Consumer spending in a recession

How brands can capitalize on an economic downturn

Interbrand

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These days, it is virtually impossible to go through a day without hearing or reading about the global economic crisis. While governments debate bailout plans and stimulus packages, consumers worry about problems that are much more tangible and closer to home. How will they pay their mortgage bills? What will happen to their retirement accounts? Will their children still be able to attend college when savings accounts are deteriorating in value? How will they adjust their lifestyles and manage their day-to-day lives?

When budgets are tight, consumers are forced to make decisions about how to spend their money. Because of this, economic downturns have an interesting way of weeding out weak brands, while further strengthening the category leaders. Successful brands have capitalized on market downturns by staying committed to their corporate strategy, remaining steadfast in pursuit of their long-term corporate vision, and ultimately enhancing their brands' equity and position in the market. So, what makes some brands succeed and others fail in times like these, and what can companies do to avoid eroding brand value during a recession?

Tough economic conditions

On December 1, 2008, the National Bureau of Economic Research confirmed what most Americans already knew—the United States is in a recession and has been since December 2007.[1] The economic downturn has been fueled by numerous factors:

- Depreciating home and property values
- Rising mortgage payments and credit crunch
- Anxiety about job security amidst skyrocketing unemployment rates
- Declining value of retirement funds and overall savings
- Insecurity in investing due to highly volatile stock market
- Rising food prices

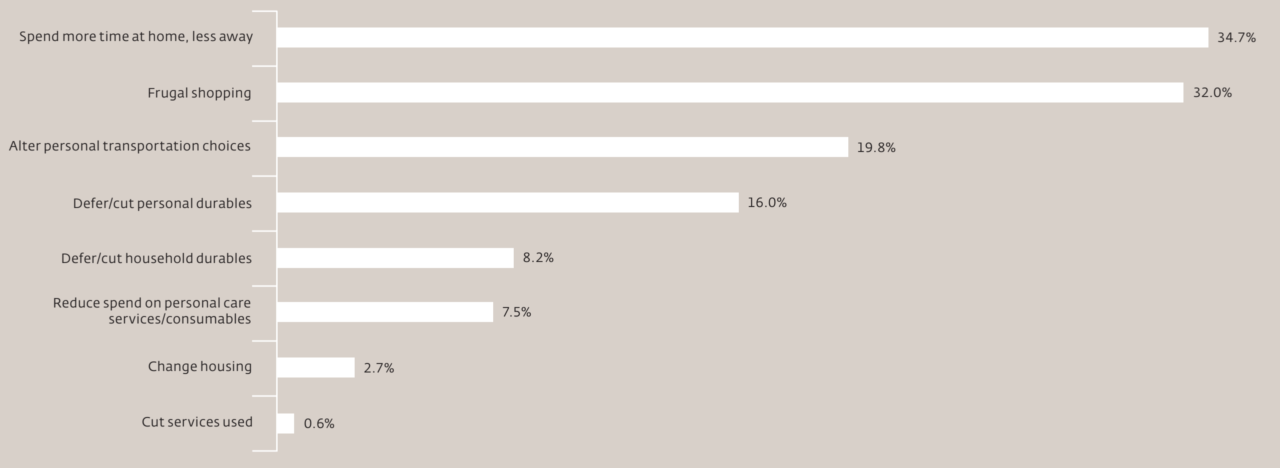
Faced with these factors and a gloomy economic forecast for the foreseeable future, many consumers are looking for ways to regain a sense of security by cutting back on spending. But how will their behaviors change, and which products and services will be hit the hardest?

A new outlook on spending

Management consulting firm Booz & Company conducted a consumer spending study in September 2008, which indicates that the vast majority of consumers across socioeconomic classes have already made substantial cuts in spending and plan to make even deeper cuts in the future. The survey of nearly 1,000 households suggests that to date, consumers have focused cost-cutting on high-expenditure, less critical areas, such as dining out less, cutting back on vacations, and shopping frugally (*see Figure 1*).

Looking ahead, consumers plan to cut even further into these three areas, while also beginning to reduce expenditures on personal durables (e.g., clothing), household durables (e.g., electronics), indulgences (e.g., premium coffee), and services (e.g., salon treatments), shown in *Figure 2*.

