Consumer Reactions to Inflation

Medallia

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ABOUT OUR RESEARCH METHODOLOGY

Medallia Market Research combines massive amounts of unblinded consumer data to answer tough questions for top brands.

We combine three datasets in our products and research studies:

1. **Spend Data.** Our transaction panel includes the credit and debit card spend of over 5 million consumers, not only at your brand but across competitors and other categories.

2. **Foot Traffic Data.** Our smartphone geolocation panel tracks the movement activity of over 5 million opted-in consumers. This enables us to see trends in foot traffic visitation at virtually any U.S. business location.

3. **Opinion Data.** Our third dataset is our survey panel. In addition to having industry-standard gen-pop survey capabilities, our panel is the largest U.S. panel of visit-based survey takers who can be tracked 24/7.

Through our foot traffic data, we target consumers who have visited specific locations of interest. They receive a survey on their smartphone 24 to 48 hours post-visit. Our survey tools utilize both quantitative and qualitative results, including video-based responses. Combining multiple datasets yields a more holistic view of the customer journey, and a more accurate way to answer strategic insights questions for brands.

ABOUT THIS REPORT

We used our credit/debit transaction panel to track activity across a variety of retail sectors to quantify changes in consumer spending amid the current inflationary environment. We also surveyed panelists to understand the reasons behind their behavior.

Samples have weighting applied for U.S. census representation by age and gender, with the following sample per respondent group:

Quantitative Survey

n = 4,035 U.S. general population aged 18+. Fielded July 2022.

Qualitative Video Survey

n = 40 U.S. general population aged 18+ who identify as having their shopping behaviors changed over the past year. Fielded August 2022.

Executive Summary

The pace of consumer behavior changes over the past three years has been astounding. But while 2020 and 2021 spending habits were driven by reactions to COVID-19, 2022 has been shaped by other factors. Labor and supply shortages, geopolitical tensions, and stock market volatility have been influences — but inflation has served as the leading factor.

By late 2021, the inflation rate shot up to 6%, and is now hovering around 9% in year-over-year increase, which is the highest in over 40 years. Based on our pulse of over four thousand U.S. consumers in July 2022, we've identified the perceptions and stated habit changes of consumers in response to inflation, and further validated these claims with observed behaviors of millions of credit and debit card panelists.

Key findings include:

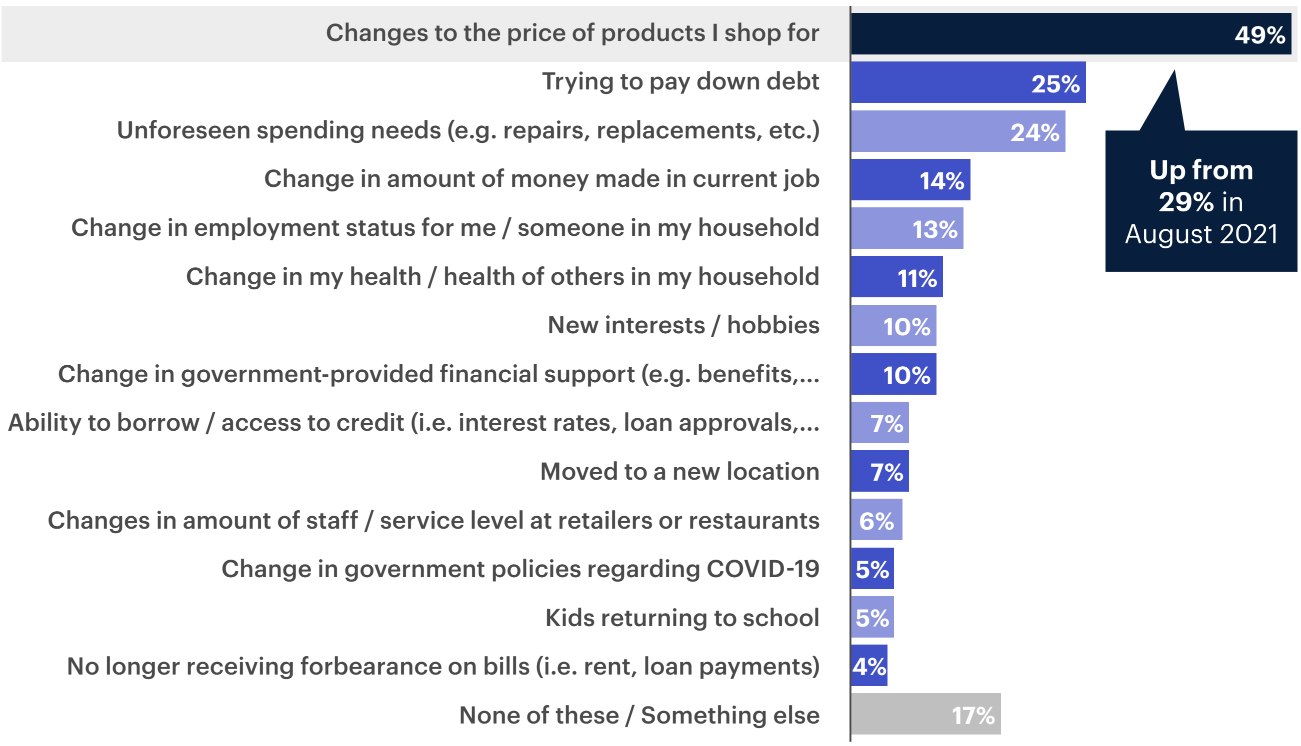
- **The price of goods has grown dramatically as the top factor affecting household purchase decisions,** pushing down other factors like COVID-19 concerns or various ordinary lifestyle changes to lower importance.
- Consumers say they are **responding by cutting expenditures and switching to cheaper alternatives**, more so than finding ways to cover rising costs with additional income or dipping into savings / taking on new debts.
- **These cuts are most common for nonessential / "nice to have" products**, whereas those deemed more essential like **fuel and household goods are generally being consumed like before**, with consumers just accepting higher prices in the process.
- **Despite efforts to reduce expenses, consumers haven't made a drastic shift away from dining out** — likely because restaurants are still fulfilling their convenience and timeliness needs that grocery stores aren't, even though the price increases on groceries have also been substantial.
- **Consumers indicate they can't tolerate more price increases from here**, as nearly all say another 5 percentage point increase in the inflation rate would be met with drastic changes to their shopping decisions.

