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Consumer and Shopper Insights
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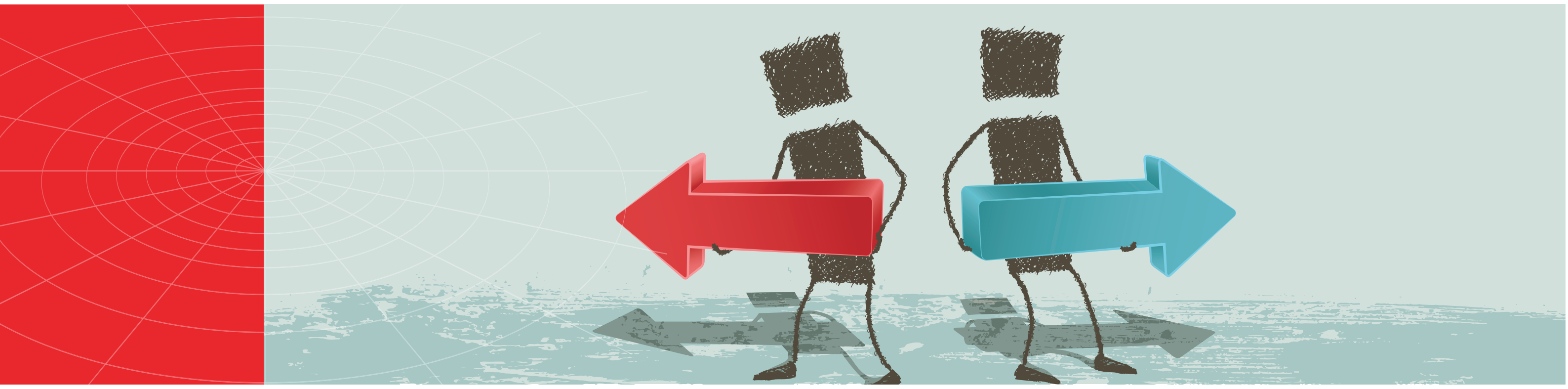
One step back: The 2013 U.S. Consumer Sentiment Survey



By Anne Martinez

After an upbeat 2012, U.S. consumer sentiment about the economy is sliding back into gloomier territory in 2013. McKinsey's most recent survey of American consumers found that the average American is more price conscious than they were a year ago and that more people are living from paycheck to paycheck. Consequently, many Americans are tightening their wallets and actively changing their shopping behavior in order to save money. Thirty-two percent of U.S. consumers say they feel a decreased ability to make ends meet and 36 percent say they are living paycheck to paycheck, both larger numbers than in September 2012 (27 percent and 31 percent, respectively) [Exhibit 1].

These results, which come from a survey of at least 1,200 people that McKinsey has conducted nine times since 2008, suggest that a true economy recovery in the U.S. remains elusive. While Americans are not as worried about their financial futures as they were five years ago, during the depths of the Great Recession, U.S. consumers are holding onto some of the behaviors they adopted during those severe economic doldrums. Many Americans (43 percent), for instance, have no intention of going back to pre-recession levels of spending or behavior. Reasons for this include the need to save for the future, a different set of

