EXECUTIVE INSIGHTS

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# L.E.K. Consumer Sentiment Survey #11: Consumers Are Feeling Better About Spending

For the first time since the fall of 2011, we are seeing a noticeable uptick in consumer sentiment and outlook for overall spending. So does this mean retailers should expect a bonanza in upcoming sales? The broader explanation will reveal itself through the following analysis of our recent research. The data suggests that consumers may finally be poised to open their wallets a little bit.

> ***Against the backdrop of slow yet steady gains in the economic recovery, consumers across all income categories are expecting their personal finances to be better over the coming months***

In the summer of 2014, L.E.K. Consulting surveyed 1,300 U.S. consumers across all major demographic groups to gauge their attitudes toward the economy, their personal finances and their expectations for purchases across 17 categories of spending. This Consumer Sentiment Survey (CSS) is the 11th since 2008 and it tracks consumers' spending expectations for the following months by both income and age groups, surfacing a range of implications for retailers and consumer products manufacturers alike.

## Economy on More Solid Footing

Since the end of the recession in 2009, economic indicators have improved, albeit very slowly. Real personal income has increased by 3.8%, and unemployment has dropped from a high of 9.5% to 5.9% in September 2014. New and existing home sales rose modestly with 12% gains and auto sales showed a healthy 63% uptick. At the same time, consumer debt continued to grow, fueling some growth in retail sales. The confluence of this activity offers one encouraging sign: real retail sales (excluding autos) have finally regained the level which they reached before the economic downturn (see Figure 1), although growth has been slow and protracted.

## Positive Outlook for Personal Finances But Unbalanced Spending Due to Income Divide

Against the backdrop of slow yet steady gains in the economic recovery, consumers across all income categories are expecting their personal finances to be better over the coming months based on our survey findings. The outlook is even more buoyant among higher income households (those in the \$75K-\$200K and \$200K+ household income groups).

*L.E.K. Consumer Sentiment Survey #11: Consumers Are Feeling Better About Spending* was written by **Francois Mallette**, a managing director in L.E.K. Consulting's Boston office. For more information, contact retail@lek.com.

However, further evidence from our survey shows how the hourglass economy is affecting and reshaping consumer spending patterns. For example, the top 30% of households by income account for nearly 60% of total consumer spending (see Figure 2). Conversely the bottom 50% of households account for only 25% of spending.

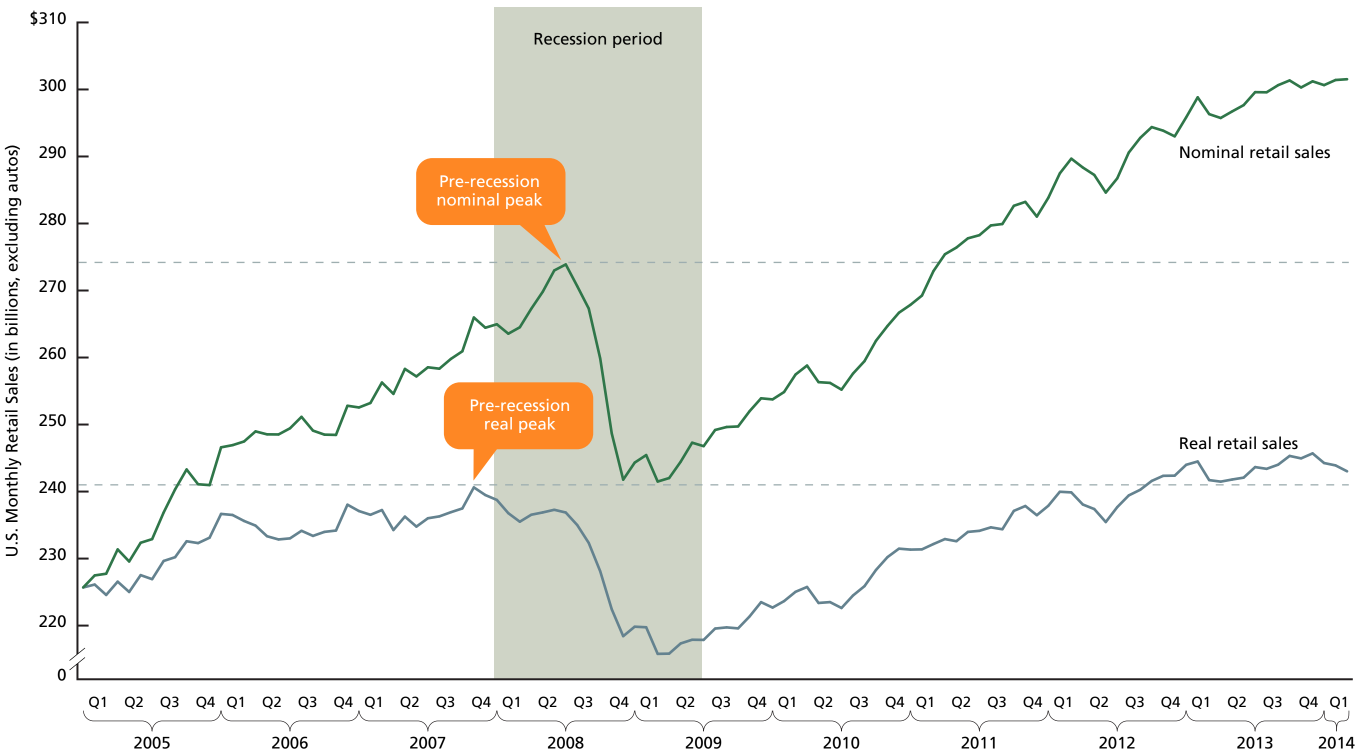
## Consumer Spending Projections Show Marked Improvement

