L.E.K.

EXECUTIVE INSIGHTS

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Affluent Consumers Are Powering The Retail Recovery

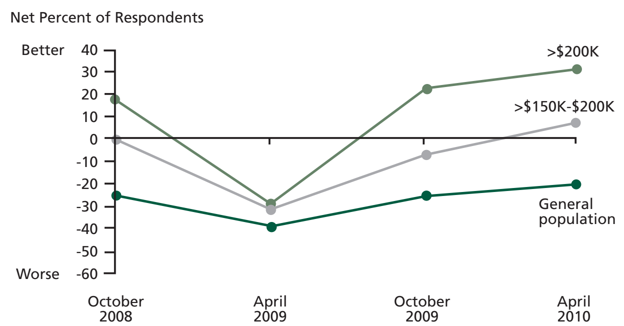
While many Americans are cautiously encouraged by economic recovery signals, the nation's most affluent consumers are rebounding more rapidly than the average consumer. Thanks to the resilient stock market, America's high-earning households are opening their wallets and spending at a significantly higher rate than the general population. This marked shift in affluent consumer spending patterns has significant ramifications for retailers who have been facing stagnant sales.

The high-income bracket has historically made a disproportionally large contribution to domestic spending, with households earning more than $150,000 annually representing more than half of U.S. retail sales[1]. Wealthy individuals have also not traditionally been as price-sensitive as other population segments, and typically make purchases based on value and quality rather than absolute price.

Approximately one year ago, these high-earning households lost confidence in their personal finances and began to strongly reflect the general population's pessimistic consumer sentiment (Figure 1). Now that the economy is recovering, wealthy consumers appear to be abandoning the relatively austere spending habits of other Americans. To fully understand this shift, L.E.K. contacted more than 2,000 U.S. households in April 2010 to gain insight into Americans' spending patterns for its semiannual Consumer Sentiment Survey.

Figure 1

U.S. Sentiment on Personal Finance by Household Income, Today vs. Pre-Recession



Source: L.E.K. Consumer Sentiment Survey

The Affluent Are More Optimistic

While the attitudes of U.S. households have only improved modestly since the depths of the recession, high-income homes have an increasingly positive outlook. L.E.K.'s research found that households earning more than $150,000 annually are much more likely than the general population to believe that their financial conditions have recovered or were never affected (39% to 22%, Figure 2). On average the general population believes that they are still more than a year away from "personal recovery" from the downturn; however, affluent consumers generally believe that their situations will return to normalcy by Q4 2010.

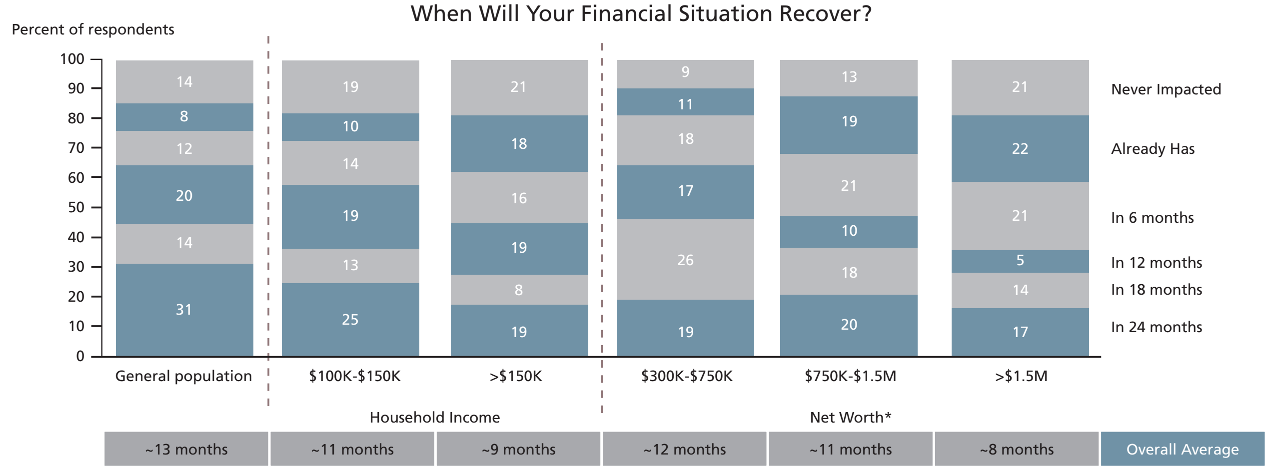
Not surprisingly, the return of affluent consumer confidence seems to have tracked the relative rebound in the equity markets, with the most affluent consumers soaring back with S&P 500 growth (Figure 3). Since spending is highly correlated with consumer sentiment, it appears that the wealthy are literally pulling the U.S. out of its recession.