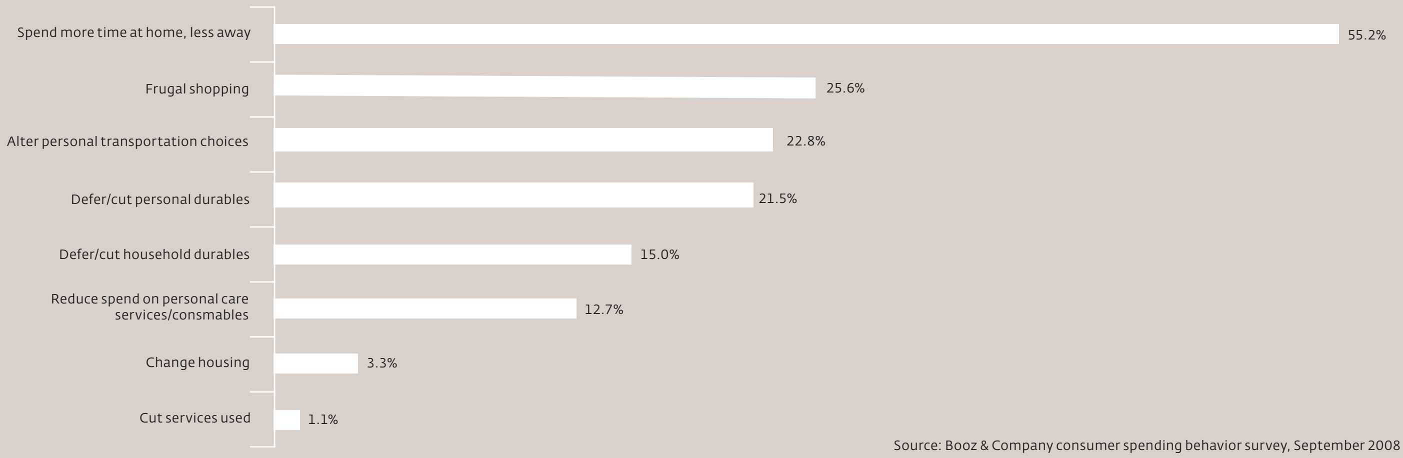
Figure 1 Changes made in the past six months (percent of respondents who already made significant changes in spending)



[1] Andrews, Edmund L., "Officials Vow to Act Amid Signs of Long Recession," *The New York Times*, December 1, 2008.

[2] Leinwand, Paul, Leslie H. Moeller, K.B. Shriram, "Consumer Spending in the Economic Downturn: The Wide Ranging Impact on Consumer Behavior," Booz & Company, September 2008.

Figure 2 Changes to be made going forward (percent of respondents who plan to make significant changes in spending)



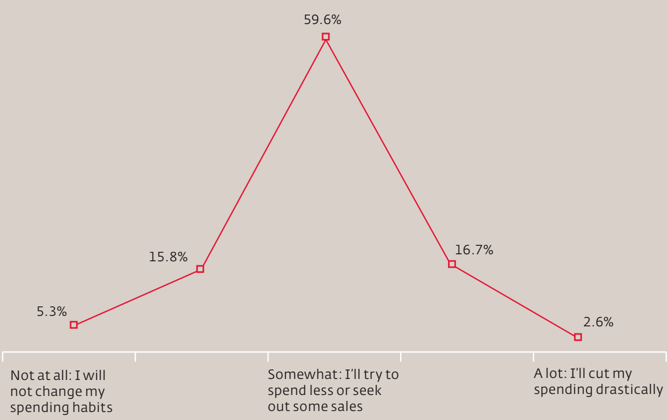
Source: Booz & Company consumer spending behavior survey, September 2008

Another behavioral change apparent in the Booz & Company study is that consumers are choosing to defer purchases of large-ticket, household durables (e.g., electronics, appliances, and furniture) rather than trading down to less expensive alternatives. As expected, the study also finds that consumers are less likely to make behavioral changes in areas that require substantial time, effort, and investment to change spending patterns (e.g., mode of transportation used for commuting).[3]

Impact on spending by category

Intrigued by the Booz & Company study and how behavioral shifts in spending will impact brands, Interbrand conducted a more focused consumer spending survey in December 2008 to identify how consumers will cut costs, and on which categories. Of the 140 respondents in the Interbrand survey, 95 percent stated that they would change their overall spending based on current economic conditions. The majority of these respondents indicated that they would change their spending somewhat by trying to spend less or by seeking out sales, while only 2.6 percent said they would make drastic cuts in spending. *(See Figure 3 for the breakout of responses.)*

Figure 3 How respondents will adjust overall spending



Source: Interbrand consumer spending behavior survey, December 2008

Consumers can achieve these cuts in spending in a variety of ways: seeking out sales, discount-shopping online, buying in bulk, finding less expensive substitutes for preferred brands, deferring the purchase of large-ticket items, and/or avoiding luxury goods and services.