Exhibit 1:
Today's US consumers feel increased levels of economic pressure

Worsening outlook vs. prior period
Improving outlook vs. prior period

Consumers agreeing or strongly agreeing

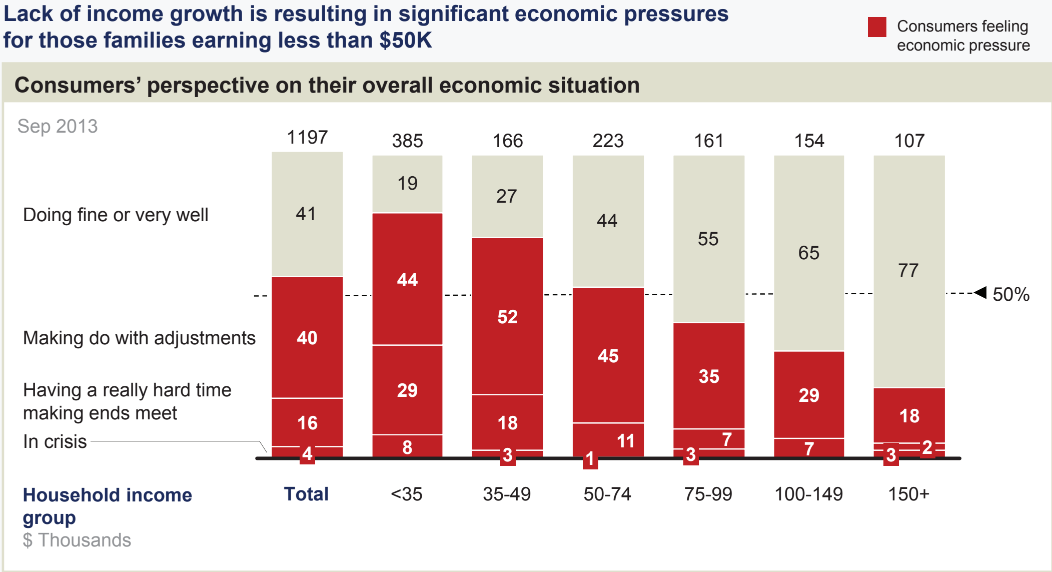
Percent

	Sep 2013	Sep 2012	Sep 2011	Mar 2011	Sep 2010	Mar 2010	Sep 2009
Optimistic about our country's economy	19%	23%	18%	20%	21%	21%	27%
Decreased ability to make ends meet	32%	27%	41%	44%	46%	43%	52%
Living paycheck to paycheck	36%	31%	41%	42%	48%	42%	51%
Somewhat or very worried about losing job	40%	40%	51%	45%	53%	54%	50%
Not making some purchases due to uncertainty about economy	40%	29%	39%	40%	45%	N/A	N/A

SOURCE: McKinsey Consumer Sentiment Survey II-IX (Sep 2009, Mar 2010, Sep 2010, Mar 2011, Sep 2011, Sep 2012, and Sep 2013) values about spending, and uncertainty about the economy and job prospects. Twenty-eight percent of consumers report that they will perhaps ease the wallet strings in one to two years once they have paid down enough debt or rebuilt their savings.

In addition to the lingering effects of the recent recession, there are several long-term trends at play here too. The U.S. income gap has been widening since the 1970s and the income of top earners has grown very quickly compared to the rest of the population. In 1970, 43 percent of household income went to the top 20 percent. Now, 50 percent of income goes to this top group. Such absence of broad-based income growth is resulting in significant economic pressures for families earning less than $50,000 a year. Nearly three-quarters of such households say they are either getting by only after making spending adjustments (such as foregoing travel or selling a car), are having a really hard time making ends meet, or are in crisis. Even those making $50,000 to $74,000 are struggling. Forty-five percent in this group say they have had to alter their household spending and behavior [Exhibit 2].

Exhibit 2:
Lack of income growth is resulting in significant economic pressures for those families earning less than $50K



SOURCE: McKinsey Consumer Sentiment Survey IX (Sep 2013)

Until these trends change course, it's unlikely that U.S. consumers will go back to the sort of economic exuberance and generous spending levels seen prior to the recession. Americans have changed their spending behavior in various ways since the beginning of the economic crisis in December 2007. Some behaviors have experienced further regression, some are stabilizing, while others are changing in a more positive direction. Here is an overview of McKinsey's findings based on our most recent September 2013 wave of research:

1) Further regression in cutting back and penny pinching:

Forty percent of consumers say they are finding ways to cut back their monthly and discretionary household spending, an increase over last year's figure of 35 percent (yet far below the elevated level of 65 percent cutting back in February 2009). Consumers in the lower income brackets are cutting back more than those with higher incomes. Forty-eight percent with annual incomes under $35,000 and 45 percent with incomes between $35,000 and $50,000 say they are trimming spending.

Consumers are actively changing their shopping behavior in order to save money. This year, penny pinching intensified. Fifty-five percent of consumers say they are actively looking for ways to save money. Fifty-one percent are paying more attention to prices and 43 percent are using coupons more often [Exhibit 3].

