McKinsey&Company

DECEMBER 2009

McKinsey Quarterly

RETAIL PRACTICE

How the recession has changed US consumer behavior

Companies waiting for a return to normality following the recession may be disappointed. Their customers have tried cheaper products—and actually like them.

Betsy Bohlen, Steve Carlotti, and Liz Mihas

While the downturn has certainly changed the economic landscape, it may also have fundamentally altered the behavior of numerous US consumers, who are now learning to live without expensive products. Many companies with strong premium brands are anticipating a rapid rebound in consumer behavior—a return to normality, as after previous recessions. They are likely to be disappointed.

New McKinsey research[1] found that, in any given category, an average of 18 percent of consumer-packaged-goods consumers bought lower-priced brands in the past two years. Of the consumers who switched to cheaper products, 46 percent said they performed better than expected, and the large majority of these consumers said the performance of such products was *much* better than expected. As a result, 34 percent of the switchers said they no longer preferred higher-priced products, and an additional 41 percent said that while they preferred the premium brand, it "was not worth the money."

As a result, a growing number of consumers are now in play. The percentage up for grabs varies by category and depends on how many consumers switch from higher-priced brands, their experience with cheaper ones, and the way they revise their buying intentions. We found, for instance, that only 12 percent of beer buyers switched to cheaper brands. Of those, 31 percent said that their experience was more positive than they had expected, which means that only about 4 percent of customers are in play. Among buyers of cold and allergy medicines, however, we found that more than 20 percent tried a lower-priced option, and 48 percent of those consumers said the experience was better than expected. That means 10 percent of the people who buy cold and allergy medicines are now in play.

In industries where consumer shifts as small as 1 percent can severely dent the profitability of brands, these changes are significant enough to alter market dynamics and force brand leaders to respond. Earlier this year, P&G, for example, released Tide Basic, a cheaper version of its category-leading Tide laundry detergent, after Tide's sales began to decline as consumers switched to less expensive brands.[2]

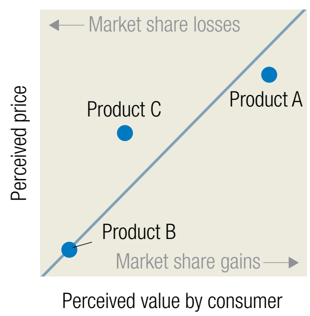
For companies attempting to address the change in consumer behavior, understanding the economic theory that explains why it is now shifting can help to inform decision making. Textbook theory posits that changes in the relationship between how much consumers are willing to pay, on the one hand, and their perception of the value they are receiving, on the other, underpins behavioral changes. As the exhibit shows, if consumers perceive enough value in a premium-brand product (Product A), they will favor it over the product of a more basic brand (Product B), despite the premium product's higher price. In a recession, though, consumers become less willing to pay more—the slope of the demand line flattens, and the preferences of some consumers begin to shift from Product A to Product B.

[1] The research, involving 2,672 US consumers, was undertaken in August 2009.
[2] See "Tide turns 'basic' for P&G in slump," *Wall Street Journal*, August 6, 2009.

Exhibit

Changes in consumer behavior

Before the downturn



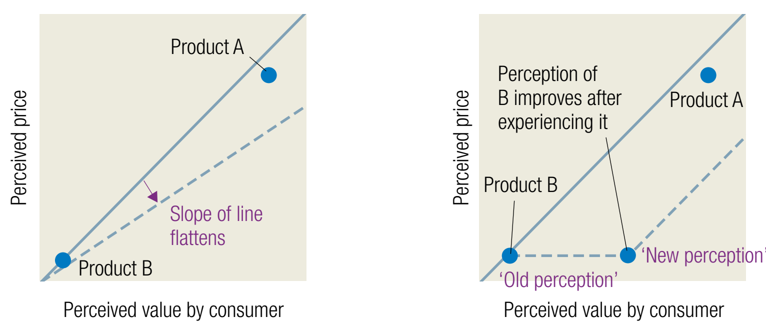
- Consumers are indifferent at any point on the diagonal 'demand line,' where perceived value and price are equal
- Product A is preferred because it is seen as a better value for the price
- Product C is at a disadvantage because its perceived value is too low given its perceived price

After the downturn

Downturn effect

Change in willingness to pay

Change in perceptions



Normally, the premium-brand product would return to favor as the economy bounced back. But the central implication of our research is that even if the willingness of consumers to pay rebounds as the economy does, changes to their perceptions of the value of lower- and higher-priced products may fundamentally alter what they choose to buy. That's troubling for consumer-packaged-goods companies whose brands command premiums. If consumers see no legitimate reason to stick with such products, the premiums will slowly erode, and profit margins will shrink until category competition is determined mainly by price. A prime example is processed meats and sliced cheese, where the difficulty of demonstrating a product's superiority means that there's little scope for brands to differentiate by price. As a result, gross margins in these categories trail those of other branded foods.

Our experience in the consumer-packaged-goods sector suggests two priorities for companies addressing this fundamental shift in consumer behavior. The first is undertaking a situation assessment to understand a category's dynamics at a greater level of detail than can be achieved anecdotally or through survey research. Such an assessment involves analyzing purchasing behavior and motivations to determine how consumer requirements are changing and the effect of these changes on lower- and higher-priced products.

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In our survey, for example, while most consumers said that the quality of the lower-priced brand was higher than expected, their precise reasons varied. More than 33 percent of bottled-water users discovered that they no longer needed some of the benefits the higher-priced brand provided. Nearly 32 percent of facial-moisturizer consumers felt better about using the lower-priced brand than they had thought they would. What companies need is a fact-based understanding of the principles of typical consumer behavior to gauge how the willingness to pay for additional benefits has changed (illustrated in the exhibit by the slope of the line), the experience consumers have with products, and how perceptions of their value have changed.

The second step is developing action plans based on consumer dynamics and how well positioned products are for recovery. That means deciding where to position them in a way that will optimize the trade-off between prices and benefits, on the one hand, and margins and volumes, on the other. In the case of bottled water, the best response may be a lower-priced product that addresses the needs of consumers who no longer see the value in additional brand benefits. Yet decisions must also take into account the broader category strategy. We believe there's an opportunity to identify and increase participation in categories that have the potential to recover more rapidly and fully while minimizing exposure to those that have a lower chance of recovery or can recover only at the cost of brand or category economics. Looking at the exhibit, this means that brand portfolios should be aligned around categories with smaller changes in slope and where consumers have less positive experiences with lower-priced products.

These steps are applicable beyond consumer packaged goods. There's evidence that the shift of consumers away from more expensive products is a widespread trend. In the consumer electronics industry, for example, McKinsey research found that 60 percent of consumers were more interested in a core set of product features at a reasonable price than in the bells and whistles of the latest and greatest technology at a higher price.[3] Similarly, in the building-products industry, there is a trend away from premium-priced design features and toward simpler, more basic designs. Understanding this challenging shift in consumer behavior is necessary for companies to compete successfully.[4] It represents an opportunity for those that respond quickly and effectively to differentiate themselves from their peers.

The authors wish to acknowledge Ned Welch's contribution to this article.
Betsy Bohlen is a consultant in McKinsey's Chicago office, where **Steve Carlotti** is a director and **Liz Mihas** is a principal.

[3] See Andre Dua, Lisa Hersch, and Manu Sivanandam, "Consumer electronics gets back to basics," mckinseyquarterly.com, October 2009.
[4] For more on managing in the consumer goods industry, see "McKinsey conversations with global leaders: Paul Polman of Unilever," mckinseyquarterly.com, October 2009.