Affluent Consumers Are Powering the Retail Recovery was written by **Andrew Rees**, Vice President and Retail and Consumer Products Practice Leader; and **Dan McKone**, Vice President of L.E.K. Consulting. Please contact L.E.K. at retail@lek.com for additional information.

[1]*Source: The American Affluence Research Center*

Figure 2

When Will Your Financial Situation Recover?

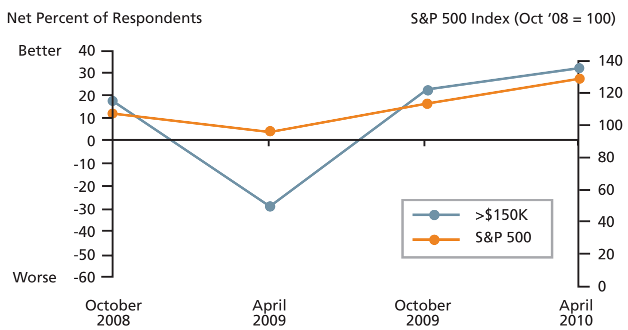


Note: *Net worth calculated as value of home plus value of other savings and investments

Source: L.E.K. Consumer Sentiment Survey

Figure 3

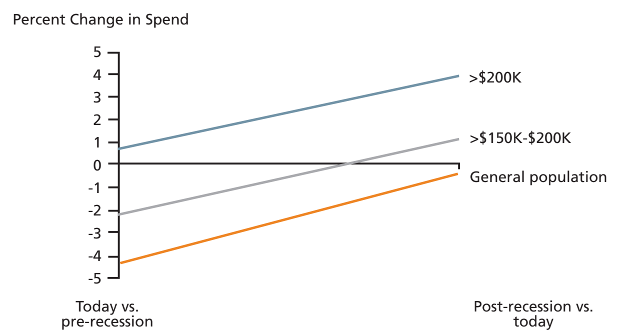
U.S. Sentiment on Personal Finances by Household Income, Today vs. Pre-Recession and the S&P 500 Index



Source: L.E.K. Consumer Sentiment Survey

Figure 4

Percent Change in Overall Spending by Household Income



Source: L.E.K. Consumer Sentiment Survey

Importantly, affluent consumers are translating optimism into purchasing power. According to the L.E.K. research, households earning more than $150,000 annually are the only demographic claiming to spend more today than before the recession (Figure 4). By stark contrast, the general population has decreased its spending by more than four percent. The affluents are also the only group explicitly planning increases in retail spending going forward.

The Affluent Drive Consumer Megatrends

Retailers also need to understand the deeper motivations of customers, and the L.E.K. Consumer Sentiment Survey identified individuals who describe themselves as "passionate" about specific consumer trends (via a series of highly targeted questions about their shopping habits). Of note, the percentage of high-income individuals who align themselves with these trends is typically more than seven percent higher than the general population (Figure 5). In addition, it appears that support for key consumer megatrends is anchored in this group; their improving attitudes have major ramifications for Teen Independence, Online Shopping and Natural Products.

Figure 5

"Passionate" Followers of Consumer Trends

Consumer Trends	General Population	Annual Household Income >$150,000	Percent Difference
Teen Independence: *Increased influence and purchasing power among teens*	35%*	43%	8%
Time Savings: *Products that address hectic lifestyles*	23%	31%	8%
"Green" Products: *Environmentally friendly items*	21%	27%	6%
Online Shopping: *Enhanced purchasing via the Web*	19%	26%	7%
Natural Products: *Organic and related food items*	17%	24%	7%

Source: L.E.K. Consumer Sentiment Survey

*Agreement among respondents with teenagers in their family

Implications of Renewed Affluent Spending Power

The attitudes of haves and have-nots generally converged during the economic crisis, but now have become markedly unhinged. While the separation of affluent consumers from the pack is not new, it raises several interesting implications regarding this group's disproportionately large impact on the economy.

Despite social equity questions related to this separation, the general population benefits from high earners returning to their carefree spending ways, given their potential to strengthen the frail economy. However, until improvements in consumer confidence are broad and robust, the current engine of retail recovery is exposed to the psychology of affluent consumers, meaning that stock market fluctuations have amplified feedback risks.

Successful navigation through today's business climate requires retailers to gain a deep understanding of their customers, segment by segment. In particular, insights into a company's most affluent consumers can have a profound impact on business strategy and provide a tangible set of marketing steps amid hazy market conditions.

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