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Retail Practice

Redefining value and affordability in retail's next normal

Most US consumers are worried about the economy. Grocers, mass retailers, convenience stores, and drugstore chains will need to carefully refine their value strategies.

by Rich Fox, Maura Goldrick, Carson Green, and Aaron Rettaliata

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COVID-19 has exacted a heavy toll on the United States, claiming lives as well as livelihoods. In some parts of the country, the public-health crisis is showing signs of abating—but economic issues are now starting to take center stage. Consumers are anxious, and with good reason: extreme macroeconomic shifts, including a historic rise in unemployment and a steep decline in GDP, portend prolonged financial insecurity and economic pain.

These developments will fundamentally reshape how consumers perceive value and seek affordability in a post–COVID-19 world. Value perception—the combination of price, quality, and service by which consumers judge whether they're getting a good deal—has long been a major factor in consumers' decisions about where to shop; it will become even more critical as we emerge from the current crisis.

Analyzing how consumer behavior changed during previous downturns can give retailers insights into how to prepare for what comes next. But the COVID-19 crisis, though similar in some ways to past economic shocks, has particular nuances that make it more complex for retailers to navigate. For one, during neither the Great Depression nor the 2008 recession were consumers homebound for months, fearing infection simply from being near other people. Also, COVID-19's impact to date has varied greatly across cities and states because of different rates of virus spread and different levels of local-government intervention.

Against this backdrop, retailers will need to be deliberate about influencing consumers' value perception. After all, for many US consumers, affordability will be the single most important factor informing purchase decisions. In this article, we share our perspectives on how retailers can develop a value strategy that will position them for success in the next normal.[1]

US consumers' top concern: The economy

Since mid-March, more than 40 million people across the country have lost their jobs. The unemployment rate—which hit 14.7 percent in April before easing to 13.3 percent in May—has soared to its highest level since the Great Depression and eclipsed the 10 percent we saw at the peak of the 2008 recession. And the economic uncertainty affects more than just the jobless: in a McKinsey survey conducted May 18–24, nearly half of US consumers reported cutting back on their spending. Just under two-thirds said they are "very" or "extremely" concerned about the national economy—making it the number-one concern of survey respondents.[2] Americans are now more worried about the economy than about their health and safety (Exhibit 1).

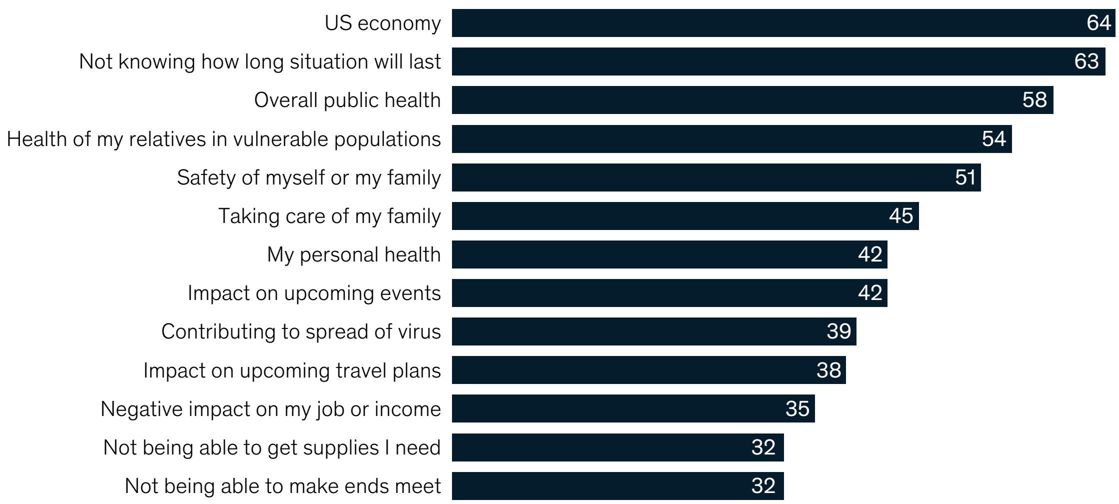
When asked why they started buying more private-label goods, 44 percent of consumers cited affordability and better value.

[1] Shubham Singhal and Kevin Sneader, "From thinking about the next normal to making it work: What to stop, start, and accelerate," May 15, 2020, McKinsey.com.
[2] Shruti Bhargava, Courtney Buzzell, Tamara Charm , Resil Das, Anne Grimmelt, Cayley Heller, Ahbay Jain, Janine Mandel, Sebastian Pflumm, Kelsey Robinson, Christina Sexauer, "Survey: US consumer sentiment during the coronavirus crisis," May 29, 2020, McKinsey.com.

Exhibit 1

The economy, uncertainty about the duration of the COVID-19 situation, and public health are the top three concerns for Americans.

