Grant Thornton

Retail Economics

The Cut Back Economy 2023: a widening crisis

Contents

Foreword

Welcome to the second edition of The Cut Back Economy report.

With our partners at Retail Economics, we asked 2,000 adult consumers in the UK about their spending priorities and plans.

I wish I could write that this year's data shows that cut back behaviours are reducing and confidence is returning. If anything, however, this research shows a widening crisis that businesses need to handle through a multi-stage strategy.

The news cycle has been dominated by headline inflation figures that are proving difficult to shift. Our report estimates that inflation will erode £65 billion of household income, with the average household £2,300 worse off by the end of this financial year.

The difference between now and last year? More middle and higher-income households are being drawn into this widening crisis as savings dwindle and mortgage rate rises bite.

This report identifies the opportunities and risks you need to understand to navigate the cut back economy and maintain a competitive advantage in 2023 and beyond.

Nicola Sartori
Head of Consumer, Grant Thornton UK

Findings at a glance

88%

of shoppers plan to cut back their spending to April 2024

69%

of consumers are spending more time browsing and researching to find the best deals

54%

Over half (54%) of UK consumers are cutting back on discretionary purchases, up slightly on last year (48%)

£65bn

Inflation has eroded £65 billion from household incomes

£2,300

The average household will be £2,300 worse off by the end of this financial year

£54bn

The £54 billion online shopping boost during the pandemic has proved temporary, with normal trends now resuming

One-in-three consumers have changed where they shop for regular purchases, switching to cheaper brands or retailers

Holidays are a top priority for people in discretionary spending categories – above clothing, electricals and household goods

Executive summary

Into its second year, the cut back economy continues to shape consumer behaviour and cast formidable challenges upon retail, leisure, travel and hospitality businesses.

This report explains the evolving macro-environment and the transformative shifts in consumer behaviour that are reshaping the customer journey across these sectors.

Retail, leisure, travel and hospitality industries have endured a turbulent twelve months characterised by soaring costs, strike disruptions, and the tightest squeeze on consumers in generations. Despite government support packages for households, businesses have witnessed sales volumes and profitability dwindle as households prioritise essentials and opt for more affordable options.

While there are encouraging signs, uncertainties remain. The UK economy has managed to avoid recession, and peak inflation has passed. However, challenges persist as inflation takes longer than anticipated to subside, and interest rates rise steeply in response. This will maintain the pinch on consumers' disposable incomes, leading shoppers to be cautious with their spending over the year ahead. Additionally, many homeowners face concerns over significant increases in mortgage repayments due to rising borrowing costs.

Consumers' intention to cut back on non-essential spending remains high. Almost nine in ten (88%) households plan to cut back their spending over the current financial year (to April 2024). This is consistent with last year (86%), as shoppers continue to favour businesses and channels that offer value-for-money.

Brand loyalty is waning as customer journeys become more complex and considered. Online growth has cooled, reverting to pre-pandemic trends as shoppers return to physical stores, driven by affordability, alongside demand for in-person experiences and new destinations. Clearly, this shift in channel dynamics presents both opportunities and challenges for brands navigating the Cut Back Economy.

The report is divided into three sections:

1. **Widening cost of living crisis:** find out which macro forces are prolonging the cost of living crisis, how persistent inflation is affecting consumer spending power, and what rising interest rates mean for UK households.

