L.E.K.

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Six Minutes With…

Jon Weber, Managing Director in L.E.K. Consulting's Retail and Consumer Products practice

Every six months since 2008, L.E.K. Consulting has surveyed more than 2,000 U.S. consumers about their spending behavior and predictions based on their perception of their personal finances and the economy. Over time, the results have offered a window into the mind of the American consumer—capturing hopes, fears and expectations for the future.

As the survey reached its five-year mark in 2013, Jon discussed the insights gleaned from the surveys and the implications for L.E.K. retail clients.

Q Take us back to 2008. Why did you decide to undertake these surveys?

We started shortly after the collapse of Lehman Brothers in the fall of 2008. The world had turned upside down: credit froze up; severe devaluations in the equity and housing markets followed; unemployment rose and consumers stopped spending. The consumer was in disarray and was panicking. Retailers were too. We realized that we could help clients by providing insights into the consumer's mindset at this extraordinary moment in history.

Q What originally started as snapshots began to form into a narrative over time. What did you learn as the survey progressed?

The consumer has been on quite an epic journey. In the first stage, which lasted about 12 months, the level of pessimism was shocking and widespread. To give two examples: When asked how long the recession would last, the vast majority reported in 2008 that the recession would linger for more than two years, which essentially means "we don't see an end in sight." That's an extraordinarily pessimistic forecast.

At the same time, two-thirds of consumers reported that they were concerned about losing their jobs. Unemployment at the time hovered around 8-9%. Yet 63% of consumers feared they might soon be unemployed. The famous parody of Lake Wobegon children "all being above average" was inverted. Everyone felt below average. It didn't matter who you were – rich or poor – the crash of 2008 and ensuing recession felt personal.

For more information, contact L.E.K. at retail@lek.com

In the second phase, retail sales started to climb again and, despite sustained high levels of pessimism and caution by the consumer, by 2010 we were on a steady upward trajectory that has brought today's nominal and real retail sales figures to above pre-recession peaks. This goes to show that the U.S. consumer is very resilient.

During this resurgence, however, a clear polarization between affluent and lower-income consumers increased, driven by rising income inequality and an increasingly squeezed middle class. Affluent consumers regained confidence in large part due to rising equity values—and opened up their wallets. The rest remained, and still are, fairly pessimistic and very careful with their spending; and indeed many have fundamentally changed their purchase behavior and are fixated on value. Today households earning greater than $75K constitute 60% of total consumer spending in the U.S., and their behavior is an extraordinary driver of overall retail sales. This bifurcation of the U.S. consumer population is striking, and it appears that it will be with us for quite some time.

Q So what does this bifurcation of consumer sentiment and spending mean for retailers?

We refer to this phenomenon as "the hourglass economy," where aggregate growth in consumer expenditure is occurring at the top and bottom income brackets, and in the middle it is contracting – graphed, the data looks like an hourglass. It's a useful framework for retailers to understand what's going on. Affluent consumers at the top are chasing quality and premium brands. At the other end of the scale, lower income consumers (of whom there are an increasing number, thus driving the magnitude of the collective spend at the bottom) are seeking value. This is reflected in their fixation on price and promotions, and propensity to shop lower-tier brands and channels.

> "In today's climate, retailers will be punished if they are sloppy on any element of their business."

What this means is that brands and retailers that appeal to the bottom and top of the hourglass have done quite well recently. The middle, on the other hand, has proven a tough place to be. Many of the best-performing businesses are firmly positioned in one camp, allowing them to clearly connect with consumers looking to satisfy needs at their respective end of the hourglass. However, businesses that can find ways to appeal to both ends of the spectrum can also enhance their prospects for growth. For example, look at the menu at McDonalds. You'll find premium items like the Angus Deluxe alongside the Dollar Menu. Further, Target and Costco are discount retailers, but their ability to appeal to a more affluent consumer provides access to the segment of the U.S. population that is growing its spend and can move sales in a positive direction. So we believe the fundamental answer for retailers is creating clarity and distinction in their propositions that are sufficient to attract consumers looking to satisfy needs at either end of the hourglass.

Q Along with consumer sentiment, what other changes have retailers had to contend with since 2008?

This same time period saw a host of online, social media and other digital tools that have made consumers much more informed and savvier shoppers. Thanks to these tools, consumers now walk into a store—or click through a web site or app—armed with information. Combine that with their recession-driven focus on value and persistence in buying on price and promotion, and they pose quite a formidable challenge to retailers fighting for those extra dollars. In today's climate, retailers will be punished if they are sloppy on any element of their business. Product development, merchandising, marketing, in-store and digital experience, pricing—it all better be top-notch.

Q What advice would you give retailers as they look forward to the next five years?

First and foremost retailers need to take an objective look at themselves. Who is our customer? And what is our reason for being? How can we define that and market it to our customer? Decisions on pricing, promotions, loyalty programs, product-mix all need to be made in a clear, strategic context. This is Business School 101, but many retailers were sloppy in the mid-2000s and are struggling to regain their disciplined approach to strategy and implementation.

I also counsel retailers to search for where disposable income is growing in both an American and international context. Emerging markets present a seductive opportunity but figuring out where to place bets, and how to roll-out in foreign markets, can be very challenging.

The world has changed since 2008, but the strategic imperative for all retail businesses remains the same: determine where to play and how to win. And then go do it!

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L.E.K. Consulting is a global management consulting firm that uses deep industry expertise and analytical rigor to help clients solve their most critical business problems. Founded 30 years ago, L.E.K. employs more than 1,000 professionals in 22 offices across Europe, the Americas and Asia-Pacific. L.E.K. advises and supports global companies that are leaders in their industries – including the largest private and public sector organizations, private equity firms and emerging entrepreneurial businesses. L.E.K. helps business leaders consistently make better decisions, deliver improved business performance and create greater shareholder returns.

For further information contact:

Boston
75 State Street
19th Floor
Boston, MA 02109
Telephone: 617.951.9500
Facsimile: 617.951.9392

New York
1133 Sixth Avenue
29th Floor
New York, NY 10036
Telephone: 646.652.1900
Facsimile: 212.582.8505

Chicago
One North Wacker Drive
39th Floor
Chicago, IL 60606
Telephone: 312.913.6400
Facsimile: 312.782.4583

San Francisco
100 Pine Street
Suite 2000
San Francisco, CA 94111
Telephone: 415.676.5500
Facsimile: 415.627.9071

Los Angeles
1100 Glendon Avenue
21st Floor
Los Angeles, CA 90024
Telephone: 310.209.9800
Facsimile: 310.209.9125

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