2) Stabilized changes in eating habits and steady movements toward value brands:

The trend toward doing less eating out and ordering in has stagnated, yet consumers are increasing pleased with their adoption of more economical eating habits. Just over half of U.S. consumers say they are eating at home more often, 43 percent are eating more leftovers, and 30 percent are packing lunches from home, all figures roughly similar to what they were in September 2012.

Exhibit 3:

Penny pinching behavior has intensified—consumers are actively looking for ways to save money

+/ ● / – Positive, neutral or negative indicator of consumer sentiment vs. prior wave

Level of consumer agreement with changes in behavior regarding groceries and household goods over last 12 months

	Percent "strongly agreeing" or "agreeing" Sep 2013	Sep 2012	Sep 2011	Mar 2011	Sep 2010	Mar 2010	Sep 2009	Feb 2009	Aug 2008
Increasingly looking for ways to save money	55 ●	51 ●	56 +	70 ●	70 ●	69 ●	69 ●	72	N/A
Paying more attention to prices	51 –	45 +	53 +	59 ●	63 ●	60 ●	60 +	66 ●	63
Use coupons more often	43 –	35	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Shop around to get best deals	35 –	30 ●	34 +	44 ●	44 ●	43 ●	38 +	N/A	N/A
Buying more in bulk	29 –	22 ●	25 +	33 ●	34 ●	33 ●	31 +	38 –	30
Buying smaller pack sizes	16 ●	16 ●	19 ●	18 ●	21 ●	17 ●	17	N/A	N/A

SOURCE: McKinsey Consumer Sentiment Survey I – IX (Aug 2008, Feb 2009, Sep 2009, Mar 2010, Sep 2010, Mar 2011, Sep 2011, Sep 2012, and Sep 2013)

During the recession many consumers stopped buying their favorite brands in favor of value brands, including private label, and experiences with these products have been such that many people (74 percent) say they do not intend to trade back up. Forty-three percent report better than expected experiences with less expensive brands, with 36 percent say they no longer prefer the higher priced product, either because the lower priced one offers a better than expected value for the money or because it is a higher quality than they thought it would be. Even many (38 percent) of those who say they prefer the more expensive brand state that going back isn't worth it. Although the appeal of value brands is here to stay, the growth of their adoption in most food and non-food categories has slowed.

For food and beverage, the categories most susceptible to trading down are bottled water, canned vegetables, spirits, cereal, wine and frozen veggies. Sixteen percent of consumers, for instance, are switching to less expensive brands of bottled water. In non-food categories, it's paper products, OTC drugs, and cleaning and laundry supplies that are most often traded down. Not surprisingly, the most popular brands to buy when trading down are private label. Sixty-two percent of consumers who traded down, bought private label [Exhibit 4].

3) Continued shift in where America does its household spending:

Consumers claim to be spending more in online sites, dollar stores, and mass/club stores, and at the same time say they are moving away from convenience stores, drugstores and traditional supermarkets. Surprisingly, this statement is true across income levels. Even though they might be able to afford shopping elsewhere, 22 percent of households with annual incomes of $75,000 and up say they are shopping more at dollar stores. When buying groceries online, consumers say that lower prices and time savings are their primary motivations.

4) Positive changes in easy meal solutions and category specific trading up behavior:

Money saving eating habits such as eating at home and packing lunches from home are adopted at rates similar to last year. Yet, more consumers rate the experience as better than expected. This year 60 percent of those eating at home liked the experience better than expected versus 55 percent last year.

Alcoholic beverages, hair care and cosmetics see consumers bifurcating towards less and more expensive brands. 7 percent of consumers claim to be trading down in beer, while 6 percent of consumers are trading up to more expensive and often imported beer brands [Exhibit 5].