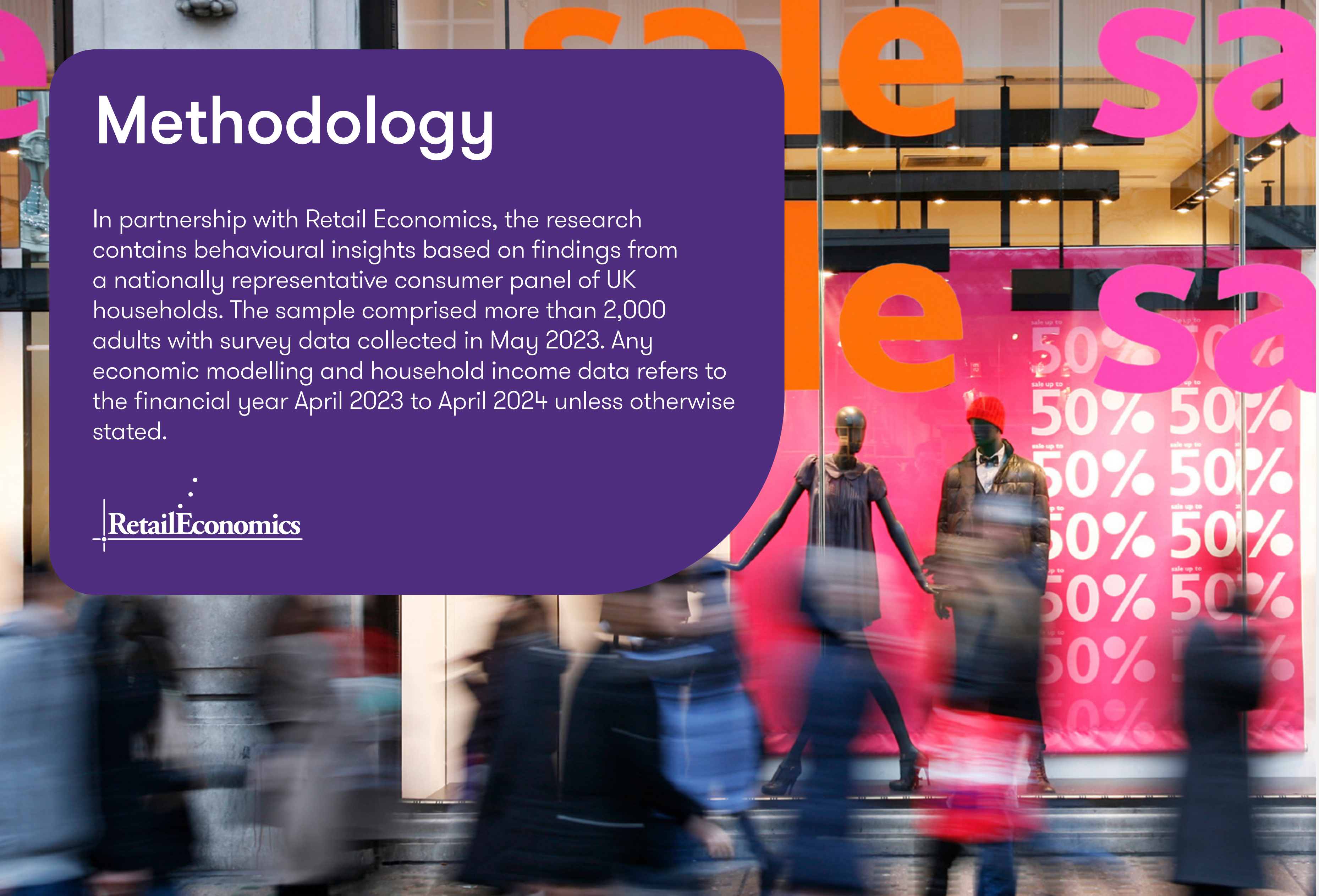
2. **Understanding cut back behaviours and changing customer journeys:** discover why a strong grasp of shifting consumer values and unified commerce is crucial in this changing environment. The report explains which shopper personas are driving consumer cutback behaviours and how they have evolved over time. It also analyses the shifting channel dynamics in retail and the future of online shopping.

3. **Financial resilience and strategies for success:** learn about the key areas that retailers and consumer-facing brands need to focus on to successfully navigate the cut back economy. There's also guidance on five strategies that can help businesses thrive in challenging times and build financial resilience.

