EXECUTIVE INSIGHTS

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Consumer Buying Behavior: Are the Changes Lasting?

Despite all the recent optimism being trumpeted by numerous economists and some of the media, L.E.K.'s most recent research indicates that such confidence is likely premature. More specifically, this economic downturn may result in long-lasting changes in consumer buying behavior, which will have significant impact on the economy as a whole.

A new survey of a demographically representative set of more than 3,000 consumers confirms that after 17 months of recession, they are actually more negative now than they were when a similar survey was conducted in October of 2008. Specifically:

- About 75%-80% of consumers report being concerned about losing their jobs and about 80% said they were concerned about someone in their immediate family losing a job.
- About 50% of consumers feel the economy will not recover for at least two years.
- Consumers estimated that their overall decline in spending was 8.8% versus a year ago – approximately twice as much as they reported last October.
- Almost 60% of consumers said they plan to spend less over the next six months.
- In a worrisome long-term indicator for retailers and CPG manufacturers, 40% of consumers also said they would continue to spend less even when the economy recovers.

Overall, consumers' views toward the state of their own personal finances have continued to darken, particularly among those with incomes of over $100k. As *Figure 1* indicates, higher-income individuals as a group have consistently become relatively more negative about their personal finances. Consumers also report that their overall spending has declined across all categories over the past 12 months – including such staples as groceries, which was stable in our October survey. The sharpest declines are coming from older consumers.

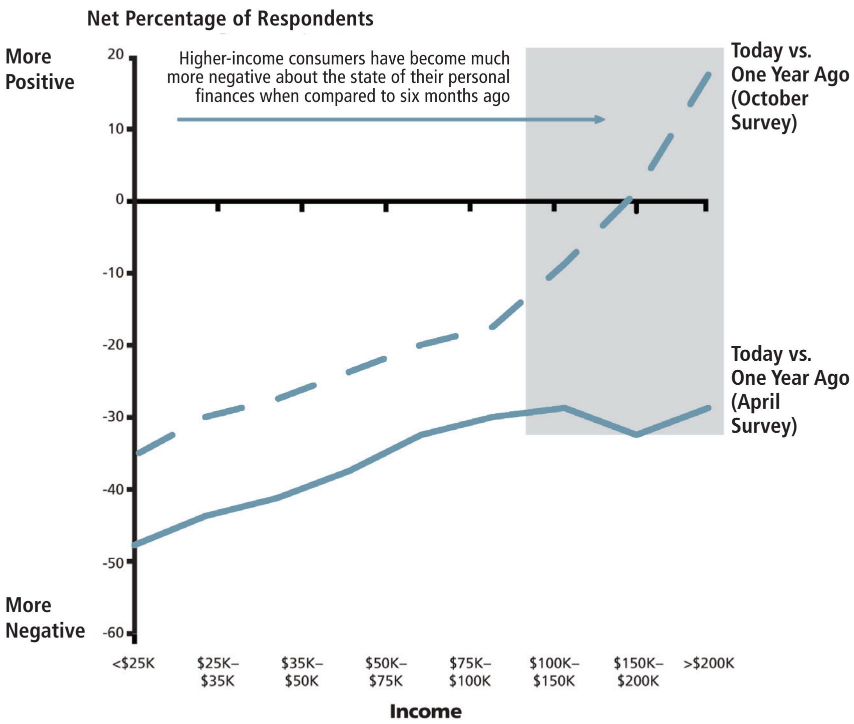
Seismic Changes in Buying Behavior?

A key finding of our study is that there are indications of seismic shifts occurring in how U.S. consumers plan to behave in both the near term and long term. Our data indicates that consumers who are spending less are actively seeking to trade down across three dimensions:

1. Trading down on brand:
Forty-five percent of consumers are now actively trading down to less expensive brands and an additional 30% report that they are mixing in less expensive brands with their traditional purchases. This means that 75% of consumers are buying less expensive brands. In addition, depending on the category, 50%-80% of consumers are buying more private-label products. For example, groceries ranked the highest with nearly 80% of consumers purchasing more private-label products this year versus last.

