

South Africa's cautious consumer

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In light of the country's challenging economic environment, how can consumer-goods companies and retailers succeed in South Africa?

Over the past decade, more than three and a half million South Africans have been lifted out of extreme poverty. As of 2015, the country's consuming class¹ grew to encompass about nine million households, accounting for \$191 billion² in private consumption. Yet, despite this expansion of the consumer pool, private consumption in South Africa has been growing at a fairly subdued annual rate of 2.8 percent over the past five years and a mere 1.6 percent in the past year—slower than Africa's other major economies.

South African consumers are under tremendous financial pressure due to higher prices (inflation has averaged 5.4 percent over the past five years, edging up to 6.4 percent in 2016) and low real growth in wages (averaging 1.3 percent in the past five years). To buy what they need, many South Africans have had to dig into savings or make purchases on credit.

Our recent survey of 1,000 South African consumers confirms that most of them are indeed concerned about their financial prospects and thus holding back spending. Almost 70 percent of respondents said they worry about imminent job loss. More than half said they are living paycheck to paycheck. No surprise, then, that they are cutting back on spending, delaying purchases, and shopping around for the best deals.

The South African survey was part of our global survey involving more than 22,000 respondents from 26 countries (see sidebar, "Our survey methodology").³ Our aim was to understand how consumers feel about their financial prospects and how these sentiments are affecting their buying behavior. The insights we gleaned carry important implications for consumer-goods companies and retailers doing business in today's challenging South African market.

Concern and caution

Most South Africans are making cautious financial decisions. Slightly more than half of survey respondents said they are finding it harder to make ends meet than they did a year ago, and 55 percent said they live paycheck to paycheck (Exhibit 1). More than 60 percent agreed that their precarious financial situation is causing them to delay purchases or cut back on spending.

This pervasive sense of financial instability in South Africa stands in stark contrast to the rising confidence of consumers in certain parts of the world. The majority of consumers surveyed in mainland China and North America, for instance, expressed no concern about job loss.

Even if their financial situation were to improve, South African consumers wouldn't necessarily loosen their purse strings. Survey respondents said that if their income were to rise by 10 percent, they'd spend only about 22 cents of every additional rand; the rest would go into savings and toward paying off debt. Among consumers who said they'd spend a portion of their extra income, most—60 percent—would buy everyday necessities. More than 40 percent said they'd allocate some of the money to clothing and home goods.

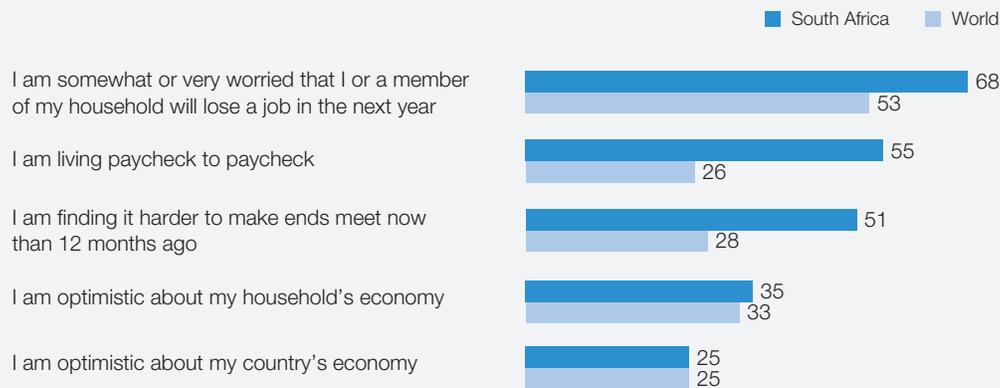
Four traits

The survey responses brought to light a set of behavioral shifts among South African consumers. These shifts, to some extent, are also evident in other parts of the world, especially in emerging markets. Collectively, they underscore the challenges and opportunities that consumer-focused companies will face in the near term. Companies doing business in South Africa would do well to keep in mind the following four traits of today's South African consumers.

Exhibit 1 A sense of financial insecurity is pervasive in South Africa.

Consumer sentiment,

% of people who agree or strongly agree with each statement



Source: McKinsey Global Consumer Sentiment Survey, 2016

1. They proactively search for savings.

Consumers are reducing their spending in a variety of ways. Seventy-five percent of South Africans agreed that they're "increasingly looking for ways to save money." More than half said they are tightening their belts by comparing prices, seeking out sales and promotions, delaying purchases, and shopping at several stores to find better deals. In addition, they're changing their eating habits—in particular, eating at home instead of dining out and cooking from scratch more often.

