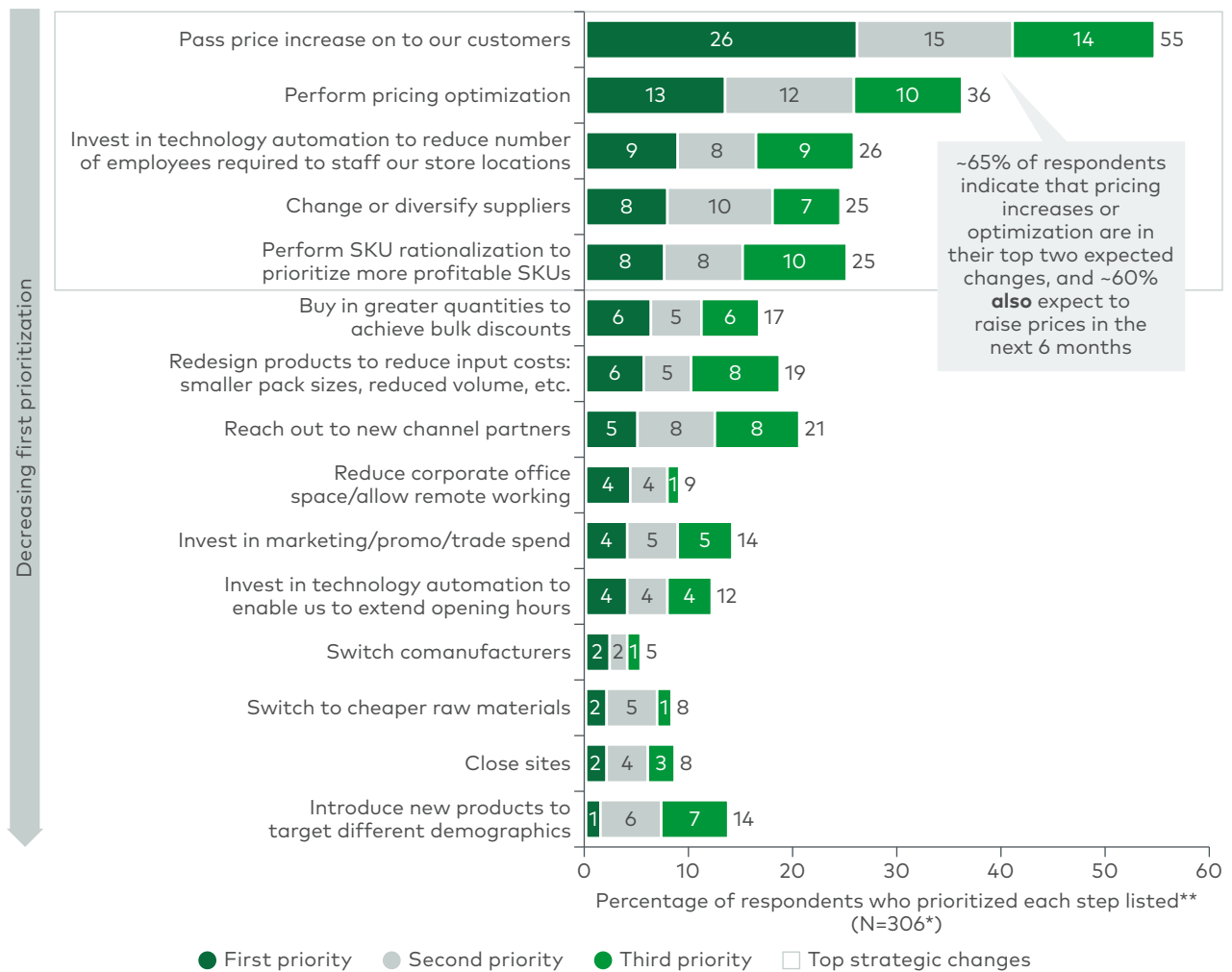
\*Survey question: Where are you feeling the impacts of inflation across your business?  
 Note: COGS=cost of goods sold; SG&A=selling, general and administrative; P&L=profit and loss; H&W=health and wellness; F&B=food and beverage  
 Source: L.E.K. survey and analysis



# What businesses are prioritizing in the face of ongoing inflation

Faced with multiple challenges during this inflationary period, business executives highlighted a number of specific approaches they're taking, in four core areas: 1) overall pricing; 2) pricing optimization, including how the portfolio mix supports overall profitability; 3) technology and automation, to reduce the labor requirement burden; and finally, 4) sourcing (see Figure 7).