Factors Affecting Household Spending

A variety of events have had the potential to affect the average U.S. household in recent months, including highly publicized labor market volatility and the gradual reduction of COVID-19 pandemic policies. But in the minds of consumers, none of these have come close to the impact of inflation on their household purchase decisions. They cite changes to the price of products as a top deciding factor for household spending, an increase from 29% in August 2021 to 49% in July 2022.

Biggest factors affecting household purchase decisions

Which of the following, if any, have affected purchase decisions for your household the most over the last 3 months?

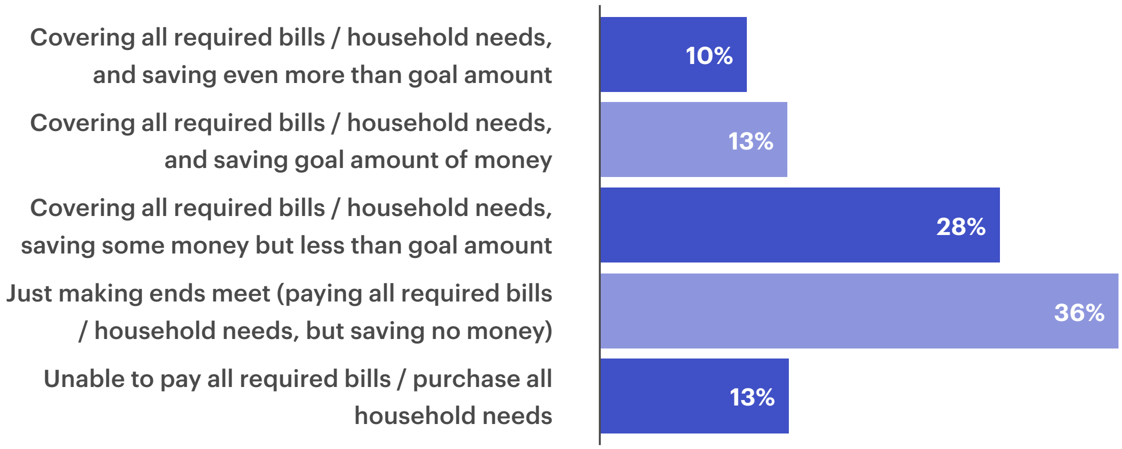


From Medallia Market Research July 2022 Ad-Hoc Inflation Survey (n = 4,035)

Only 23% of households say they are able to not only make ends meet, but are also saving money. Across the whole population, 44% say their ability to pay all of their required bills is worse than a year ago, whereas only 15% say it is better.

Status of household finances

Which of the following best describes the financial status of your household?

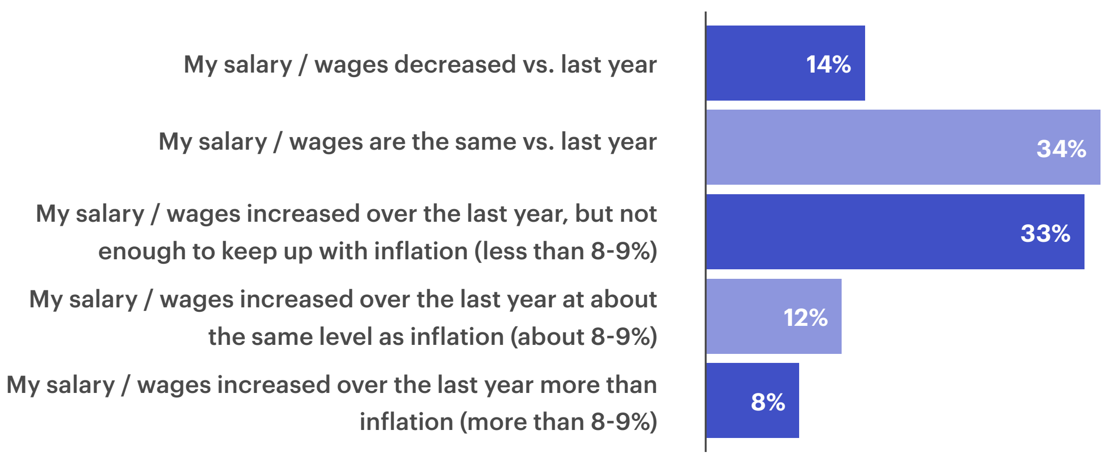


From Medallia Market Research July 2022 Ad-Hoc Inflation Survey (n = 4,035)

Further limiting their purchasing power, only 20% of consumers say they received raises at or above the level of inflation, leaving the rest to resort to options like cutting expenses, reducing savings, taking on debt, or receiving outside financial help to deal with higher prices.