2. They are brand loyal—but only if the price is right.

Three out of every four South African survey respondents said they've modified their buying behavior when it comes to their favorite brands. Many haven't abandoned their preferred brands but are shopping around to find retailers that sell these brands at lower prices. Some are also purchasing in smaller quantities, waiting until the brands are on sale, or buying only with discount coupons (Exhibit 2).

3. Once they trade down, they might not go back.

In the survey, 21 percent of South African consumers, compared with only 12 percent of

consumers globally, reported trading down—that is, buying cheaper brands or private-label products instead of their preferred brands. Among consumers who traded down, 36 percent opted for private-label products. The most vulnerable categories (those with the highest trade-down rates) were pasta, bottled water, and household-cleaning supplies, perhaps indicating that some branded products in these categories may not have differentiated themselves enough and thus don't stand out in the minds of South African consumers (Exhibit 3).

Many consumers who traded down didn't regret it; they were satisfied with the less-expensive options. Indeed, 57 percent of those who traded down said they intend to stick with the less-expensive option and not return to the brand they bought previously. That said, 43 percent of down-traders in South Africa (compared with 31 percent of down-traders worldwide) expressed a desire to go back to the more-expensive brand they used in the past. This suggests that the value brands and private-label products available in the South African market have room to improve with regard to quality. It is perhaps also a testament to the

Exhibit 2 Many South Africans are brand loyal but look for ways to buy their preferred brands at lower prices.

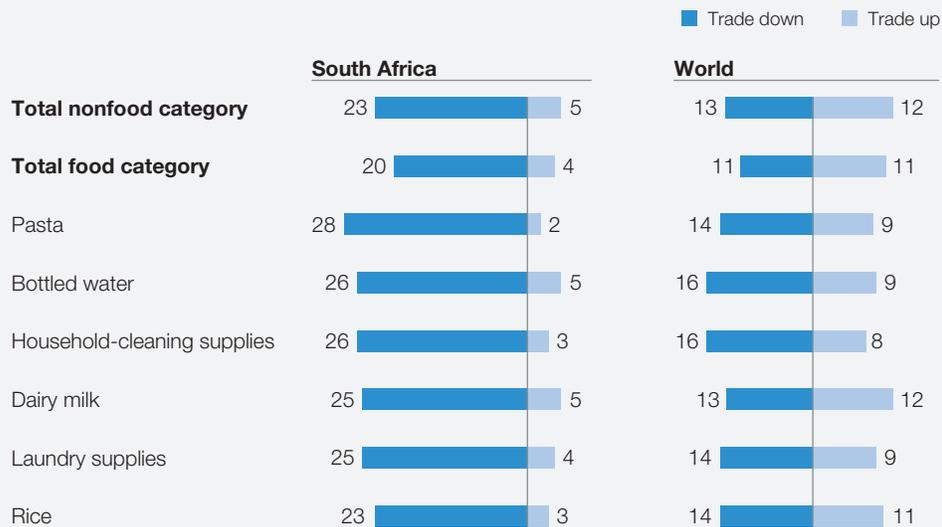
Shifts in the past year among those who changed buying behavior,
weighted average for categories in consumer basket, %



Source: McKinsey Global Consumer Sentiment Survey, 2016

Exhibit 3 South African consumers report trading down in many categories.

Trade-off rates in the past year among those who changed buying behavior,
select categories, %



Source: McKinsey Global Consumer Sentiment Survey, 2016

Our survey methodology

The online survey was in the field from September 3 to 27, 2015, and garnered responses from at least 1,000 consumers in each of 20 countries, including South Africa, plus another 1,000 consumers across the Middle East and 250 consumers in Taiwan. Because the survey was administered online, the sample largely reflects the characteristics of the typical online population—younger, urban, and more affluent.

The country results are weighted by age based on census data and weighted by income based

on panel data. The category-specific results are weighted by purchase incidence. The weighting of region- and country-specific data aligns with the procedures used by the McKinsey Global Institute. In particular, responses to survey questions on consumer confidence are weighted according to the size of the consuming class; responses to questions on consumer behavior are weighted according to both the size and per capita consumption of the consuming class.

powerful allure of aspirational brands for South African consumers.