Methodology

In partnership with Retail Economics, the research contains behavioural insights based on findings from a nationally representative consumer panel of UK households. The sample comprised more than 2,000 adults with survey data collected in May 2023. Any economic modelling and household income data refers to the financial year April 2023 to April 2024 unless otherwise stated.

RetailEconomics



A widening crisis: more households to feel the pinch

The UK's cost of living crunch is far from over. What initially began as an energy-driven price shock disproportionately affecting the least affluent, has now shifted into its second phase.

It's a phase punctuated by sharp rises in interest rates, persistent inflation and protracted financial pain to more households – including those in middle and higher-income brackets.

Uncomfortable inflation lasting longer than expected

Although inflation peaked at the end of 2022, the path back towards more palatable levels is likely to be a long one. There are some signs that energy and other input cost pressures are beginning to ease – for instance, the official energy price cap from Ofgem has been reduced to £2,074 per annum for a typical household.

However, these benefits are taking longer than expected to filter through to households, with prices 'stickier' than many economists had forecast. Core inflation (which strips out the more volatile components such as food and energy) is at the highest level in three decades. This raises concerns that a wage-price spiral has emerged, as higher wage demands lead to higher costs for businesses, causing inflation, which necessitates further wage rises. Subsequently, this sets the stage for more aggressive interest rate hikes and tighter credit conditions which could prolong the financial pinch on households.

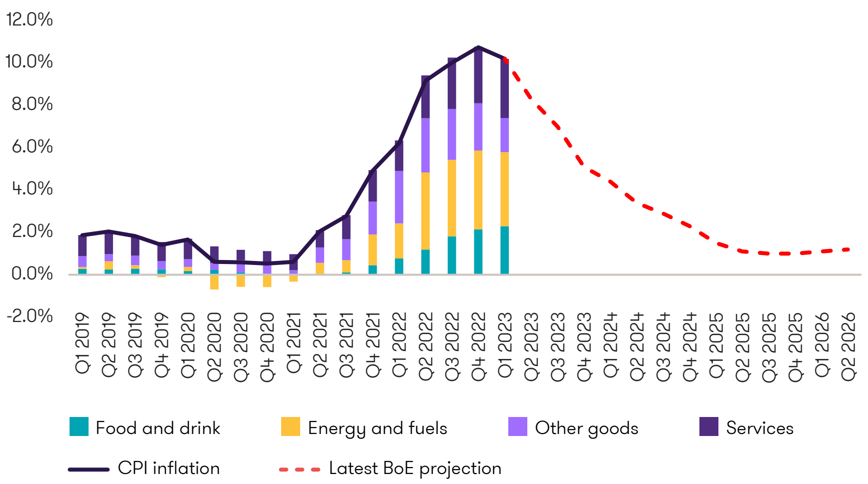
Although inflation has fallen back from double-digit highs amid retreating wholesale energy prices, it's now not expected to return to the Bank of England's 2.0% target until 2025 (Fig. 1).

Importantly, even when inflation slows, the proportion households spend on food and energy will remain significantly higher than two years ago. This will have long term implications on levels and distribution of discretionary spending – particularly as government support is withdrawn.

A series of consecutive interest rate rises have occurred since December 2021 as the Bank of England attempts to tame inflation. However, further rises are expected with markets now pricing in a 6.0% peak interest rate this year – a level last seen in 2001.

Such steep rises in interest rates risk tipping the economy into recession, stifling growth as consumer spending, investment and hiring slow down.

Fig 1: Higher inflation for longer, not expected to return to 2.0% target until 2025



Source: Bank of England, Retail Economics

Inflation erodes £65 billion from household incomes

Regardless of whether the UK economy manages to avoid a technical recession, many households have embraced recessionary behaviours as they operate with diminished spending power.

UK households have already endured the sharpest squeeze on disposable incomes in generations. The spiralling cost of food, energy and other daily expenses – and the failure of wages to keep pace – has already cost UK households £50 billion in lost income.