Respondents pointed to non-essential, luxury items as the products and services on which they would cut their spending the most:

- Luxury apparel and shoes
- Home furnishings
- Personal care services
- Electronics
- Vacations

On the other hand, consumers were most reluctant to cut spending on those categories that were either health-related or would require a major life change.

- Prescription medications
- Over-the-counter medications and vitamins
- Cell phone or telephone services
- Housing
- Gym memberships

Figure 4 illustrates the rating of each category tested, where one (1) denotes no change in spending, three (3) indicates a moderate cut in spending, and five (5) points to a significant cut in spending.

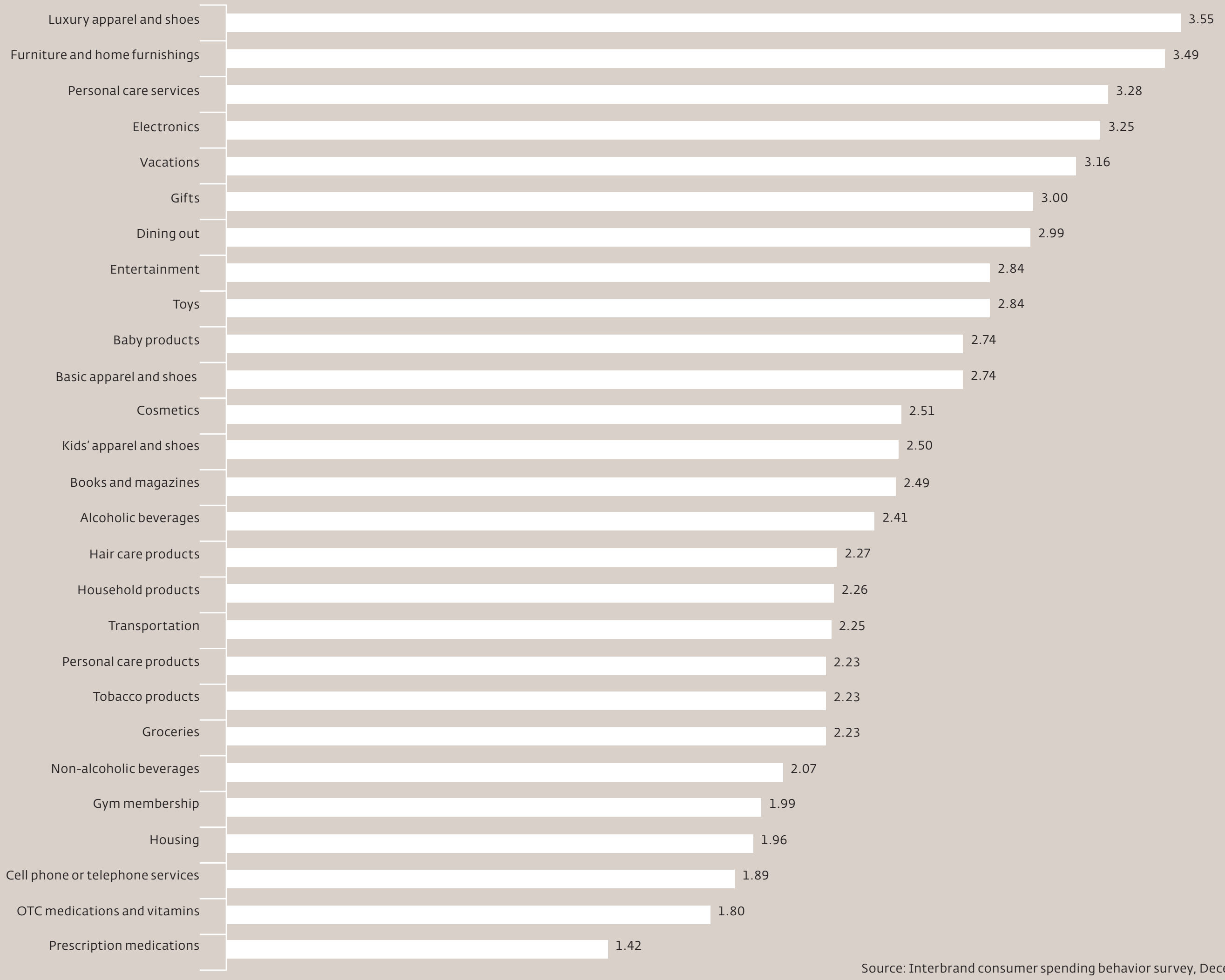
Factors that loosen the purse strings

The recession will force many consumers to cut back on spending, but how they cut back, and by how much, will vary immensely by brand and by category. Every consumer has a different set of priorities and loyalties which will ultimately determine if and how their spending behavior will change.

Though a handful of consumers claim to look only at prices and features when making purchase decisions, the large majority of

[3] Leinwand, Paul, Leslie H. Moeller, K.B. Shriram, "Consumer Spending in the Economic Downturn: The Wide Ranging Impact on Consumer Behavior," Booz & Company, September 2008.

Figure 4 Expected changes in spending by category (1 = no change; 3 = moderate reduction; 5 = significant reduction)



Source: Interbrand consumer spending behavior survey, December 2008

consumers have some level of brand loyalty. Brands that have fostered this sense of allegiance with their consumers are more likely to withstand an economic downturn than those that lack these customer ties. Respondents to the Interbrand survey specifically pointed to brands in the electronics, cosmetics, food, and personal care categories as those to which they are most loyal. At the top of the list are:

1. Apple (6.6 percent of responses)
2. Sony (3.9 percent of responses)
3. M·A·C Cosmetics (2.7 percent of responses)

Other brands mentioned repeatedly include Dove, Tide, Tropicana, American Express, Bare Escentuals, Coca-Cola, and Whole Foods. Presumably, these brands should fare better than competitors during the economic downturn.

