MAPPING CONSUMER BEHAVIOR IN 2022

MANAGING PRICE DURING TURBULENT TIMES

April 2022

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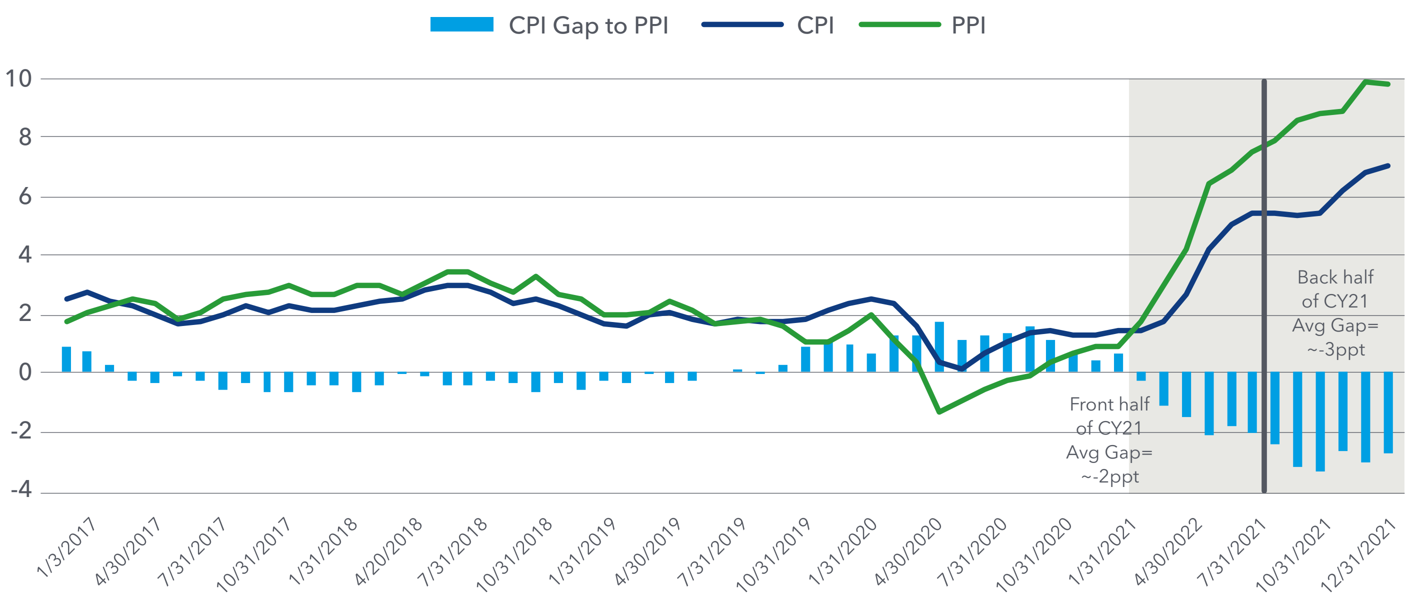
The Keys to Successfully Navigating Price Sensitivity in 2022

The first two years of the COVID-19 pandemic have created an unusual environment for price sensitivity that has, at times, made the concept of elasticity seem almost irrelevant. Until recently, manufacturers have managed to increase CPG product prices again and again without the corresponding decrease in sales volume you would normally expect.

Several factors help account for this. A big one is the fact that retailers have been reluctant to fully pass on price increases from producers to consumers. But as the gap between the producer price index (PPI) and the consumer price index (CPI) grows, retailers will soon have no choice but to close the gap.