Unfortunately, there is further pain to come. UK households face an additional £15 billion erosion of disposable incomes this financial year, with real earnings not expected to return to growth until May 2024. A typical household will then be over £2,300 worse off.

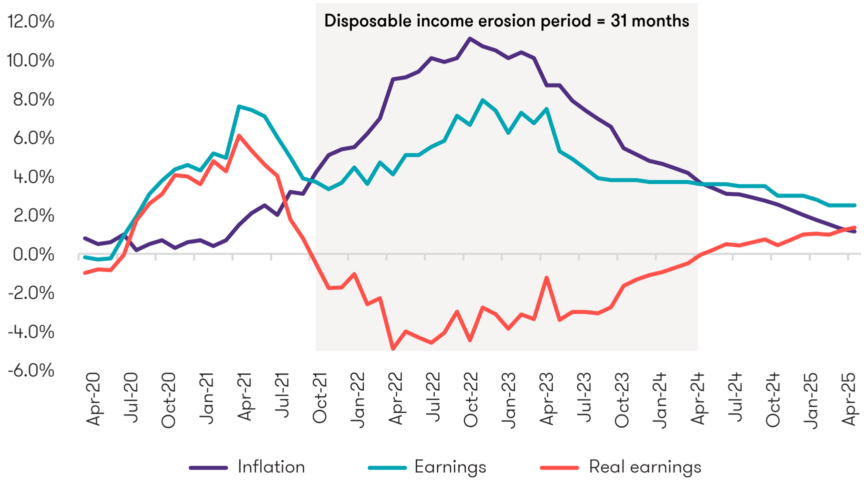
Dwindling pandemic savings

UK households were able to set aside savings worth almost £200 billion during lockdown from cancelled holidays, less commuting and socialising. This helped cushion the blow of higher inflation for many households despite falling real incomes, particularly in the middle-income bracket.

However, excess savings consumers amassed during lockdowns have now been significantly eroded, both in terms of value (due to higher prices) and from withdrawals to support increased household costs and sustained discretionary spending.

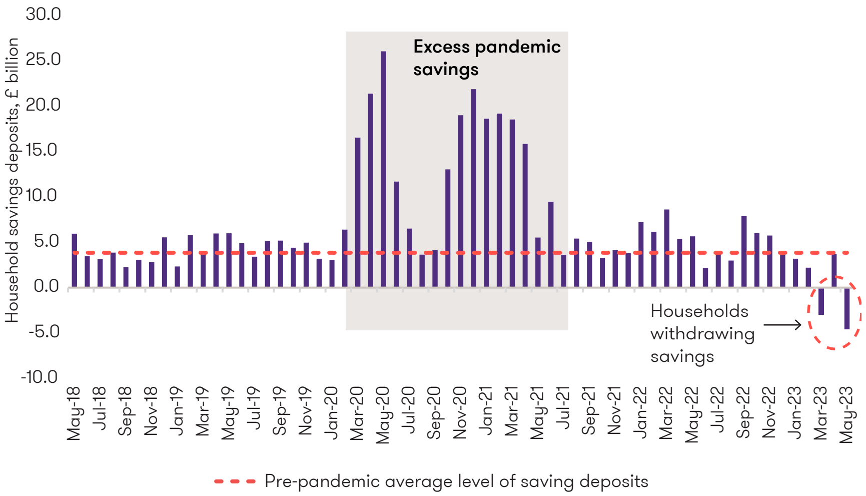
As pandemic savings continue to unwind, many households will be forced to modify spending habits to make ends meet.

Fig 2: The average household will be £2,300 worse off by the end of this financial year



Source: Retail Economics, Grant Thornton

Fig 3: Household deposits in banks and building societies



Source: Bank of England

Mortgage wake-up call for households

The surge in mortgage rates reaching levels unseen in over a decade, presents a significant hurdle for homeowners – particularly those in the middle-income bracket, typically with young families and burdened with higher debt levels relative to their income.