Consumer Buying Behavior: Are the Changes Lasting? was written by **Daniel McKone,** Vice President, and **Andrew Rees,** Vice President and Retail and Consumer Products Practice Leader. Please contact L.E.K. at retail@lek.com for additional information.

Figure 1
Sentiment on personal finances by income today vs. one year ago



2. Shifting channels:
About 40% of consumers said that they are actively shopping at less expensive stores and an additional 25% of consumers said they have been mixing in some shopping at less expensive stores. This means that about two-thirds of consumers have migrated to less expensive stores. This is a significant shift of consumers moving from traditional channels to lower-price channels. For example, 68% of consumers are shopping at less expensive stores for apparel.

3. Buying fewer and cheaper items:
Fifty percent of consumers said they are buying items at the same price, but buying fewer of them, and 50% of consumers said they are buying lower-priced items this year compared to last. Approximately 70% of these consumers are saying that when they buy, they buy fewer items. For example, 54% report that they are buying fewer over-the-counter (OTC) medicines, and of these, 70% said that they are buying fewer OTC medicines overall.

Implications for Retailers and CPG Manufacturers

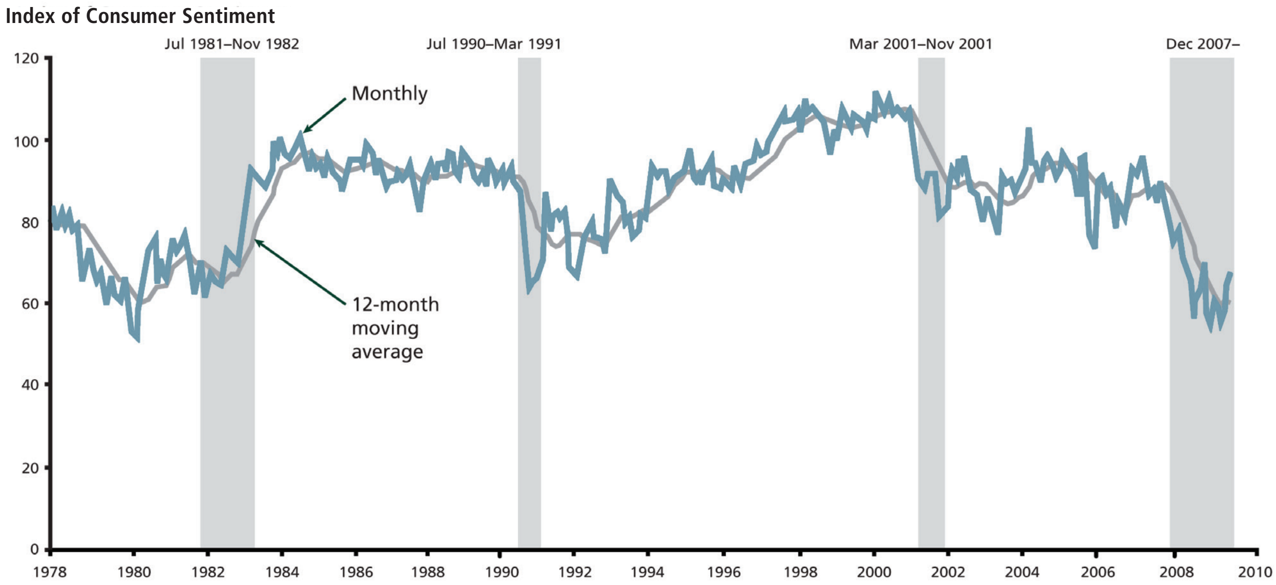
Some readers may be surprised by these findings, so it is important to put them into historical perspective. For example, the University of Michigan Index of Consumer Sentiment rose to 67.9 in May from 65.1 in April. But despite this recent uptick, the fact is that consumer sentiment remains at historically low levels, as shown in Figure 2. In addition, the recent increase in household savings rates (which jumped to 4.2% in the first quarter of 2009) is still well below the post-World War II norms.