Price Will Continue to Increase With the Gap Between CPI vs. PPI (Historically ~-0.5ppt) Indicating Continued Inflationary Increases

12-Month Percent Change, not seasonally adjusted



Tracking the increasing, unsustainable gap between CPI and PPI

Source: https://www.bls.gov/

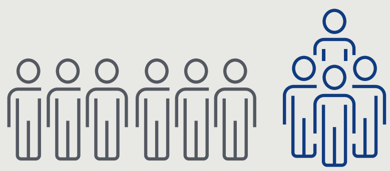
In part, retailers have been hesitant to pass along price increases to maintain a more normal 0.5% gap between PPI and CPI because they've seen firsthand in this supply-constrained environment that consumers are very willing to switch stores or brands when they can't get what they want.

There's been a delay in price sensitivity taking hold thanks to some other factors too. One is remaining channel inventory bought at the old prices that still needs to be sold. Another is the fact that once prices are passed along to consumers, there will be another lag before they realize these prices are higher and act in response.

Out-of-Stock Issues Are Persistent, But Not Category Consistent

December Out-of-Stocks

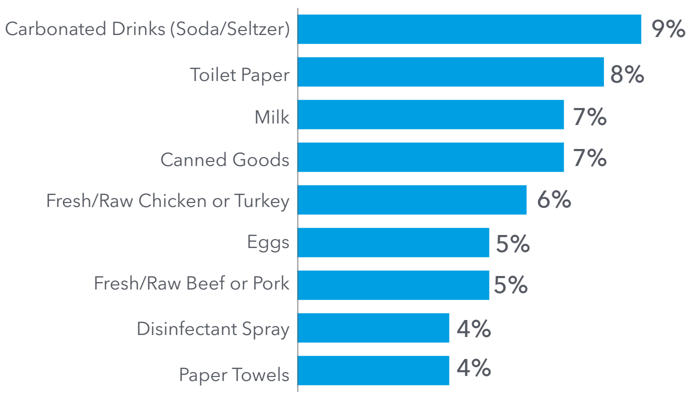
Have you personally experienced issues with out-of-stocks or items being unavailable during the past week?



= 38% have experienced out-of-stocks

Most Impacted Categories

Have you personally experienced issues with out-of-stocks or items being unavailable during the past week when you tried to buy any of the following types of products?



Changes in Shopping Behavior

What did you do most often when something you wanted to buy was recently unavailable at your store/site? (among those who experienced out-of-stocks)

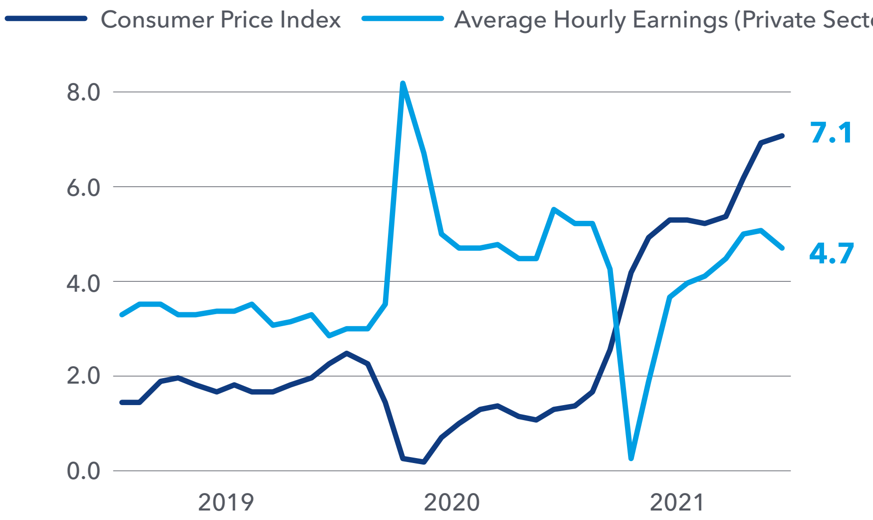
34%	Went to a different physical store and bought the item I wanted
24%	Bought a different brand or variety instead, from the same location
19%	Went back to the same location to buy later
7%	Went online to order the item I wanted
26%	Didn't make the purchase

Source: IRI OmniConsumer™ Survey Solutions, December 2021, n=1,069 total respondents, fielded 12/3-8/2021

But as this sequence of events unfolds, some consumers undoubtedly will change their buying behavior, because they are already taking economic hits on several other fronts. The stimulus checks that helped boost CPG sales have dried up. And while personal savings grew substantially during COVID-19, rising inflation has caused many households to dip into savings for everyday expenses. At the same time, wage growth has failed to keep pace with inflation.