Similarly, consumers demonstrated brand loyalty in certain "indulgence categories." These are categories on which consumers like to spend their money, but will reduce spending drastically during a recession in order to cut back on the non-essentials. However, these categories are also likely to recover most quickly from an economic downturn when consumers feel that they have better financial footing. Not surprisingly, respondents to the Interbrand survey pointed to restaurants, vacations, luxury clothing, and spa services as their top indulgences. This is consistent with the Booz & Company findings which suggest that spending on these categories are the first to be cut.

While the brands and categories on which consumers choose to spend their money vary from person to person, the one thing that is consistent is that each of them evokes a certain set of positive feelings from the consumer. Respondents indicated that these purchases make them feel happy, confident, special, powerful, young, sexy, or stylish, to name a few. Therefore, for a brand or product to be successful in an economic downturn, it is critical to do more than just fulfill a need or service; it must also create an emotional connection with the consumer that evokes a positive feeling and keeps him coming back for more.

What to do with your brand

Research suggests that the impact a recession has on a particular brand will invariably be dependent on the category in which it operates; however, there are still some key learnings which can help drive the success of brands in this depressed economy:

1. Stay the course; do not abandon the long-term strategy.

Though some predict this recession could be a long and protracted one, experts continue to stress that the economy will eventually return to growth and prosperity. It is important for brands to stay true to their vision through the ups and downs. History shows that those brands which have changed their strategy to appease short-term needs (by reducing their investment in marketing, for example) end up failing in the long-term because they lose the customers that helped them build the brand and who were loyal to them when times were good. Specifically, brands in indulgence categories (such as spa services) that change their strategy run the risk of losing their cachet, eroding brand loyalty, and deterring consumer purchases even after the recession ends.