Wage change in 2022 vs. 2021 among full-time employees

Which best describes how your income has changed in the past year?



From Medallia Market Research July 2022 Ad-Hoc Inflation Survey (n = 4,035)

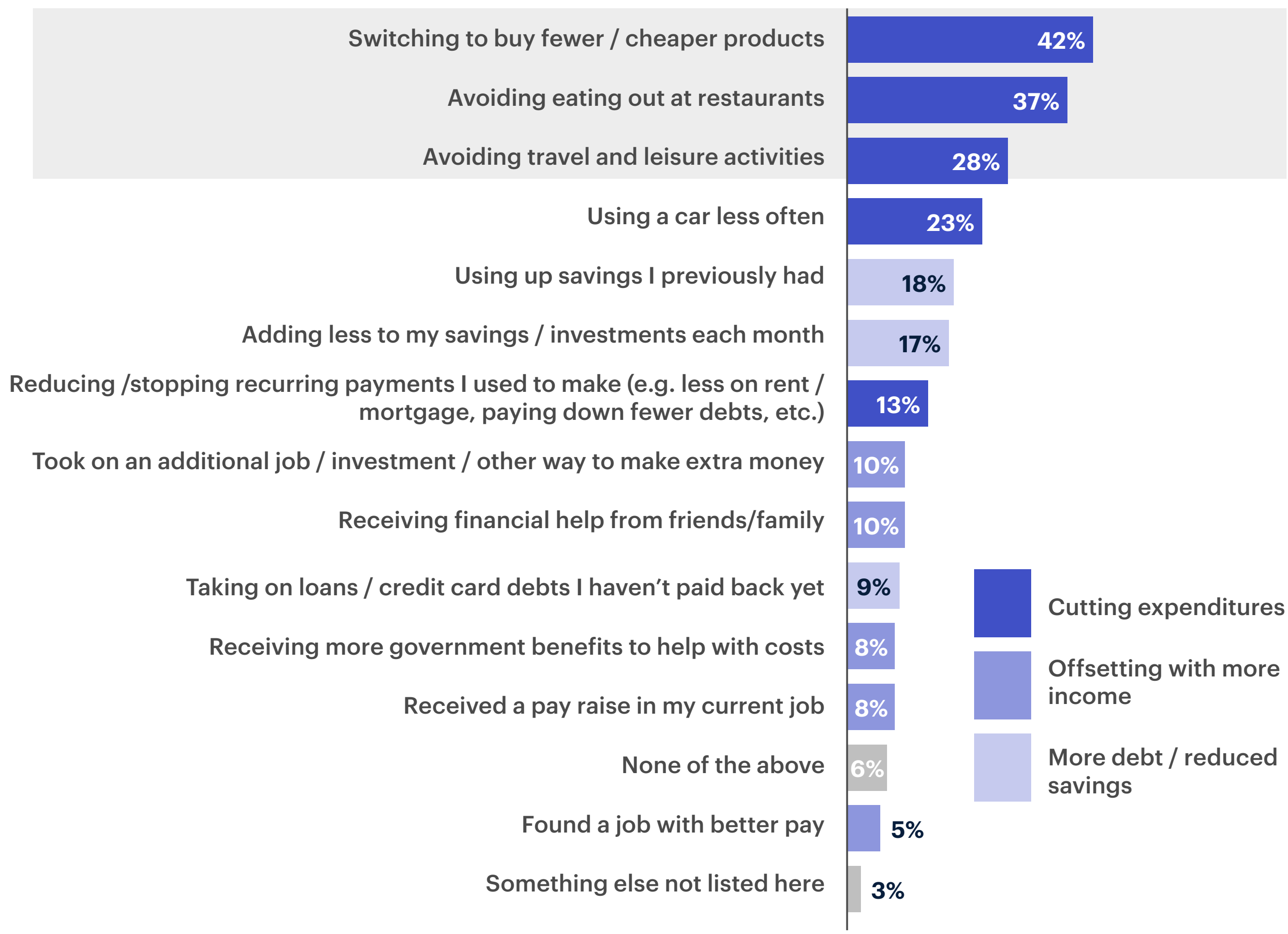
The Consumer Response to Inflation

With only a small minority of households finding ways to increase their incomes to adjust to the effects of inflation, the remainder have generally cited reducing expenses among the other available options. Opting for cheaper products or buying fewer of them was cited as the most common approach, with cutting back on restaurants ranking second and travel & leisure ranking third.

Another portion of the population is turning to less sustainable approaches like using their savings or taking on loans they have not yet begun to pay off. Collectively, 37% indicated that at least one of their top three actions includes reducing savings or adding debt.