**Figure 7**  
Steps that business operators are beginning to roll out



\*Survey question: What specific aspects of your business do you expect to change moving forward in response to the inflationary environment?  
 \*\*Percentages may not equal total due to rounding  
 Note: SKU=stock keeping unit  
 Source: L.E.K. survey and analysis

## Business executive feedback

### 1. Pricing

Pricing is a prime concern of business leaders. But while many view pricing-related actions as a key lever, the best-positioned companies view such actions as more than just a pass-through and instead focus on more strategic pricing elements like redesigning packages, offering new products, partnering with new channels, etc.

"... **Pricing analysis is key. ...Driving distribution partners to take less commission as unit volume is declining as prices are driving up revenue dollars only ...**"

"... Pricing — **working on product mix to increase our profitability ...**"

"... **Consumer pricing. Focusing on long-term customer loyalty rewards and discounts with customers to offset price increases they feel at day of purchase. ...**"

### 2. Pricing optimization

Executives are focusing on maximizing the profitability of their portfolio by reassessing pricing strategies, using promotions and new product introductions as levers to grow higher-price and higher-margin products, and actively reducing lower-profitability SKUs, which also reduces overall organizational complexity.

"... [We focus on] **opening price points that keep cost-conscious shoppers engaged with brands. ...Expanded data initiatives to mitigate risk of excess inventory buys. ...**"

"... **New product development within the key areas of market price points needed to amplify the spaces we operate in. Developing products that fit our portfolio and obtain costing needed to maintain our competitive position. ...**"

"... Since our product is purchased with discretionary income, our potential clients are more price sensitive than before. **Our sales staff is focused on presenting more value-added aspects of our company** than appealing to aesthetics. ..."

### 3. Technology, automation and labor

Meanwhile, when it comes to labor, many businesses cite cost along with employee retention and hiring as significant concerns — and in an attempt to mitigate them, are increasingly turning to technology and automation.

"... Labor and productivity improvements ... **Using technology to improve/reduce manpower needs and reduce costs ...**"

"... Looking at tasks that can be **performed by autonomous vehicles** inside the distribution center ..."

"... [We are focusing on] managing labor costs. Key priorities include **reducing turnover, improving scheduling, and lowering labor costs through use of technology.** ..."

#### 4. Sourcing

Another significant issue for many business leaders is sourcing, specifically as it pertains to supplier concentration risk and price increases. To mitigate the impact of supply chain disruptions and inflationary pressures, many businesses have shifted toward bulk buying, supplier diversification and alternative product sourcing.

"... **We are spending more time sourcing products and vendors to get better pricing.** More **in-depth conversations** with suppliers **including fixed pricing** ..."