This creates a 'mortgage lottery' scenario where timing is everything, and in combination with uncertainty surrounding fixed-rate expirations and the likelihood of higher repayment costs, this is creating financial instability.

About 1.4 million homeowners are set to roll off fixed-rate mortgage deals before April 2024. Among these, 99% are fixed on rates lower than 2.5%. However, most households face having to renew at interest rates that are at least double their current rate, with the average new fixed mortgage deals at 6%-plus.

When this pain finally hits as households' remortgage, annual mortgage bills will rise by around £3,000 on average (or £250 a month) if they re-fix.

Factoring in the 1.6 million households on variable and tracker rates (who face immediate repayment increases when bank rates rise), over 3 million UK households face mortgage pain over the year ahead.

This isn't a problem confined to homeowners. Private landlords are also passing on the cost of higher mortgage rates to their tenants. Rents are rising at their fastest rate in over a decade, disproportionately impacting younger consumers and the least affluent.

Fig 4: Mortgage turmoil: Soaring interest rates set to hit UK mortgage holders

Mortgage balance	Mortgage repayments at average 2% mortgage rate	Additional monthly repayments at 3%	at 4%	at 5%	at 6%	at 7%
£50,000	£185	£26	£54	£83	£115	£148
£100,000	£370	£52	£107	£167	£230	£295
£150,000	£554	£78	£162	£251	£345	£444
£200,000	£739	£104	£216	£335	£460	£592
£300,000	£1,109	£156	£323	£501	£690	£887
£400,000	£1,478	£208	£432	£669	£920	£1,183
£500,000	£1,848	£260	£539	£836	£1,150	£1,479
£1,000,000	£3,696	£520	£1,078	£1,672	£2,300	£2,957

Term assumed: 30 years
Source: Retail Economics, Grant Thornton

Understanding cut back behaviours and changing customer journeys

Having a deep understanding of how consumer behaviour is changing in context of more complex customer journeys is now an imperative for retail, leisure and hospitality businesses.

This section explains consumer cut back intentions, identifies various cut back personas, and explores shifts in consumer values within the all-important omnichannel environment.

Consumer cut back intentions

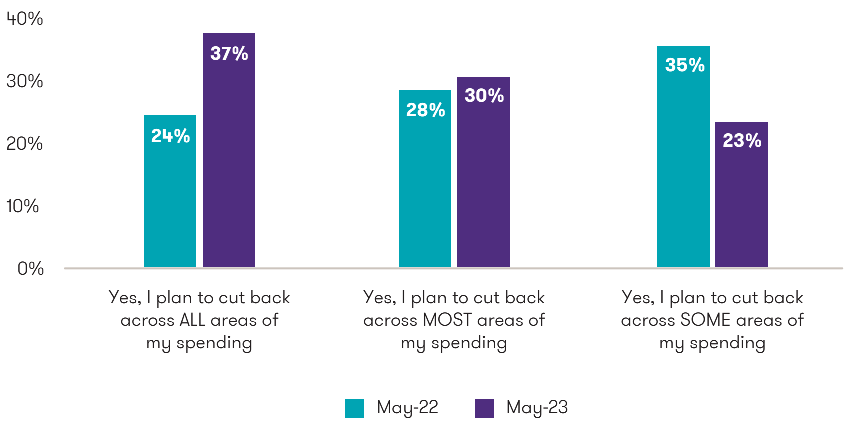
Consumers' cut back intentions remain high. This reflects weak confidence and continued financial pressure experienced by households.

Our research shows **almost nine in ten (88%) shoppers plan to cut back their spending** over the twelve months to April 2024 (i.e. spend less, delay or cancel purchases), virtually unchanged from last year (86%).

However, the scale of cut back appears to be intensifying. Nearly two thirds (65%) of consumers intend to cut back across most, if not all, areas of spending, up from a little over half (52%) a year ago.