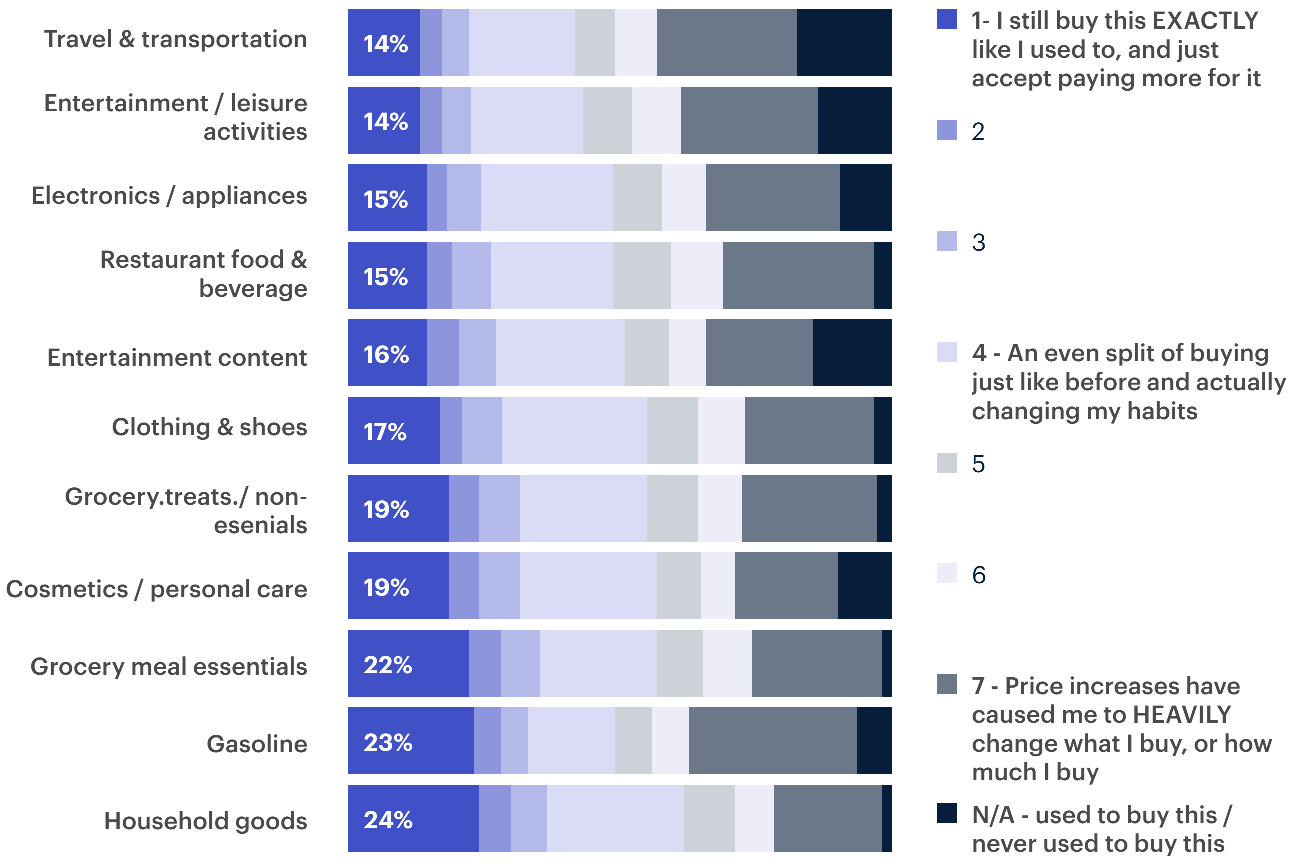
How consumers say they are adapting to the challenges of inflation

Which of the following most describes how you have handled price increases over the past year?



Perceived changes in consumption by product category

Have your purchase habits actually changed for any of the following over the past year?



From Medallia Market Research July 2022 Ad-Hoc Inflation Survey (n = 4,035)

Most consumers indicate that they've needed to decide where to reduce their spending. Across each category, they fall somewhere in the middle on a spectrum of continuing to buy products the same as before versus heavily changing what or how much they buy due to the increasing costs.

Unsurprisingly, the product categories with the most spending changes, the "nice to have" categories, include travel and entertainment. The categories with the least change include household goods and gasoline.

In their own words: consumer response to inflation

Over the past year, how have your shopping habits changed, if at all? What has caused those changes?

- "It's just kind of realizing what I didn't need – iTunes, and I had to stop getting so many hair products. I had to stop going out every Friday and make it like once a month..."
- "...I try to pick up one or two gig shifts a week so that I can make an extra $100 to $400 by doing that. And it definitely helps cover all the cost of inflation. My employer has increased the reimbursement for mileage too..."
- "...We've included more vegetables and less meat in our diet. And definitely try to buy anything that's on sale..."
- "...I buy things that are cheaper. I buy things that have a longer shelf life. I don't buy nonsense..."
- "...I started growing a lot of my own vegetables to try and help offset some of the produce cost that we have..."
- "Since the price of products have increased, I just stay at home and do things that don't cost money to do..."

Reducing waste by buying items that can be kept longer was a theme appearing more than once. For those that have found ways to gain additional income to offset higher expenses, solutions like gig or "side-hustle" work was an avenue cited by some.