Conclusion

U.S. consumer confidence is not fully recovered. Those who had hoped the worst was over will have to contend with the fact that economic sentiment has taken one step back, with more regression than

Exhibit 4:

Trading down – Impact of perception changes varies by category

Consumer trade down rate and perception changes

Sep 2013, percent

	Category	Trade down rate	Perception changes [1]	Consumers at risk
Precarious* **High** trade down rate **High** perception changes	OTC	15	56	**9**
	Bottled water	16	53	**8**
	Paper products	16	45	**7**
	Canned vegetables	14	45	**6**
	Cereal	13	50	**6**
	Frozen vegetables	12	49	**6**
	Rice	10	47	**5**
Threatened **Low** trade down rate **High** perception changes	Snack foods	9	58	**5**
	Butter/ margerine	9	49	**5**
	Ice cream	9	49	**4**
	Pasta	10	46	**4**
	Milk	9	47	**4**
	Pasta sauces	9	44	**4**
	Deodorant	8	48	**4**
	CSD	8	47	**4**
	Cosmetics	8	45	**4**
	Fresh produce	6	43	**3**
Steadier perceptions **High** trade down rate **Low** perception changes	HH cleaning supplies	14	39	**6**
	Laundry supplies	14	37	**5**
	Wine	12	38	**5**
	Juice	11	41	**4**
	Spirits	13	29	**4**
Safer **Low** trade down rate **Low** perception changes	Oral care	10	42	**4**
	Hair care	9	38	**4**
	Pet food	9	38	**4**
	Skin care	10	36	**4**
	Cookies	9	33	**3**
	Canned soup	10	31	**3**
	Candy	7	39	**3**
	Frozen dinners	8	32	**3**
	Beer	7	26	**2**
	Fresh bakery	7	25	**2**
		10	**43**	**4**

NOTE: Trade-down rates: % of respondents who have switched to a less expensive brand
Perception changes: % of respondents who rated their experience with less expensive brands as better than expected
Consumers at risk: % of consumers who are at risk of never returning to more expensive brands

1 Experience with brand traded down to relative to what was expected of the brand prior to making the purchase

SOURCE: McKinsey Consumer Sentiment Survey IX (Sep 2013)

progression. And, with the upcoming changes in government spending on food stamps (officially called SNAP), another step backward is likely before we make progress again.

The path forward will include many changes:

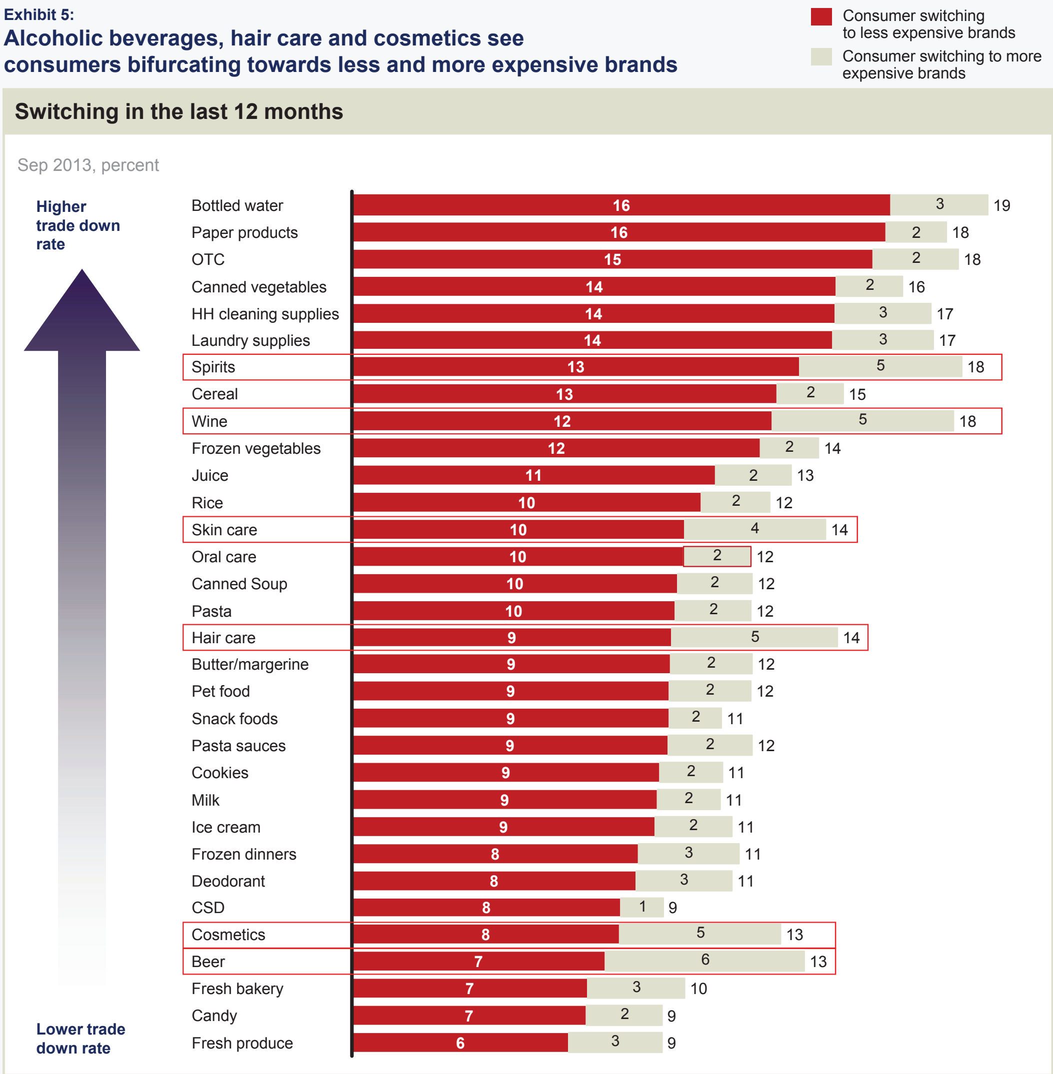
1) With government spending on SNAP starting to decline, those in the lower income brackets have less financial support for the purchase of groceries and need to make further adjustments just to put food on the table. Since one-seventh of the American population is currently receiving SNAP benefits, these household cutbacks are likely to have a slight dampening effect on economic growth, shaving an estimated 0.1 percentage point off the annual growth rate of the GDP.[1]