The fact that nearly three-quarters of consumers across all demographic groups are expecting that the economy won't recover until the fourth quarter of 2010 at the earliest and about half don't expect it to recover for at least two years, is also negative news, as shown in Figure 3.

Of greater concern is the fact that even after the economy recovers, our survey found that consumers are planning on making significant changes to their buying behavior. In fact, 40% stated that they will spend a little or a lot less than they have historically even after the recession ends – and for older consumers (e.g., older families, empty nesters and retirees) it is nearly 50%. In addition, these consumers are planning on significantly increasing their savings post-recession with one-fifth saying they will save "a lot more" than they have historically (*see Figure 4*).

Figure 2

University of Michigan Index of Consumer Sentiment (January 1978 – May 2009)



This combination of historically low consumer sentiment and increasing savings rates has enormous implications for retailers and CPG manufacturers. If consumers continue to increase their savings rate to 7% – which is the average over the past 60 years – it will take approximately $120 billion out of the economy on a quarterly basis. And if they save at a rate of 10% – and there is a historical precedent for this – it could take as much as $200 billion out of the economy each quarter.

We also see consumers making very different choices about where they shop, shifting their spending from more expensive specialty and department stores to discounters, dollar stores and mass merchants. This shift can be seen across categories but is particularly pronounced in such categories as consumer electronics and children's apparel. While this data isn't unexpected, the key question retailers need to ask themselves is whether this shift is temporary or more long lasting.

Similarly, while it may not be surprising to see that nearly 80% of consumers are buying more private-label brands at grocery stores, the trend to private-label spending across an increasing number of categories begs the question of whether this shift is temporary or more long lasting as well (*see Figure 5*).

Figure 3

Belief in when the economy will recover by demographic group

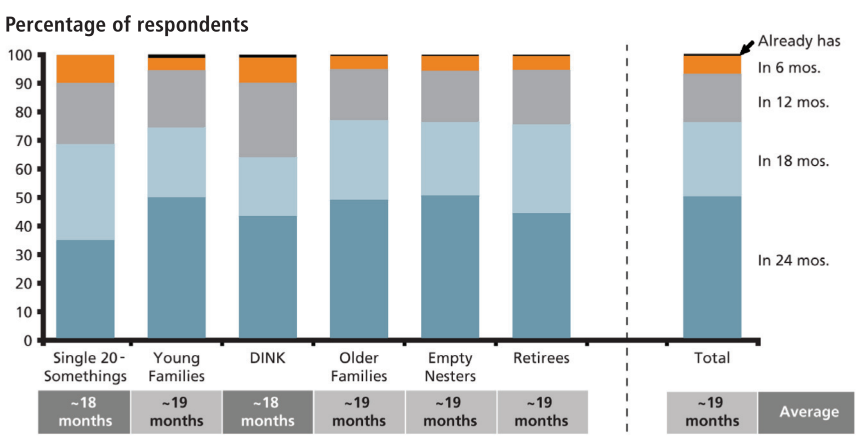
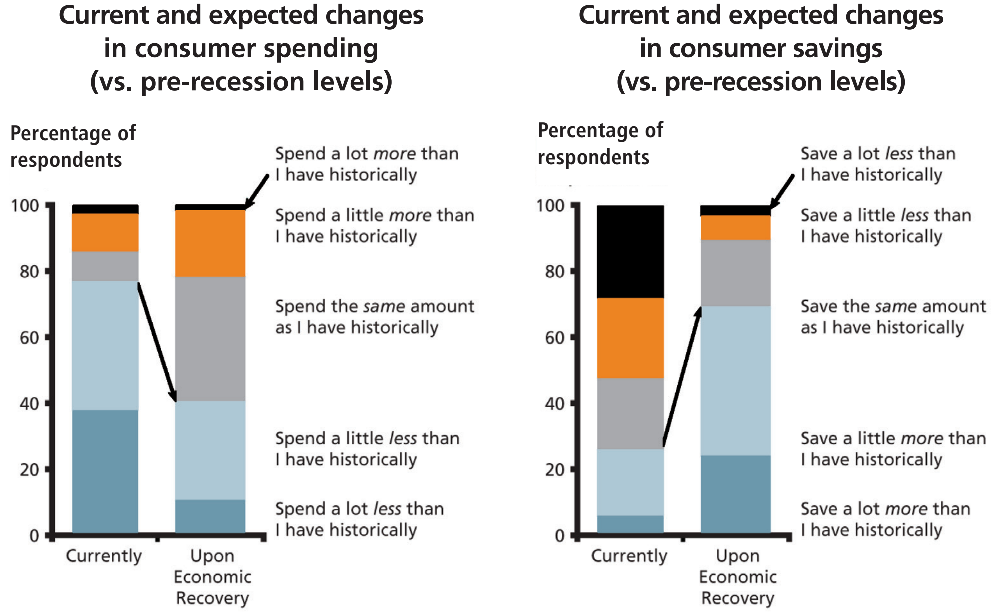