Since the fall of 2011, despite acknowledging that they expect their personal finances to improve, consumers have remained cautious about their expectations for personal spending over the next six months. In this survey, consumers overall have indicated an important improvement in their expectation for spending. While consumers are notoriously difficult to read, the data shows that this is the largest improvement in spending expectation since immediately after the precipitous decline in spending that occurred in 2008.

Some product categories appear more likely to benefit from this increased expectation to spend. While consumer staples such as groceries have consistently led the 17 categories in which consumers have expected to increase their spending (although by very little), CSS11 shows that discretionary categories such as home renovations, vacations, cars and furniture have made their way to the top of the list of growth in expected spending.

"What we are seeing is most likely a combination of pent-up demand and a real up-tick in consumer confidence," says Francois Mallette, managing director and head of L.E.K.'s North American Private Equity Practice, who led the research effort. "But it's definitely an encouraging sign; when we conducted the survey in the past, consumers expected to increase spending in very few categories."

**Figure 1**
**U.S. Retail Sales (excluding autos)**
Real Retail Sales Regain Pre-Recession Peak




Notes: Sales data is adjusted for seasonal, holiday, and trading-day differences, but not for price changes; ** Real monthly sales indexed to January 2005 and adjusted with CPI data; monthly data up to, and including, February 2014
Source: Bureau of Labor Statistics, U.S. Census Bureau, L.E.K. analysis

## Millennials Lead the Pack

Millennials are a beacon of optimism in what is still a relatively tepid consumer landscape. This large cohort, ages 18 to 34, makes up about 31% of the adult U.S. population. Millennials are more sanguine about the economy and they expect their spending to increase more than any other age groups over the next six months. Their rise in projected spending is driven by expectations that their incomes will grow. Other reasons they cite for increasing their spending are a major life event, a rise in the value of their financial assets and better job security.