2) Merchandising is an increasingly important tool to sway consumers. Coupon usage is at an all-time high and is expected to increase – especially digital coupons. Thanks to the greater effectiveness of digital coupons, the total value of these types of promotions in the U.S. is expected to reach $22 billion in 2014 up from $8.3 billion in 2009.[2] Redemption rates for digital coupons are between 10 and 15 percent, compared to less than 1 percent for traditional coupons. Many consumer packaged goods players are partnering with tech-savvy retailers and digital coupon services to make the delivery of digital coupons seamless and the savings automatically applied at the check-out.

3) The retail landscape will continue to change. Due to the increased popularity and penetration of the online channel, there is a shift away from physical stores. By 2020, online will represent 12-20 percent

1 JP Morgan Chase, *New York Times* October 31, 2013
2 Borrell Associates

Exhibit 5:
Alcoholic beverages, hair care and cosmetics see consumers bifurcating towards less and more expensive brands



SOURCE: McKinsey Consumer Sentiment Survey IX (Sep 2013)

of total retail sales, up from 9 percent in 2011. This migration will have significant impact on the entire consumer landscape, and brick and mortar retailers will need to adopt a multichannel strategy in order to thrive in this new environment

4) Category behavior will follow an hourglass shift. In some categories such as bottled water, value brands will continue to grow in popularity. Although lower than what are seen in Europe, acceptance rates for value brands in the U.S. will accelerate in these categories. Other categories, such as skin care and baby food will be able to benefit from the concurrent trend of a subset of consumers trading back up.

Manufacturers need to assess their brand position and margin structure to determine if they should expand into the mid-tier and value segment, or forge instead into the more profitable premium segment.

5) Consumers are eating more dinners at home and report positive feedback about these experiences. The NPD Group estimates that the average number of meals eaten at home was 902 last year, up from 870 four years earlier.2. Strapped for time yet also wanting to put a healthy meal on the table, consumers are increasingly looking for meal starters such as the newly launched Campbell's Skillet Sauces and Kraft Recipe Makers.

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Anne Martinez *is a knowledge expert in McKinsey's New Jersey office. She has been researching the American consumer since 2000.*