The 1990 recession brought this point to life in the athletic shoe industry. Reebok experienced unprecedented growth between 1981 and 1987, achieving an annual growth rate of 155 percent and growing sales from US$ 1.5 million to US$ 1.4 billion in a matter of a few years.[4] As a result, Reebok quickly overtook its competitors and became the market leader in the athletic shoe industry. However, when the recession hit in 1990, Reebok took a cautious approach to spending and made numerous cuts in costs to mitigate the negative impact of the recession. The result was a decrease in profits and a loss of market share. On the other hand, Nike entered the 1990 recession as a secondary player in the market and took an aggressive approach to spending. Instead of cutting costs, Nike tripled its marketing investment and strengthened its brand, growing sales from US$ 270 million in 1985 to over US$ 3 billion in 1991.[5] This investment proved to be very worthwhile, as Nike realized profits that were nine times higher after the recession than before it.[6]

The recession will force many consumers to cut back on spending, but how they cut back, and by how much, will vary immensely by brand and by category.

2. Create and communicate differentiation.

A recession is likely to put a great deal of strain on the competitive environment and to intensify competition among those left standing. Competition can come from all types of brands in the category (name brands, store brands, private labels, and generics), as well as from other categories looking to expand into a new area. In a recession, it becomes even more critical for companies to aggressively and tirelessly create a compelling case for their brands. The brand must be perceived as truly special, clearly differentiated, and have attributes that are unique enough to create a strong and lasting value proposition for its customers. Otherwise, consumers will just choose to not buy it.

3. Evaluate brand portfolios.

Since companies with offerings deemed to be "non-essential" are likely to be most impacted by the downturn in the economy, they may look to expand or diversify their brand portfolios to include products that capture more of the buying market and help keep the company solvent. Effective product diversification requires a keen focus on protecting the equity of the existing brand. To do this, new brands should leverage the existing brand to help lower barriers to entry in new markets, and then create a separate identity that makes it obvious that the two brands are distinct from one another.

When soft drinks began to receive negative publicity for associated health risks such as diabetes and high blood pressure in the early 1990s, PepsiCo and Coca-Cola were faced with an interesting decision: either remain focused solely on soft drinks and potentially experience declining sales as consumers switch to new products, or diversify the portfolio and create offerings that fit with new consumer preferences. They both chose the latter option. In the mid-1990s, PepsiCo launched the Aquafina brand to capture the large portion of consumers who were substituting soft drinks with bottled water. Coca-Cola followed suit several years later when it launched Dasani. By evaluating their portfolios and introducing new products that appeal to changing consumer trends, both PepsiCo and Coca-Cola positioned themselves to withstand the downturn in the soft drink industry. In addition, they protected the immense value of their flagship brands by creating different brand identities (logos, signage, advertising, messaging, and customer experience) to create a clear distinction between the two offerings.

4. Make it personal.

Research indicates that the less personal the product, the lower the need to remain loyal to a particular brand. For instance, consumers are generally unwilling to compromise on products that are applied to the skin and hair (cosmetics and beauty products), but are often very willing to replace name-brand household products with less expensive alternatives. Similarly, research shows that all else being equal, those products which evoke a positive emotion from consumers will be impacted less severely and will recover more quickly than those that do not evoke this emotion.

Some categories are naturally less personal than others (household products vs. cosmetics), so brands in these categories must fight even harder to create a personal connection with their customers. Consumers can only afford to remain loyal to a handful of products in the face of an economic downturn, and each brand should strive to be in this set. The more customers can identify with a brand, the more a brand will help users to further define themselves, and thereby become an indispensable part of users' lives.

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[4] Lechner, Frank and John Boli, *The Globalization Reader*, Blackwell Publishing, 2004, p. 169.
[5] Lechner, Frank and John Boli, *The Globalization Reader*, Blackwell Publishing, 2004, p. 169.
[6] "Capturing Opportunities in Challenging Times: Marketing and Advertising in a Recession," The Yellow Paper Series, DDB.

Opportunities for store brands and private-label brands

As mentioned earlier, one way that consumers may be able to cut back on spending is by replacing more expensive, name-brand products with less expensive, store-brand or private-label alternatives. A Nielsen report from late November 2008 states that sales of private-label brands in the U.S. grew to US$ 81 billion in 2008, a 10.2 percent year-on-year growth versus 2007.[7] Meanwhile, overall consumer spending during the first three quarters of 2008 grew at the slowest rate since 1991, achieving only +0.8 percent growth versus the same period last year.[8] In fact, spending has been on a steady decline each month since July 2008[9] and analysts expect a further decline in the fourth quarter of 2008. The Nielsen study also found that 72 percent of respondents surveyed viewed private-label brands as good alternatives to name brands, while 62 percent of respondents stated that store brands were just as good as name brands.[10]