Largest concerns of the US population related to COVID-19,[1] % of respondents who are “very concerned” or “extremely concerned”



[1]Question: What concerns you most about the COVID-19 situation?
Source: McKinsey COVID-19 US Consumer Pulse Survey, May 18–24, 2020 (n = 1,975), sampled and weighted to match US general population aged ≥18 years

Several states have eased restrictions, in an effort to jump-start their economies, but it will take time before consumer confidence and spending return to precrisis levels. More than two-thirds of survey respondents believe the pandemic will have an impact on their financial situation for at least another two months; 30 percent foresee the impact lasting until early 2021 or beyond. (For the latest US consumer-sentiment survey findings, visit McKinsey.com/coronavirus.)

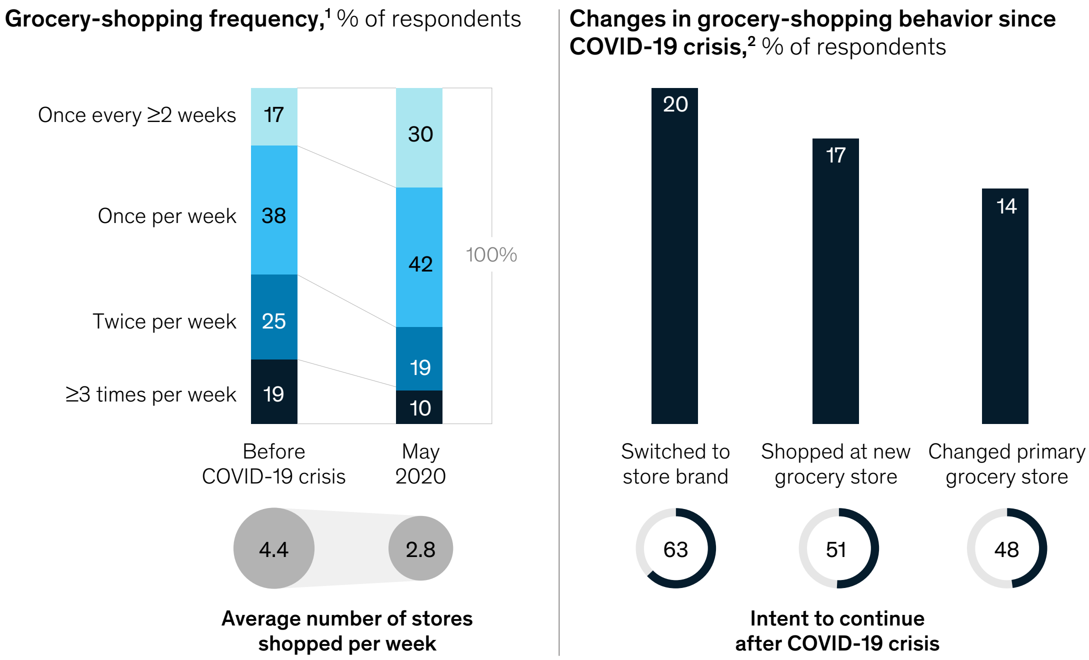
A classic economic crisis … with a twist

Early indications suggest that the changes in consumer behavior during the COVID-19 crisis will largely mirror the changes that manifested themselves during the 2008 recession—but with some unique nuances. We’ve observed, for instance, the familiar flight to value: our recent research shows that 34 percent of consumers have increased their spending on private-label products during the pandemic and that most of those consumers plan to continue doing so even after the crisis has passed. When asked why they started buying more private-label goods, 44 percent cited affordability and better value.

The current crisis, similar to the 2008 recession, has thrown off many consumers’ traditional shopping cadence. Take grocery shopping: in the early days of the pandemic, consumers loaded their pantries, made fewer shopping trips, visited fewer stores each week, and targeted their spending on essentials. Consumers have also tried new retailers and new brands during the crisis, possibly shifting the loyalty dynamics within the retail sector (Exhibit 2).

Exhibit 2

US consumers are consolidating shopping trips and shifting their retailer and brand loyalties during the COVID-19 crisis.



Note: Figures may not sum to 100%, because of rounding. Consumer sentiment and behavior may be because of current public uncertainty and official restrictions.
[1]Question: How frequently did you purchase groceries (in store or online) before the novel coronavirus outbreak? How frequently are you purchasing groceries (in store or online) currently during the novel coronavirus outbreak? Indicate how many stores you visited for your grocery needs, both before and during the current novel coronavirus outbreak.
[2]Question: Have you used or done any of the following since the coronavirus (COVID-19) situation started? Compared with now, will you do or use the following more, less, or not at all once the coronavirus situation has subsided?
Source: McKinsey COVID-19 US Consumer Pulse Survey, April 20–26, 2020 (n = 1,052) and May 18–24, 2020 (n = 1,975), sampled and weighted to match US general population ≥18 years

But the COVID-19 crisis, unlike past economic disruptions, brings a new layer of complexity: the severe threat to consumers' health and safety. Consequently, the pandemic has amplified and accelerated the consumer behavior we've seen in times of crisis. For example, during the 2008 recession, financially strapped consumers drastically reduced their spending on out-of-home dining. But during this pandemic, restaurant dining has come to a standstill as physical distancing and stay-at-home orders in many regions forced consumers to eat practically all their meals at home.