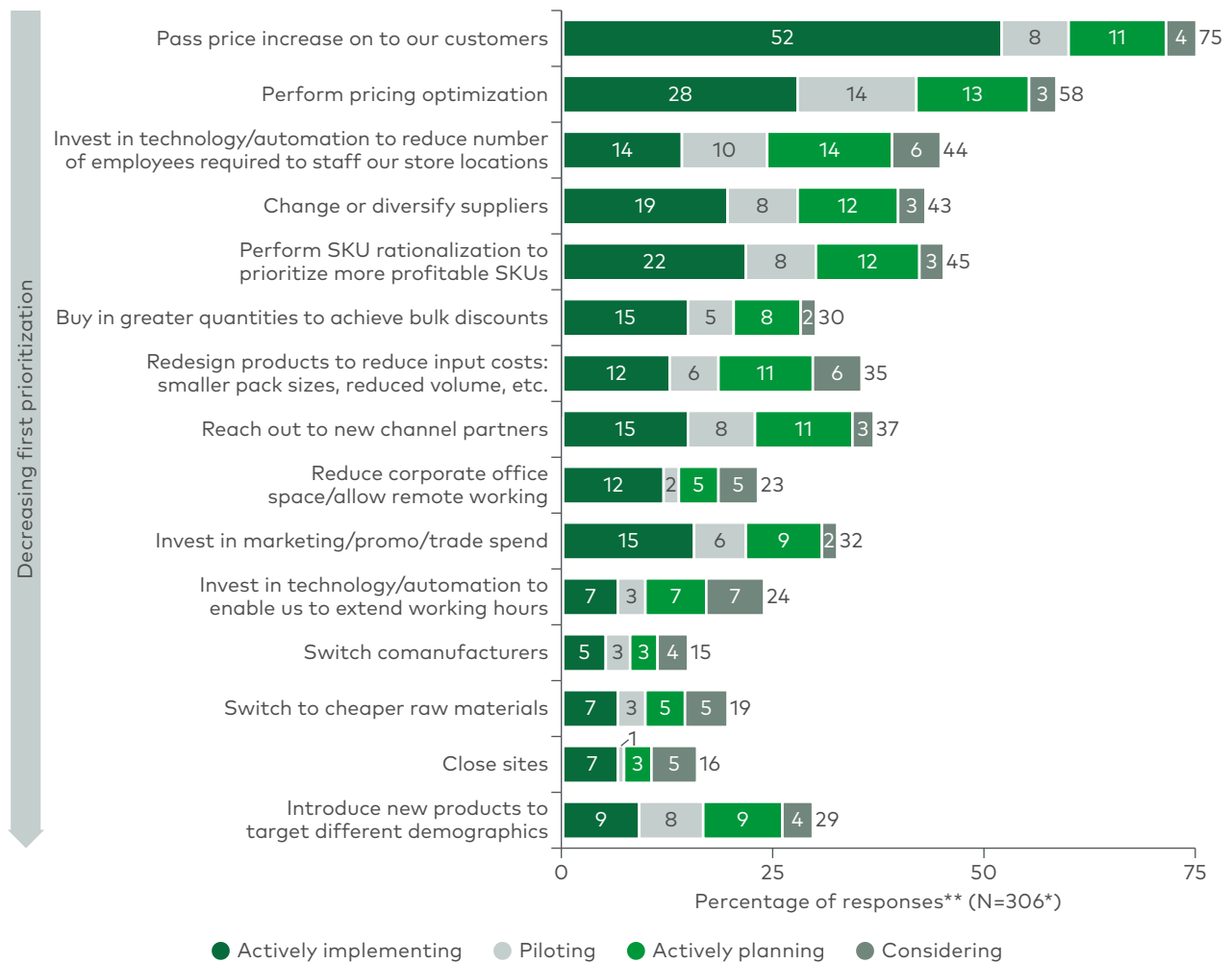
"... Sourcing costs are our biggest challenge, with one key cost more than doubling in 14 months. We are starting **to lock in longer-term agreements on materials,** trying to improve yields and **seeking alternative vendors.** ..."

"... [Our focus is] mostly on sourcing and manufacturing. The cost of purchasing goods overseas has gone up so much it is creating many issues for us as a business. **We are trying to find new suppliers willing to work with us on pricing** and are scaling back our ordering ..."

# Priorities for 2023 and stage of execution

As to their strategic priorities for 2023, more than half of the business leaders we surveyed have already begun increasing their prices (see Figure 8). On the revenue side, other steps that are being prioritized include optimizing strategic pricing and rationalizing SKUs that can't support price increases, as well as attempting to generate revenues through ecommerce or entirely new channels. On the cost side,

**Figure 8**  
Stage of planned responses to inflation



\*Survey question: In what stage are these changes (planned reactions to inflation)?