## Online Shopping Is Here to Stay

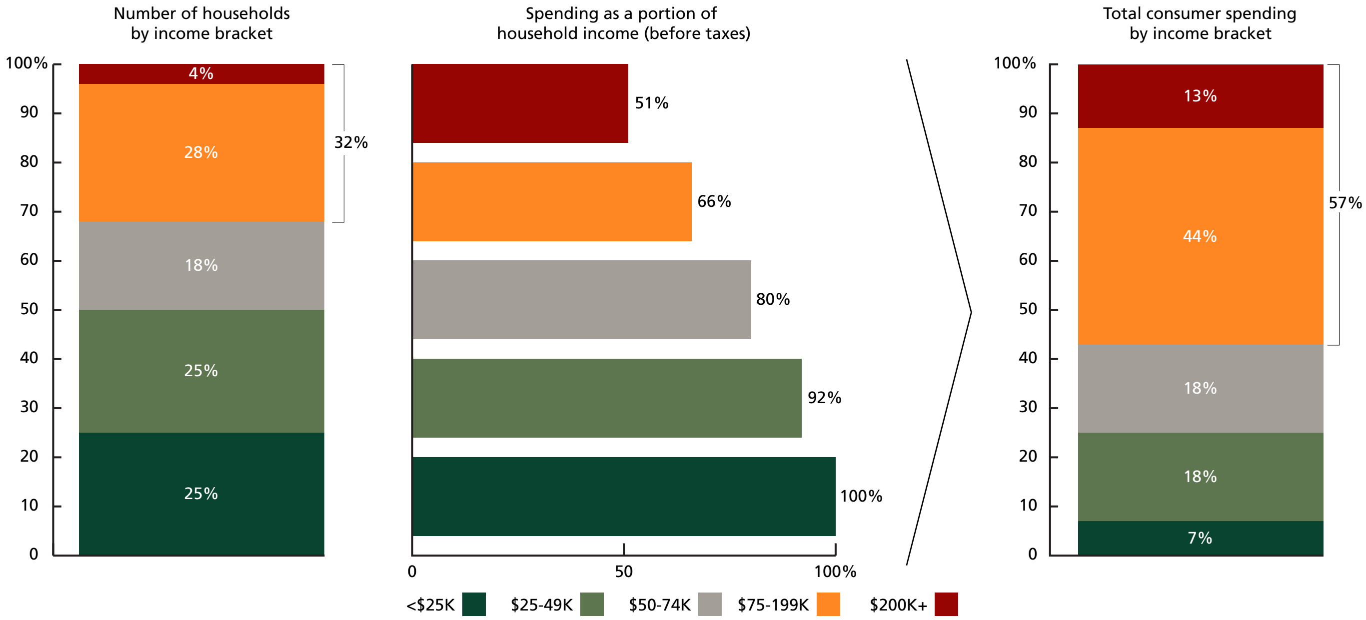
The Internet shopping tidal wave continues to erode in-store sales, and retailers without a compelling e-commerce strategy are suffering as a result. Our survey indicates that online shopping has achieved significant acceptance among all age brackets, with younger groups slightly more likely than older groups to shop online, but only by a small margin. While online shopping is prevalent across all age groups, younger consumers report a much higher level of engagement with mobile shopping, and more than 80% of millennials say they make purchases on their mobile devices, versus only about half of consumers 55 and over.

Consumers report plans to increase online spending over the next six months, citing such advantages as convenience, ease of use, product availability, and selection. Big box, fast fashion and department stores appear to be most vulnerable to the ubiquity of online shopping, with consumers saying they have already changed their shopping behavior by reducing their visits to these types of retailers.

## Key Takeaways and Implications

Overall, consumer sentiment has shifted in a more positive direction, an encouraging sign for retailers and consumer products companies. But this outlook does not hold true across the board. Wealthier consumers are far more likely to open their wallets in the coming months than consumers in lower income brackets, who are still planning to cut back.

**Figure 2**
**U.S. Consumer Income and Spending**
Top 30% of Households Account for Nearly 60% of Consumer Spending




Note: Households earning $75K+ annually make up ~32% of all households but account for ~57% of all expenditures
Source: BLS, U.S. Census Bureau, L.E.K. analysis

Retailers that target these consumers will need to focus strongly on value-based offerings to attract more buyers.

On the other hand, things are looking up for companies that offer products and services in certain categories, provided they target their offerings appropriately. For example, travel companies may find opportunities in marketing to older, wealthier customers, while home renovation suppliers may be more apt to find customers in the middle income brackets.

Finally, traditional big box retailers, department stores and other retailers will probably see sales continue to drop unless they complement their in-store marketing with innovative online strategies designed to attract customers across all income levels and age groups. It is incumbent on retailers to create new, engaging experiences as shoppers increase their online and mobile shopping activity. While consumer spending is moving in a positive direction, it will be tempered by the fact that only 30% of households are driving spending growth. Companies that study the trends and cater to specific markets are the most likely beneficiaries.