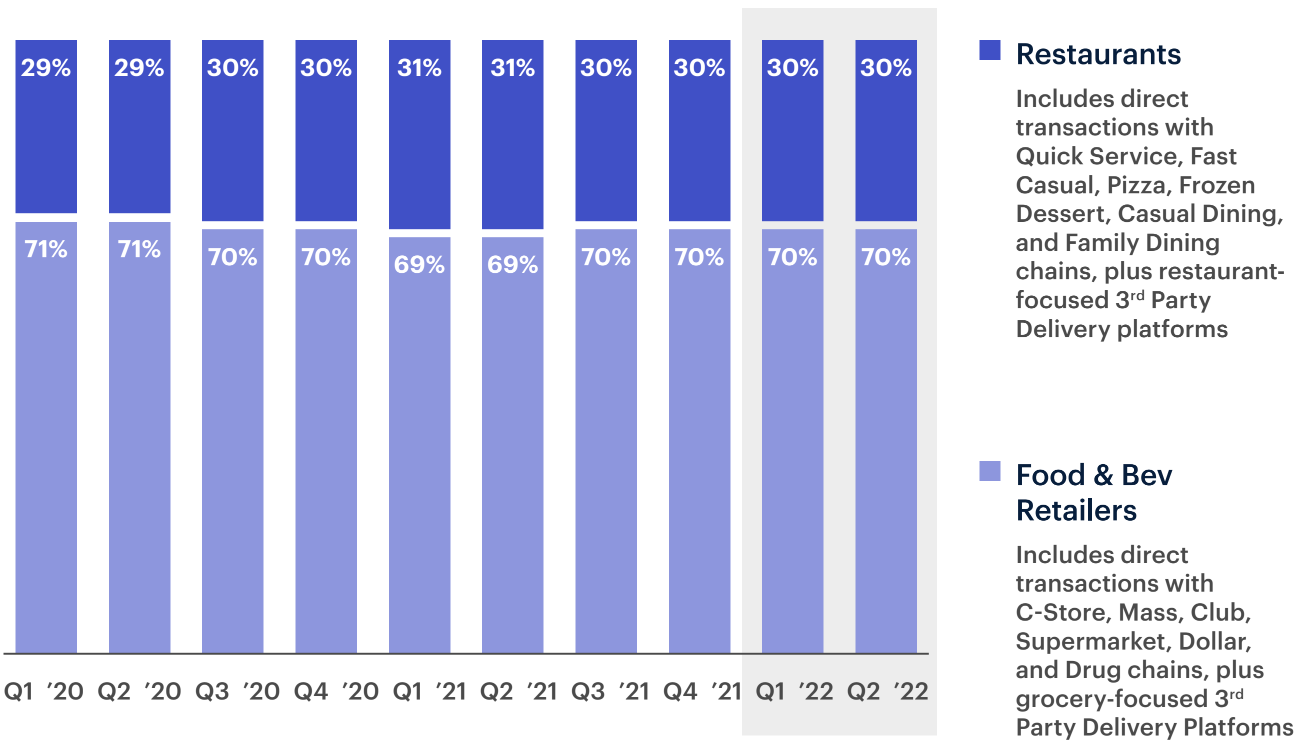
Impacts Specific to Food and Beverage Spending

As consumers have made it clear that adapting to the challenges of inflation has primarily meant cutting back on expenditures — especially on product categories that are not deemed necessities — we could expect a possible behavior change to be a bigger cutback on dining out and turning to groceries more often.

However, this does not appear to be the case. The share of transactions split between restaurant purchases and food- and beverage-focused retailers has held roughly constant over the past year. This also isn't just a shift to bigger grocery stockups — the quantity of food purchases during a grocery trip also doesn't seem to have changed much, hovering below 2020 levels in terms of how long the food purchased is meant to last.

Share of transactions by food / beverage sector

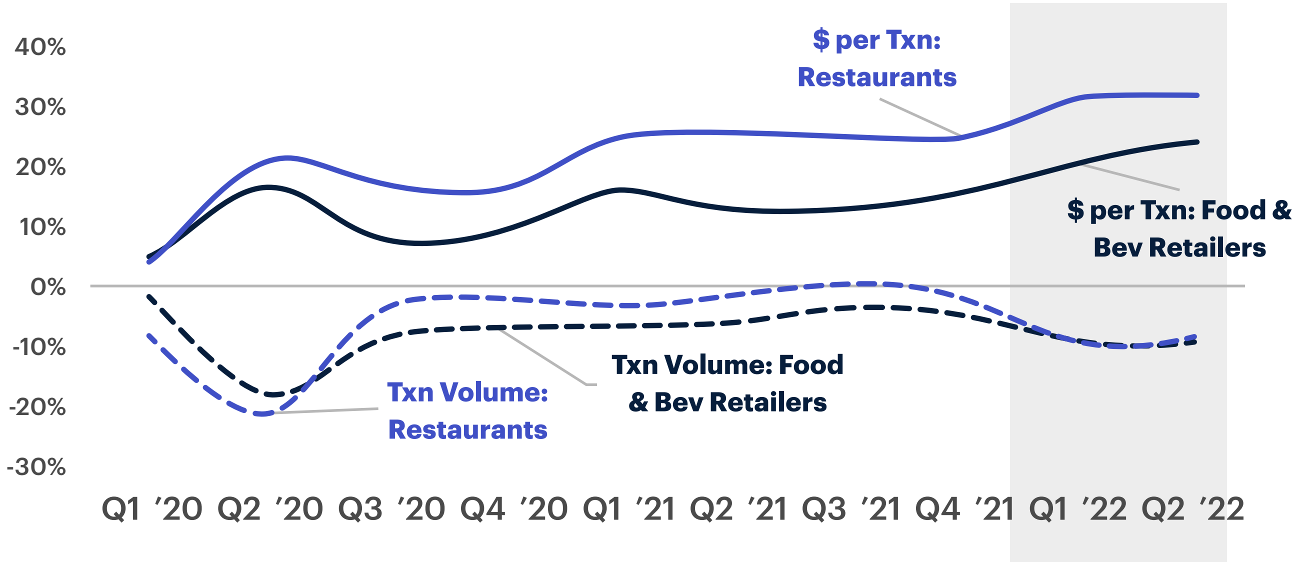
US National; % of transactions going each industry category listed