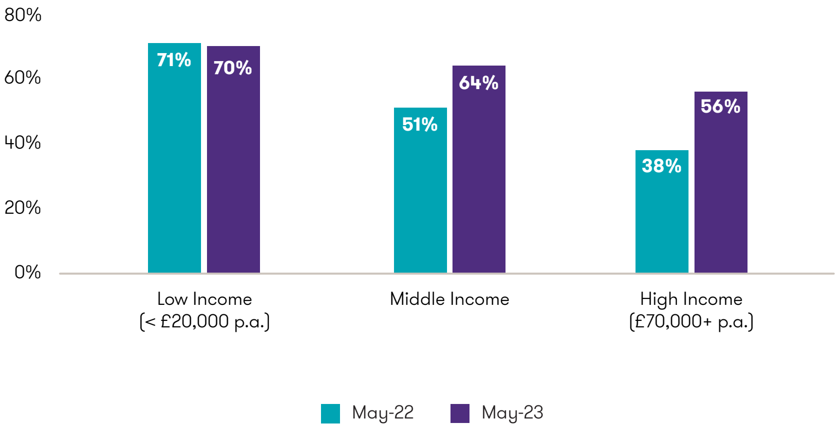
The increase on last year is being driven by a step change in the proportion of middle and higher income households planning to cut back. It reflects consumers' concerns about the impact of higher interest rates on their personal finances, alongside lower levels of savings compared to a year ago (Fig. 6).

Fig 5: Consumers' cut back intentions remain elevated



Source: Retail Economics, Grant Thornton

Fig 6: Consumers' cut back intentions by income



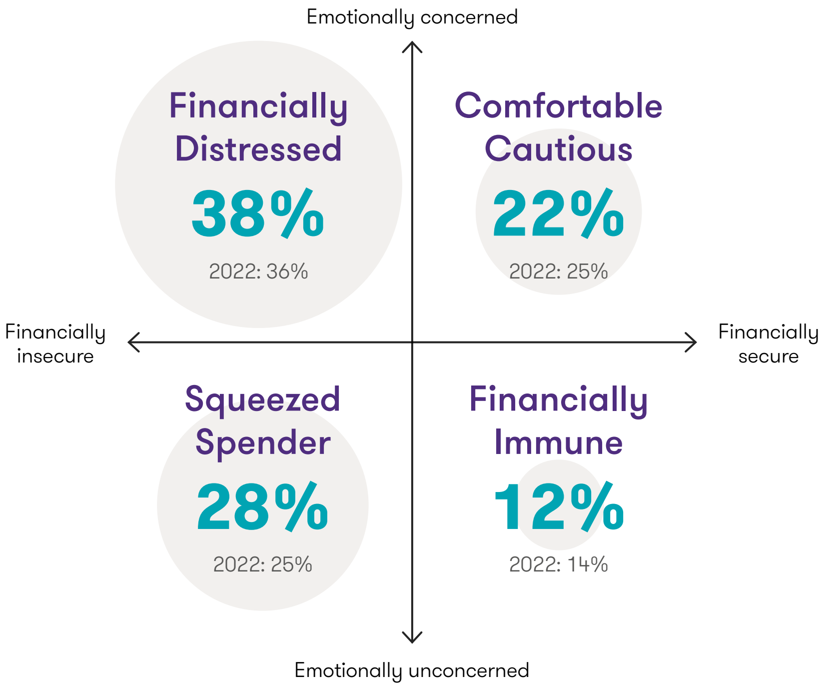
Source: Retail Economics, Grant Thornton

Cut back cohorts

Our 2022 Cut Back Economy report revealed four distinct consumer cut back cohorts, based on how UK households perceive the cost of living crisis and how their spending behaviour has changed as a result.