Types of Brands

There are four main types of brands. Name brands are trademarked or distinctive names that are used to identify specific products or companies. An example of this is "Advil"—Wyeth Consumer Healthcare's brand for ibuprofen. Then there are private labels, which are typically manufactured or provided by one company and offered under another company's brand. An example of this is "Equate" – Wal-Mart's brand for over-the-counter pharmaceuticals like ibuprofen. Next, there are store brands (also called house brands), which are specific to a retail store or store chain. The retailer can manufacture goods under its own label, re-brand private-label goods, or outsource the manufacturing of store-brand items to multiple third parties. In some cases, the manufacturer of store-brand products also manufactures name-brand and/or private-label goods. An example of a store brand is "Walgreens" for ibuprofen. Finally, there are generic brands, which are devoid of any brand attachment. An example of this is a product simply labeled "Ibubrofen" – whose packaging only lists the UPC, ingredients, and required product information for that item.

Statistics like these point to a large potential upside for less expensive alternatives during the recession. Interbrand's study suggests that some categories present greater opportunities than others. When respondents were asked to prioritize products in terms of how willing they would be to change to store-brand alternatives, they pointed to household products as the "most willing to switch to store brand" and electronics and cosmetics as the categories for which they were "least willing to switch."

Key themes emerged from the responses:

- While consumers' perceptions of the quality of store-brand products vary by person and by category, store brands are generally perceived to provide less peace of mind and trust than name brands.
- If consumers are willing to accept a lower quality product, they are much more willing to switch to a less expensive alternative.
- Products that are viewed as essentials (household products) are generally more easily substitutable than those that are deemed to be non-essential goods (electronics).
- Parents are much more willing to substitute name brands with store brands for themselves than for their children; in fact, respondents with children ranked baby products as the category for which they would be "least willing to switch."
- When it comes to food and medicine, there is a big split in respondents' willingness to switch to store-brand alternatives; some stated that there is little (if any) difference in the ingredients of name-brand and store-brand foods and medicine, while others cited that because these products are ingested, there is an unwillingness to substitute and potentially compromise on quality.
- Items that are considered to be long-term investments, infrequent purchases, or high-ticket items are categories in which consumers are least likely to switch to store brands due to perceived lower quality.
- Visibility and perception are very important to consumers; they are much less willing to substitute on items that are highly visible to others (e.g., a TV in the entertainment center or soft drinks served to guests).

Conclusion

To succeed in a recession, brands need to reinforce and solidify their long-term strategy. By continuing to make smart investments in their brands, companies can provide customers with a clear value proposition, use messaging to articulate differentiation versus competitors, and ultimately strengthen the equity and market position of their brands. If necessary, companies can also look into adding new brands to their portfolio, which address the short-term needs of their customers and help sustain the business model during economic downturns. Brands should also seek to create strong personal connections with their customers that generate positive emotions, drive loyalty, and ultimately make the brand feel irreplaceable to its users.

The recession also creates fantastic opportunities for store brands and private-label brands to advance their market position. With consumers focused on reduced spending, these less expensive brands have an opportunity to steal significant market share from more expensive, name-brand competitors. The focus for these types of brands should be on developing alternatives in less personal categories where consumers are not as sensitive to the prestige of a name brand, are less concerned about potentially compromising on quality, and do not seek out the trust and peace of mind that name brands tend to offer.

When consumers are focused on saving money, companies need to do even more to convince them that their brands are truly indispensable. Doing this requires that companies invest in and nurture their brands extensively in order to effectively communicate a clear value proposition and message to the market. If not, these brands may not be around when the economy recovers. ■

[7] Wong, Elaine, "Nielsen: Private Label Deemed Equal to Name Brands," BrandWeek, November 17, 2008.
[8] Bureau of Economic Analysis, "National Income and Product Accounts Table 1.1.6: Real Gross Domestic Product, Chained Dollars", Hhttp://www.bea.gov/nationalH, November 25, 2008.
[9] Bater, Jeff and Brian Blackstone, "Retail Sales, Wholesale Prices Fall," The Wall Street Journal, December 12, 2008.
[10] Wong, Elaine, "Nielsen: Private Label Deemed Equal to Name Brands," BrandWeek, November 17, 2008.

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