From Medallia Market Research Credit / Debit Transaction Panel
3PD Restaurant = DoorDash, UberEats, GrubHub, Postmates, Caviar. 3PD Grocery = Instacart, PeaPod, Shipt, and FreshDirect

Food / Bev transactions and $ per transaction trends

Relative % change vs. equivalent quarter in 2019; US National



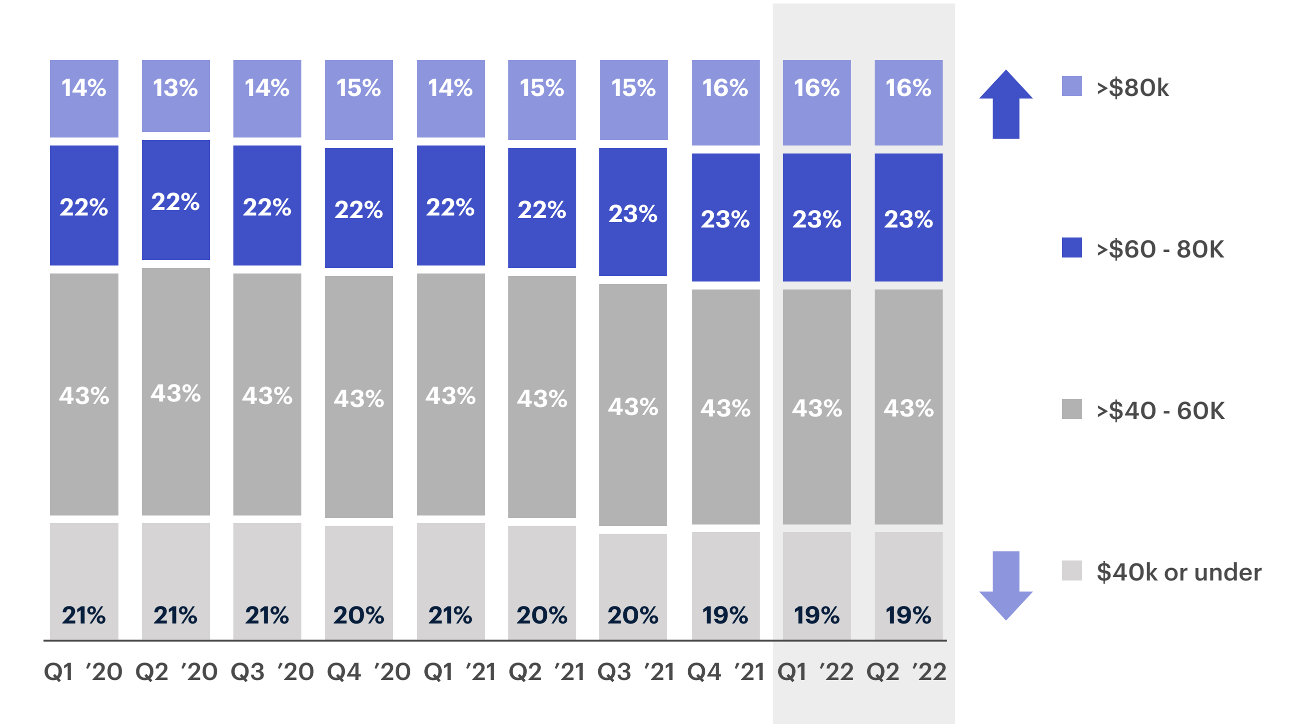
From Medallia Market Research Credit / Debit Transaction Panel
Both industry categories do not include 3rd party delivery platforms for these metrics

But for both restaurant and grocery purchases, that regularity is still declining, just at similar proportions. By the end of 2021, transaction volume for restaurants (excluding third party delivery orders) was continuing to trend upward versus early spring 2020 levels. However, the first half of 2022 has shown a slowdown with a negative momentum of several percentage points lower than the months that preceded it. Despite this, sales for restaurants and food- and beverage-focused retailers are treading water due to the sustained increases in average guest check, driven by price increases.

Not all restaurants are riding this wave equally, however. As cutting back on restaurant spend is still a tactic exhibited by many households, their approach seems to involve “trading down” from sit-down dining toward quick service and fast casual, as these two categories have had better transaction volume trends (vs. 2019 levels) than a category like casual dining or family dining.