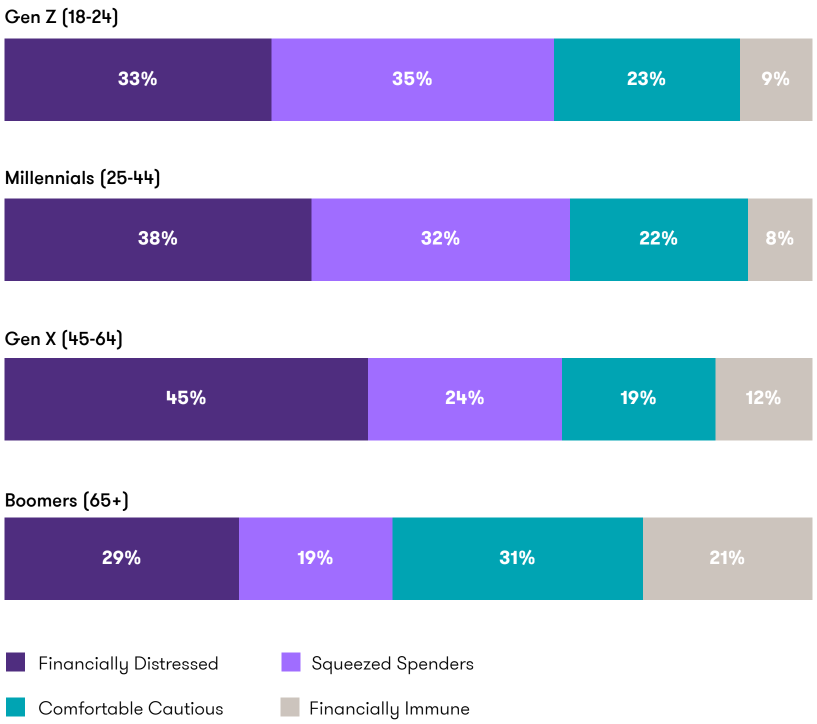
One year on, our research reveals how these cohorts have evolved, with a marked increase in the proportion of consumers defined/characterised as 'Financially Distressed' and 'Squeezed Spenders' (Fig. 7).

Fig 7: Four consumer cut back cohorts



Source: Retail Economics, Grant Thornton

Fig 8: Consumer cut back cohorts by age group



Note: figures may not add to 100% due to rounding
Source: Retail Economics, Grant Thornton

Financially Distressed

Typically under the age of 45, this cohort consider themselves to be financially insecure and intend to cut back across most (if not all) of their non-essential spending. This is a decision based on necessity rather than choice, as weak disposable incomes and/or high debt levels leave limited income remaining after routine outgoings, especially with rising bills and higher interest rates.

Squeezed Spenders

These consumers are financially squeezed yet are largely unconcerned by the rising cost of living. This cohort tend to live for the moment, likely to dip into savings, increase their borrowing, or use buy-now-pay-later schemes to make non-essential purchases as they tend to not let money worries impact their spending habits. They recognise that making cutbacks and delaying major purchases will be necessary, but their carefree attitude often makes them reluctant to do so. Squeezed Spenders, mostly urban and middle-income, are typically under the age of 45.

Comfortable Cautious

This cohort are financially secure, but the rising cost of living is still a concern on an emotional level. Typically comprising middle-income households, often with children, this cohort are risk-averse and prefer to adopt a considered approach to spending rather than act impulsively. They will consciously look for deals and switch to cheaper brands to cut back across some of their spending; but do possess the financial means to go ahead with big ticket purchases if desired.

Financially Immune

For this affluent group of consumers, the cost-of-living crisis has had no financial or psychological impact on their behaviour. They have no plans to cut back spending. Most likely over the age of 45, this cohort are cushioned by strong earnings growth, low debt levels, and a significant savings buffer.

Recessionary behaviours

Facing financial pressures and uncertainty, consumers are adapting by cutting back on non-essential purchases, re-evaluating leisure activities, seeking alternative financial solutions, and making trade-offs in their daily routines.