A small fraction of South Africans bucked the trade-down trend: 5 percent decided to upgrade their purchases in certain categories—in particular, alcoholic beverages and cosmetics. This indicates that higher-end brands in these categories can thrive even in a depressed economy, so long as they can persuade consumers that they are worth the price premium.

4. They shop across channels and find value at discounters.

Another important change in spending habits has to do with where people shop. South Africans claimed to have shifted a considerable fraction of their spending toward modern retailers and away from the small independent retailers collectively known as the fragmented trade or informal trade. Indeed, South Africa's modern retail trade continues to grow at the expense of the fragmented trade, as big-name retailers expand into more local markets and as more consumers demand the breadth of products and low prices that large modern retailers provide. In particular, consumers'

search for value has driven a channel shift to discounters and hypermarkets, where consumers expect to find lower-priced offerings (Exhibit 4).

Implications for consumer companies

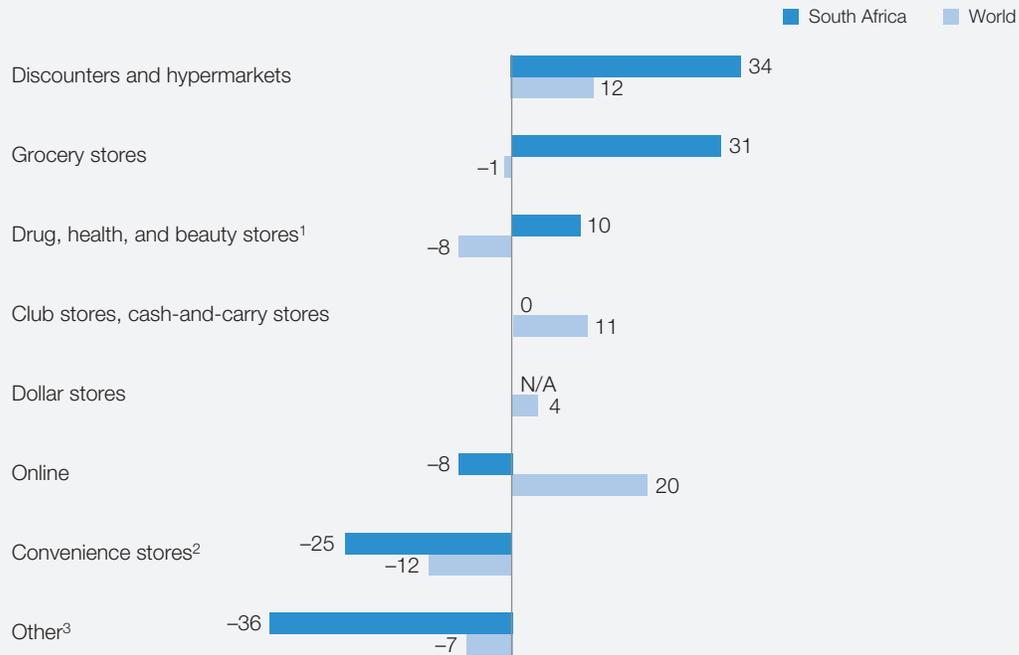
In light of these consumer behaviors, what actions should consumer-goods companies and retailers take in South Africa? How can they best position themselves for future success? In our view, they would do well to consider the following imperatives. Some of these are applicable to companies operating both in South Africa and elsewhere in the world; others are specific to the South African market.

At every price point, get credit for value

With many consumers seeking savings opportunities, companies must give consumers solid reasons to choose their product or store over alternatives. Our research shows that the perception of value for money is by far the biggest factor influencing South African consumers when they consider a brand or a retail store, make a purchase decision, and decide to become loyal to a brand or store. Our research also shows that value perception

Exhibit 4 South Africans say they're shifting their spending toward discounters, hypermarkets, and grocery stores.

Net change in household spending by channel cluster in past 12 months, %



¹ Single-brand beauty stores are excluded in North America, South America, and Western Europe.

² Convenience stores include kiosks in Western Europe; in all other regions, kiosks are included in other.

³ Other includes country-specific fragmented-trade channels.

Source: McKinsey Global Consumer Sentiment Survey, 2016

is informed by more than just low prices. Getting credit for value requires companies to pull several levers—for example, consistent value communication across all consumer touchpoints, price investments in the items that consumers are most likely to shop around for, and targeted promotions.