Distribution of restaurant spend by household income level

US National, by quarter



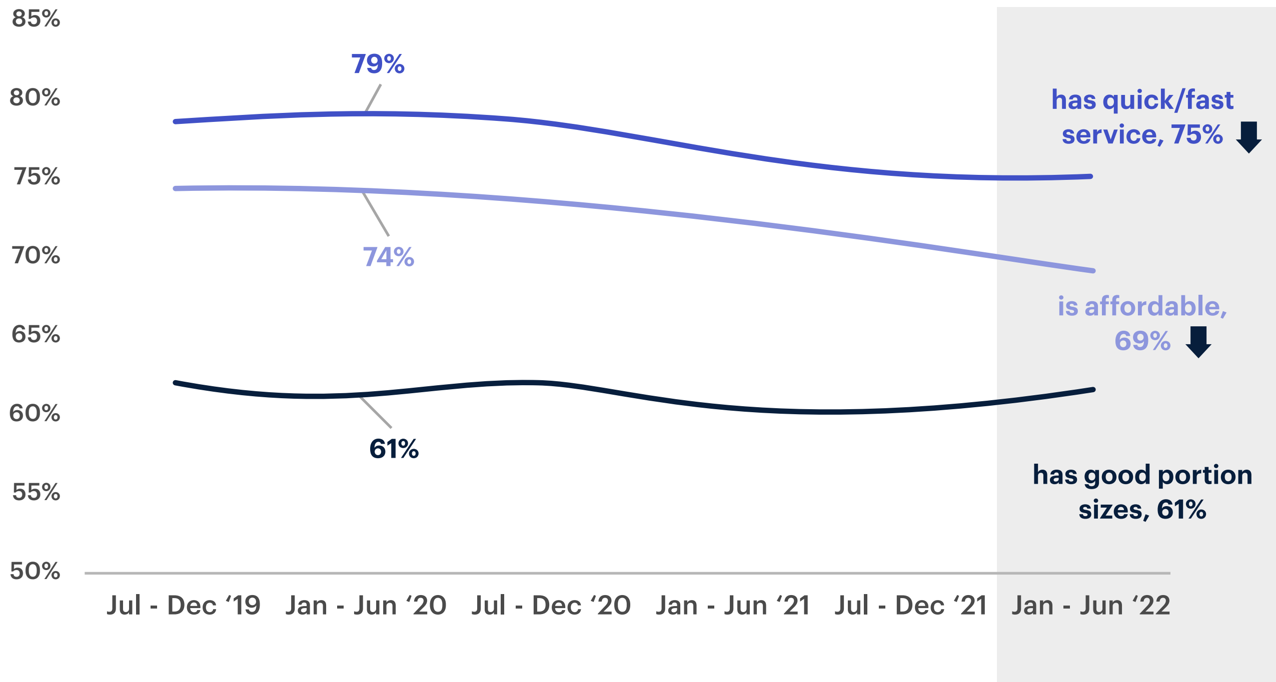
From Medallia Market Research Credit / Debit Transaction Panel.
Cuts by income level are non-standard metrics subject to restatement

On the one hand, these brands can do everything possible to be perceived as value-centric by keeping prices stable and lowering product quality, service levels, or pulling other levers to maintain profitability. Presumably, this will give them the best chance of attracting customers who are especially price-sensitive and see that brand as the best pick when compared to others who have raised prices substantially amid the inflation wave. On the other hand, brands can be unapologetic about price increases but lean into the quality of their product and service when marketing themselves, in an effort to attract those who want the best experience and are concerned little with the effects of inflation.

Each brand is different and has potentially decades of value vs. quality positioning built into their image, which cannot be changed overnight. But the proportion of restaurant customers is shifting more affluent. With the choice of restaurants versus groceries being more about a balance of price with a better overall experience, restaurants may not be successful when trying to appeal to the price-sensitive consumer at all costs. Offering a quality product and experience that appeals to the affluent consumer is an opportunity with more potential now than before.

Average rating for group of QSR leaders, among prior 6 month visitors

US National; QSR Group = Burger King, Chick-fil-A, McDonald's, Sonic, Starbucks, Subway, Taco Bell, and Wendy's



From Medallia Market Research Restaurant Brand Perceptions Syndicated Tracker Survey

By maintaining affordability perceptions and sacrificing some cost input in order to stay profitable, consumer perceptions also indicate there is more room to manipulate portion size than there is to cut back on service.

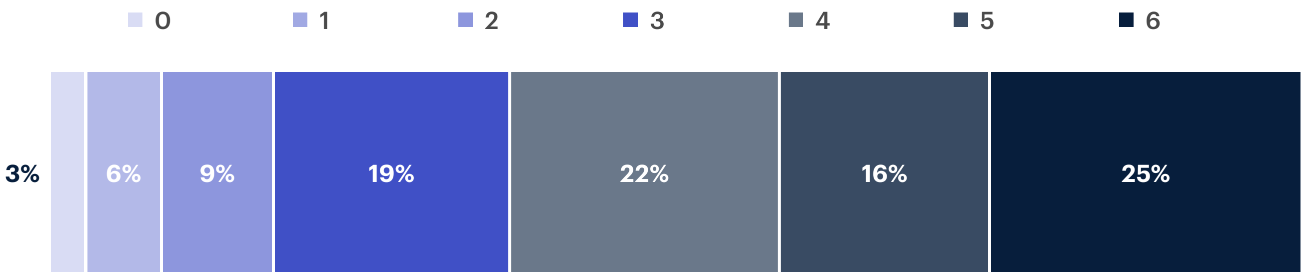
Consumers have accurately recognized that affordability is becoming a concern, and so is speed of service. Portion size ratings, however, have stayed relatively flat and leave room for brands to shrink them while keeping prices stable as a way of appealing to price-sensitive consumers.

Outlook

Though many consumers have already expressed that they've hit their limits due to inflation, those not yet at a breaking point could be soon if the problem gets any worse. About 2 in 5 responses score themselves as a 5 or 6 on a 0–6 scale of how much they'd be affected by another 5% increase in prices (beyond the 8–9% already experienced over the past year).