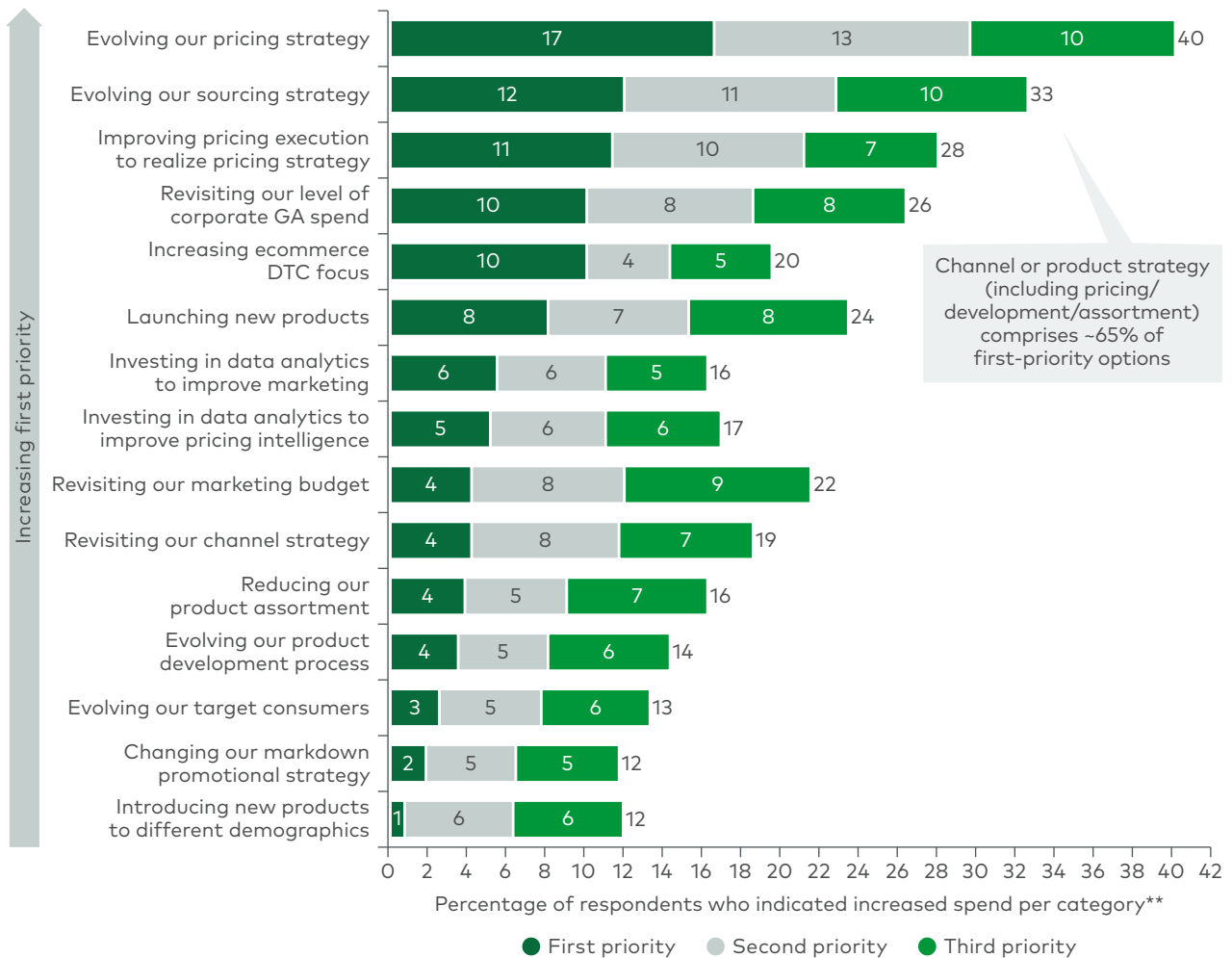
\*\*Percentages may not equal total due to rounding

Note: SKU=stock keeping unit

Source: L.E.K. survey and analysis

businesses are focusing on diversifying suppliers, buying in bulk and investing in technology to reduce the number of employees required to staff locations (see Figure 8). Whether making choices pertaining to revenues, costs or both, business leaders must ensure their choices align with the long-term trajectories of underlying markets and the preferences of their core consumers (see Figure 9).

**Figure 9**  
Planned strategic focus for the upcoming year\*



\*Survey question: Related to inflationary pressures, which of the following strategies are you likely to focus your organization on further developing in the coming year? Please rank at least three strategies in order of importance.