Products don't necessarily have to be in the lowest price tier, but any price premium needs to be explicitly linked to well-defined benefits. That means emphasizing not just the emotional attributes of a product but its functional benefits as well—reminding and reassuring shoppers about the particular features that make the product worth its

price. Consider the success of salon-quality hair-care brands: consumers feel they're getting good value for money, even though the salon-quality brand might be twice as expensive as their old shampoo brand.

[Invest in advanced revenue-growth-management \(RGM\) capabilities](#)

Through investments in robust RGM solutions and analytical talent, leading companies arrive at data-driven answers to critical questions such as these: What role does each brand and each pack size play in the assortment? How, if at all, does that role differ by channel and by geographic region? Which

promotions are most effective, and why? Based on such insights, companies devise granular strategies for their brands, portfolio, pricing, and promotions and tailor these strategies to each channel, customer segment, and geographic region.

Using advanced RGM analytics, a South African consumer-goods manufacturer discovered the pivotal role that smaller pack sizes play in owning the opening price points. In addition, RGM analytics enabled the company to boost the effectiveness of its promotions—it not only doubled the return on its promotional investments but also improved consumers’ perception of the affordability of its products.

[Be thoughtful about channel strategy, especially with regard to the informal trade](#)

As large modern retailers expand across South Africa, they put more pressure on CPG manufacturers to increase promotional spending and trade discounts, eroding manufacturers’ profits. Ironically, many manufacturers themselves are contributing to the channel shift from informal to formal retail by paying insufficient attention to the informal trade. For instance, manufacturers often provide informal retailers with an inferior offering when it comes to product, promotions, and in-store investment. By contrast, CPG companies that serve the informal trade in a distinctive but cost-efficient way—providing customized pack sizes, regular consumer promotions, and an appropriate level of in-store investment—are rewarded with higher sales and margins. For CPG companies that don’t have the scale to serve the informal trade directly, effective third-party-distributor management can allow them to reap the benefits of a direct-sales system without incurring the full costs of serving many small outlets themselves.

[Be crystal clear about who your target consumer is, and define a truly differentiating value proposition](#)

Instead of trying to appeal to the generic “consumer,” the most sophisticated companies gain a thorough understanding of the various consumer segments and microsegments, as well as the factors that drive

buying behavior in each: What attributes does each microsegment value the most in a specific category? What will consumers in these microsegments pay for, and what don’t they care about? Delving into these questions requires gathering data from multiple sources—including transactions, consumer research, and social media—and harnessing the power of advanced analytics.

Retailers, for their part, must give consumers compelling reasons to shop their stores. Winning retailers don’t try to differentiate themselves in every possible dimension, but rather in only one or two. Apparel retailer H&M, for example, built its reputation on its ability to offer fast fashion at highly attractive prices. Although other retailers have since entered the fast-fashion fray, H&M’s stores globally and in South Africa still attract long shopper queues.

[Bifurcate your portfolio; avoid getting stuck in the middle](#)

As South African consumers trade down and selectively trade up, companies whose portfolios consist primarily of midtier products might have little to offer. Such companies could consider developing a low-priced offering aimed at down-traders and mass consumers; companies that play in categories with high trade-up rates might also consider developing a premium offering. In these product-development efforts, a design-to-value approach and skillful management of portfolio complexity will be essential to achieving profitable growth.

Companies can learn from the experience of a beverage manufacturer that captured growth in China by establishing a “price ladder” to encourage trading up within its brands. The company launched a series of progressively more-expensive offerings, from value to core to premium and finally to superpremium. It also consistently raised the price ceiling through innovation—for instance, introducing an “artisanal” beverage that came in a sleek container with a distinct shape, color, and design. That product sold at five times the retail price of the brand’s core offering. The result of this

clear pricing hierarchy: double-digit increases in net revenue and significant market-share growth.



CPG companies and retailers in South Africa will most likely continue to face low levels of consumer spending and an increasingly competitive landscape for at least the next several months. To win in this environment, companies must relentlessly sharpen their focus on delivering exactly what the customer wants at the lowest possible cost, even as they seek to build strong brands and position themselves for future growth. ■

¹ Defined as households with annual income exceeding \$5,000.

² In 2015 prices.

³ For highlights from our global consumer-sentiment survey, see Max Magni, Anne Martinez, and Rukhshana Motiwala, "Saving, scrimping, and . . . splurging? New insights into consumer behavior," March 2016, McKinsey.com.

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