Perceived effect of another 5% price increase re: curbing shopper behavior

The latest data suggests inflation (prices being up) is, on average, about 8% to 9% compared to this time last year. If prices went up another 5%, where do you fall on the scale below in terms of how much that would affect your future purchase decisions?



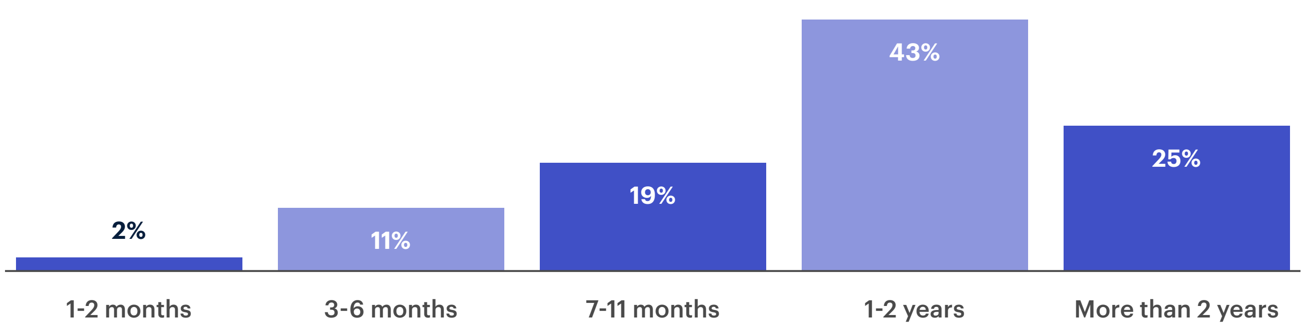
From Medallia Market Research July 2022 Ad-Hoc Inflation Survey (n = 4,035)

And for those looking for a time horizon on when the issues of inflation will be resolved (or at least when their impact on shopper behavior will be mitigated), there's little consensus from the population on what can bring that to fruition.

Americans generally disagree on the types of solutions that would be best, with popular choices ranging from widely different approaches like increasing domestic production of oil, another round of stimulus checks, or the government instituting price controls. Unsurprisingly, 68% of Americans believe inflation won't return to normal levels again for at least a year.

Expected length of time before inflation gets back to "normal" levels

Earlier you mentioned an increase in prices has had a large impact on the purchase decisions made by you / your household. How long do you expect this current wave of price increases to continue, before slowing down to a normal level?



How Brands Can Respond to Inflation

Although a period of high inflation coupled with weaker consumer purchasing power presents a challenge for any business to grow traffic, there is an opportunity to outperform your competition by developing the right strategies.

1. **Inflation is the most important factor for consumers right now, so only ignore rising costs if you have a strong justification to do so.** Consider being vocal about the effects of inflation on your own overhead costs, and the efforts of your brand to limit price increases as best as possible in order to build and sustain consumer trust.

2. **Being competitive on price isn't the only way to win, but you need to be really good at something else instead.** Brands must be able to justify their higher prices through exceptional quality and/or service. If necessary, a reduction in product size and/or quality may be more tolerable than cutting service and experience. Satisfaction metrics in the near future may lower, but cutting prices to boost them might not be necessary as consumers may be unhappy but won't ultimately leave if something other than price gives them a compelling reason to stay.

3. **Plan for the long game.** This period of inflation previously unseen for decades may not end soon. Brands can do more to design and promote products where the customer satisfaction will be less dependent on having abundant but expensive labor — for instance, fewer items whose value is dependent on immediate delivery. Brands may also consider unbundling groups of items to avoid sticker shock even if price per item is much higher.

4. **It's more important than ever to benchmark performance, and to reference more than just topline sales.** The main financial objective of any business isn't to simply grow revenues, it's to grow profit. So if revenues are only up due to major price increases despite declining volume, and input costs per unit are much higher than before, a business might not be growing profitability. It's especially critical now to understand the underlying drivers of sustainable growth and how your brand stacks up to the rest of the market – metrics like new customer acquisition rate, lapsed rate, transactions per customer, and others.

Performance in this environment cannot be accurately gauged by only judging performance using data from your customers. You may think you're doing well without knowing the rest of the market is doing even better, and vice versa. Also important is understanding which competitors your own lapsed customers have migrated to, and why, so that the right strategies can be formulated to win them back.

As brands continue to see the more recent impacts of inflation or other pressing topics like labor shortages or health concerns, Medallia Market Research can guide you in the right direction by acting as an extension of your team and answering your toughest insights questions. If you'd like to scope out your next research project, see a demo of our self-service insights dashboards, or if you simply have a question about our research – don't hesitate to contact us.

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About Medallia

Medallia is the pioneer and market leader in Experience Management. Medallia's award-winning SaaS platform, the Medallia Experience Cloud, leads the market in the understanding and management of experience for customers, employees and citizens. Medallia captures experience signals created on daily journeys in person, digital and IoT interactions and applies proprietary AI technology to reveal personalized and predictive insights that can drive action with tremendous business results. Using Medallia Experience Cloud, customers can reduce churn, turn detractors into promoters and buyers and create in-the-moment cross-sell and up-sell opportunities, providing clear and potent returns on investment. www.medallia.com

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