Inflation Is Outpacing Wage Growth

January through December, year-over-year change in U.S. **consumer prices** and **earnings**



Source: 1. https://fred.stlouisfed.org/series/PSAVERT 2. U.S. Bureau of Labor Statistics. As of January 2022. Wage data covers private sector.

The storm hasn't hit yet, but the dark clouds are looming and we can forecast with high levels of confidence that CPG prices will continue to rise.

Russia's invasion of Ukraine has likewise only exacerbated the problem of rising energy costs, which saw a 29.3% increase in the energy consumer price index from 2020 to 2021. Consumer costs have also risen in other categories. And we could soon see a series of interest rate hikes that make loans and mortgages more expensive.

The storm hasn't hit yet, but the dark clouds are looming and we can forecast with high levels of confidence that CPG prices will continue to rise. And with it, elasticity will return and brands that once felt immune to price sensitivity could see product volumes drop off a cliff. To avoid that outcome, brands and retailers need to plan for this likely scenario and be prepared to respond quickly when it occurs. To do that, they should act now to:

- **Monitor volume and be ready to switch tactics.** While the pandemic has led some brands to believe that price elasticity no longer exists, consumer behavior will shift as CPG prices keep rising and consumer dollars get stretched further. It's important to be nimble, closely monitor volume, and be ready to switch on promotions or a new pricing strategy the moment you see sales volumes start to dip.
- **Invest in innovation now.** When the dust settles a year from now, if you've raised your prices 20% over that period, you'll be left with a higher-priced brand that needs to be supported with some sort of value proposition. Whether it's a special benefit, package or ingredient, consumers will seek a justification for the higher prices and good reasons not to switch to a less-expensive brand.
- **Focus on assortment and consider pack alterations.** While consumers may seek out larger value-priced packages of shelf-stable items, cash-strapped shoppers may also go the other way for more perishable items and trade down to individual/single portions. In lieu of raising prices yet again, some producers may instead opt for product downsizing, as we've seen previously in things like cereal box sizes and ice cream containers. Producers need to be ready to meet changing demand with the right assortment of pack sizes. They should also consider portfolio shifts to eliminate low-margin offerings. And retailers need to be ready to selectively increase prices while keeping their highest-value, most-price-sensitive items competitively priced.

- **Be ready to promote products you know you can supply.** As prices continue to rise, promotions will return as brands feel the need to provide an incentive for cash-strapped consumers to continue to buy their products instead of going to a private label or making another choice, because they'd rather find sales or deals instead of switching to lower-cost products if the option is available. But in this supply-constrained environment, it's critical to keep these incentives targeted to products you can keep in stock.
- **Target audiences based on price sensitivity.** By leveraging your shopper database, you can target various audiences in different brick-and-mortar and e-commerce environments with unique offers. Maybe that means reaching less-price-sensitive shoppers (e.g., wealthy boomers) with an offer at $14.99 and price-sensitive shoppers (e.g., low-income millennials) with a different offer on the same product at $9.99.

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With products like **IRI Price and Trade Advantage™** that enable predictive price and trade strategies, **IRI Assortment Optimization** modeling to help ensure you have the right products in the right channels, and our **IRI product innovation solutions**, IRI helps clients better predict and effectively respond to changing market conditions like the ones we're now experiencing. The brands and retailers that plan for and adapt to these market shifts will emerge stronger from these challenging conditions. They also have a great opportunity right now to capture market share from competitors who would prefer to keep their heads in the sand and hope for the best.

About the Author

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