In addition, some retail trends that we expected to unfold over several years have now taken hold in a matter of weeks. Digital and alternative fulfillment models (such as curbside pickup), which some retailers previously viewed as experimental, suddenly became must-haves. In US grocery, e-commerce penetration was a mere 3 percent before the crisis and is expected to reach 8 to 10 percent this year. Because online grocery typically comes with steep price markups, as well as delivery fees and tips, we expect demand to soften as consumers' financial considerations begin to outweigh their health concerns. Already, consumers are predicting that after the crisis they'll prioritize affordability when deciding where to shop (Exhibit 3). E-commerce penetration in grocery will likely dip back down to between 5 and 6 percent postcrisis.

Furthermore, the impact of COVID-19 hasn't been uniform across the country, because of differences in both virus spread and government regulation. Geographic variability in consumer sentiment is therefore likely to persist and potentially even widen—which means that retailers will need to vary their value strategies by region.

How to shape value perception in the next normal

Since consumers will increasingly look for value and affordability, retailers must offer a convincing value message to succeed in the next normal. They will, of course, still have the classic value communications, pricing, and promotional tools at their disposal, but they must deploy these tools in new ways. Every retailer will also need to reassess its entire value strategy—reevaluating both products and services—to ensure alignment with consumers' new need states.

For food, mass, convenience, and drug retailers in particular, we recommend the following six actions.

1. Develop a value strategy for each consumer segment.
In light of economic uncertainty, the general consensus is that value will matter—but there is unlikely to be a one-size-fits-all approach to maintaining or improving consumer value perception. There are, of course, no-regret moves: look to "recession-proof" your assortment by doubling down on private label and ensure that you have a robust set of opening price points in each category.

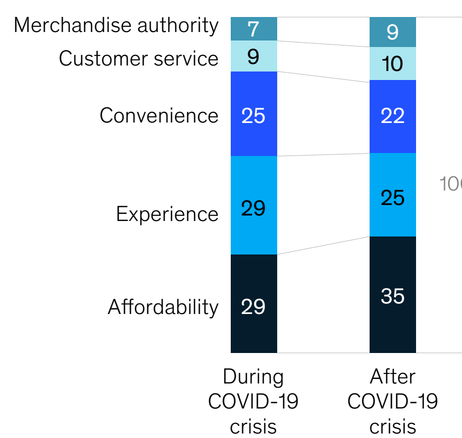
With the significant shift away from off-premise food consumption, you need a multipronged strategy to address what affordability means to your most important customers. For example, consumers under intense financial pressure will seek out grocers that offer compelling price points on the approximately 1,000 essential SKUs that consumers purchase most often (which are typically SKUs that both traditional grocers and small-box discounters carry). Conversely, more-affluent consumers might be less price sensitive but may look to grocers to provide substitutes for needs typically fulfilled elsewhere, such as eating out or entertainment. To appeal to these consumers, consider highlighting premium items (such as gourmet chocolates, fine wines, and international cheeses) or enhanced services (such as ready-to-eat meals and home delivery), especially since these tend to be less expensive alternatives to restaurant dining and can therefore help drive value perception while also pushing up average price points.

2. Localize your value levers.
Given the variability in COVID-19's impact across the country, adjust your pricing, promotions, and assortments to best serve local communities.

Exhibit 3

Affordability will become the most important factor for US consumers when choosing where to shop after the COVID-19 crisis.

Most important factor when choosing where to shop for groceries,[1] % of respondents



Note: Figures may not sum to 100%, because of rounding. Consumer sentiment and behavior may be because of current public uncertainty and official restrictions.
[1]Question: Which factors are most important as you choose where to shop for groceries during the novel coronavirus outbreak (ie, during past 2 weeks), and which ones do you expect will be the most important after the outbreak is over and the situation is back to normal?
Source: McKinsey Marketing and Sales COVID-19 US Pulse Survey, May 1–3, 2020 (n = 2,300)

Boldly exploring innovative tactics in promotions, pricing, and assortment will be paramount for responding to the changing needs of your consumer base.

Consumers in areas that are still under heavy restrictions, for example, may respond better to value messaging around pantry loading and at-home eating. In states that have already eased restrictions, you might instead capitalize on the pent-up demand for out-of-home dining by introducing new products and services that compete with restaurants.