\*\*Percentages may not equal total due to rounding

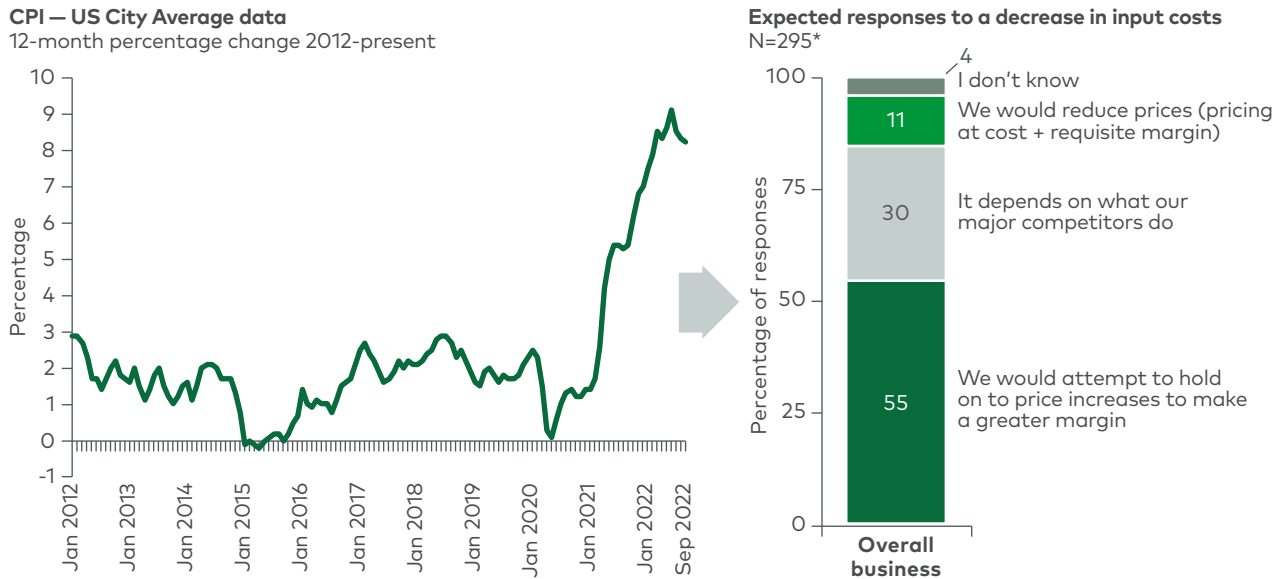
Note: DTC=direct to consumer; GA=general and administrative

Source: L.E.K. survey and analysis

# Future stickiness of price increases

Even if key costs across the supply chain fall, most of the executives we surveyed will try to maintain their organizations' price increases, consistent with the historical rarity of deflation in the U.S. Reinforcing this point is that 55% of business leaders said they would attempt to hold price increases regardless of input costs, with an additional 30% indicating they'd wait and see what their competitors — which are also likely to attempt to keep prices high — do (see Figure 10). In the event of margin expansion, companies should capitalize on the opportunity to strategically reinvest in the interest of long-term prospects.

**Figure 10**  
Historical CPI and how surveyed businesses will hold on to price increases



\*Survey question: If input prices (e.g., utilities/gas/raw materials/shipping costs) decrease, how do you anticipate prices will change? (Select one)  
Note: CPI=Consumer Price Index  
Source: L.E.K. survey and analysis

# Conclusion

Consumer businesses have been significantly impacted by inflation, though not all equally. For example, nondiscretionary categories like pet and H&W appear to have been relatively more insulated from pricing and cost pressures, and therefore able to better cope with the current environment. Yet across the board, executives have been trying to maximize prices while offsetting rising costs; they are also thinking about or implementing further responses.

Pricing is a critical lever for businesses to pull and will offset further margin pressure. While continuing to pass through costs to consumers, the best-positioned companies will be those that are focused on optimizing their pricing strategy and execution while keeping consumer, channel and macro market trends in mind. The anticipated upside (for businesses at least) is that once costs begin to stabilize, price increases will remain sticky, which may yield an opportunity for further strategic investment.

We invite you to connect with us to learn more about our survey and how businesses are adjusting their go-to-market strategies in the face of the current inflationary environment. Please don't hesitate to contact us.

For more information, please contact [strategy@lek.com](mailto:strategy@lek.com).



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