Figure 4

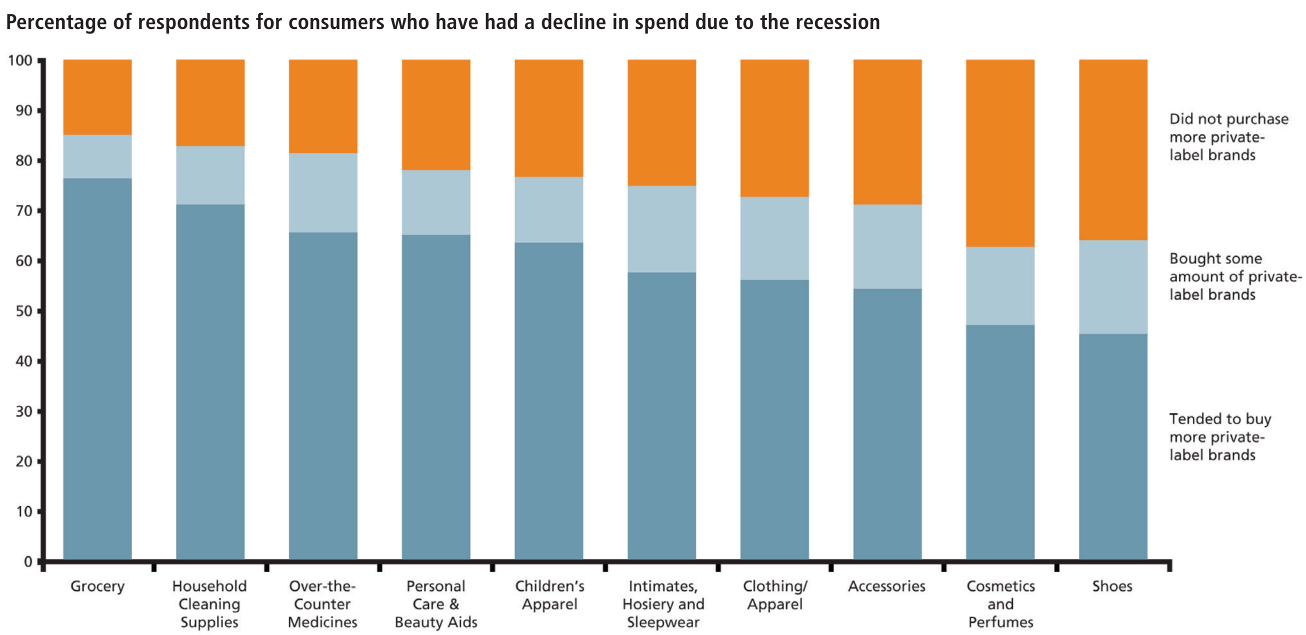


Conclusion

Despite recent expressions of optimism by a number of economists and some of the media, retailers and CPG manufacturers would do well to understand that this may be deceiving. As our research shows, on a relative basis, consumer confidence remains near historical lows, savings rates are rising and consumers have made fundamental changes in their buying behaviors. If these changes do prove to be long lasting, then retailers and CPG manufacturers must continue to diligently re-examine their businesses, stay constantly in tune with their customers, and respond swiftly and strategically.

Figure 5

Trend in private level spend for relevant categories



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