Account for new market dynamics and determine who your true competitors are in the post–COVID-19 world. We expect a wide range of competitive responses, including stronger opening price points and new services (such as free delivery) to meet local needs—all of which will require close attention at a regional level. A broad approach to value and affordability will be less effective than a targeted, localized one.

3. Build agility into your commercial activities.
While the pandemic's peak may be behind us, the shape of the recovery is still difficult to predict. Agility—the ability to respond rapidly to changes in consumer sentiment and value perception—will be crucial. As part of building agility, you will need to monitor carefully chosen metrics that are reliable indicators of how consumers are thinking about price and value, such as e-commerce penetration, basket size, and private-label penetration. Consider supplementing commercial levers that have long lead times (for instance, print circulars and TV advertising) with levers that allow for immediate adjustments (such as digital circulars, in-store product pricing, and store displays and promotions).

Also, maintain connectivity to broader trends in the business. By accessing real-time data on the inventory availability of "spiky" items such as toilet paper and cleaning supplies, for example, you'll be able to adjust the timing of promotions based on availability, instead of disappointing your customers. Boldly exploring innovative tactics in promotions, pricing, and assortment will be paramount for responding to the changing needs of your consumer base.

4. Update your value communication for the postcrisis context.
Given the shifts in consumer behavior—more cooking at home, larger baskets, less cross-shopping across retailers—each shopping occasion, for loyal and new customers alike, takes on greater importance for retailers. Find new ways to communicate and deliver value. First, use your unique value proposition as a base for value communications, expanding beyond purely communicating price points. Highlight the areas in which you are best positioned relative to your competitors, whether that's the broadest private-label offering, the freshest produce, or the best shopping experience.

Additionally, consider launching new product offerings to serve COVID-19–related occasions. For example, advertising a single, attention-getting price for the ingredients for a family meal ("Feed the family for $15"), instead of promoting individual items, may resonate with parents who have been cooking multiple times a day for the past two months. Presenting indulgent purchases as replacements for products and services from nontraditional competitors (for instance, billing a popcorn-and-candy deal for an at-home movie night as a substitute for going to a movie theater) could be attractive to shoppers seeking affordable entertainment. Relevant and empathetic messaging that avoids tone-deaf references—such as references to fancy dinner parties or large social events—will help consumers continue to view your stores as a trusted resource in a time of need.

As your consumer value proposition evolves, your relationships with vendors and your trade-investment decisions should evolve as well. With many annual promotional plans disrupted, choices about how to allocate funding and what new avenues to invest in (digital channels, for instance) will become more important.

5. Define value-perception triggers to help guide rapid decision making.
Identifying specific customer and competitor triggers up front can equip you to make decisions quickly and to execute more effectively. To illustrate: many retailers are currently debating whether or not to expand shelf space for private-label products. Instead of trying to predict customer demand, agreeing on a specific trigger—for example, the growth of private-label share by more than five percentage points in a given category—can provide clarity and help the business respond rapidly to consumer trends.

Define similar triggers with regard to the supply chain (for example, resuming promotional activity when out of stocks return to normal levels), competitor dynamics (repricing the top 20 key value items when competitors reduce prices on them by a certain percentage), and customer loyalty (sending “best customer” coupons to customers when the number of their shopping trips per month falls below a certain level). Attempts to define value-perception triggers in real time often devolve into chaos and can lead to ill-advised tactics, such as running promotions on items that are already out of stock. Set up these triggers now to be ready for a variety of scenarios.

This will be particularly important if you rely on a high level of promotional intensity to drive value perception and, ultimately, customer choice. In the next normal, you may find such an approach to be incompatible with consumer needs and opt for a different approach instead (such as everyday low pricing on select items and categories).

6. Upgrade your tools and organization.
Analytics, consumer insights, and systems play a central role in delivering impact through commercial levers. In the wake of this crisis, you will almost certainly need to enhance current tools and build new capabilities, such as automated reporting to track consumer responses, and systems that can deploy localized store-level promotions.

With many retailers forced to close stores and furlough employees, consider hiring new talent for your most critical functions (such as e-commerce and digital). New work-from-home norms could also open up talent pools across the country and beyond. Reevaluate build-versus-buy decisions regarding tool deployment in the context of COVID-19, since the pandemic may have changed the factors that influence those decisions.

While no one can say for sure how the next normal will play out, it’s becoming clear that economic uncertainty and shifts in consumer behavior—both mandated and voluntary—will reshape the retail landscape. By reexamining core merchandising strategies and tools, tailoring them appropriately to the new environment, and deploying them in innovative ways, retailers can offer the value and affordability that consumers will seek in the post–COVID-19 world.

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