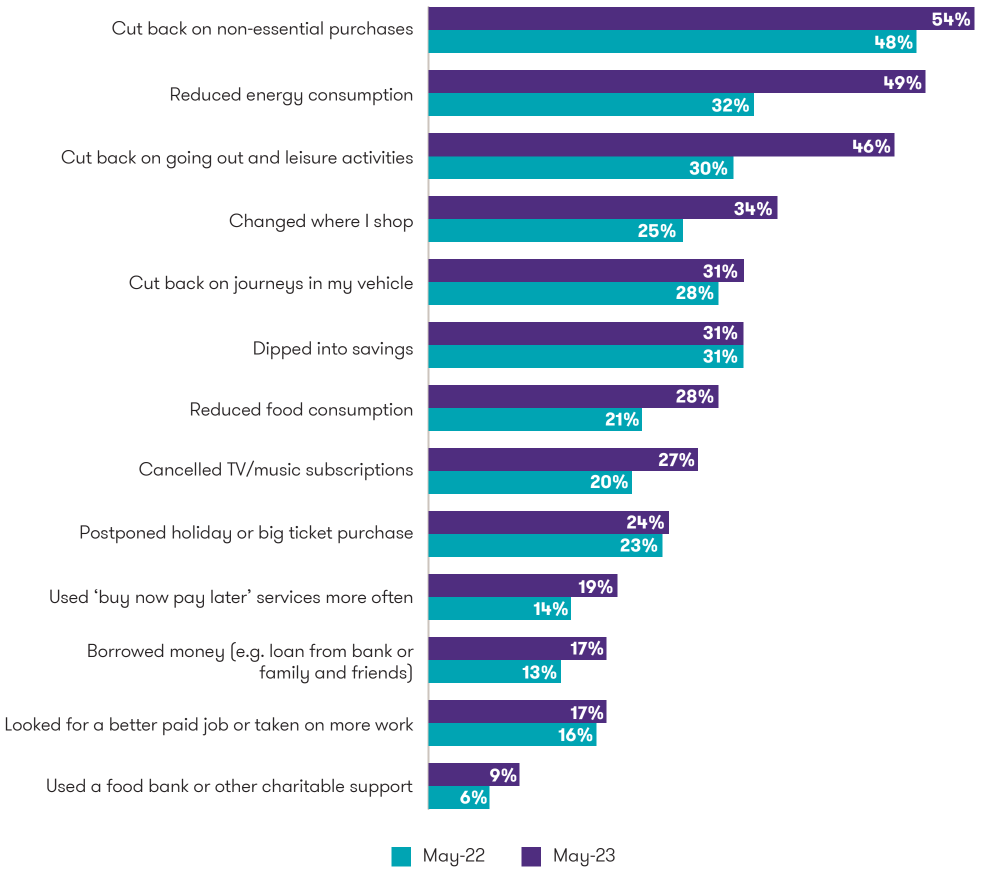
These behavioural adaptations highlight the continued influence of rising costs on consumers' decision-making and the proactive measures adopted to navigate current economic challenges. Understanding these shifts in consumer behaviour presents opportunities for retail, leisure and hospitality operators to deliver effective strategies.

Key cut back behaviours

- Over half (54%) of UK consumers are cutting back on discretionary purchases, up slightly on last year (48%). This indicates a continued trend of more cautious and focused spending on essentials
- Almost half of all consumers (46%) have made the decision to cut back on going out and leisure activities, a notable increase from the previous year (30%)
- One-in-three consumers have changed where they shop for regular purchases, switching to cheaper brands or retailers
- Around one-in-three (31%) consumers are tapping into their savings to sustain their lifestyles in the face of rising costs, while almost a fifth (19%) are increasingly using 'buy now pay later' services
- One-in-two households have actively reduced their energy use, while one-in-four have reduced food consumption. This highlights conscious efforts to manage household expenses and mitigate the impact of escalating energy and food bills

Fig 9: Consumer behaviour adaptation

Since the start of the year, have you done any of the following in response to the increased cost of living?



Source: Retail Economics, Grant Thornton

Two-track spending

Our research shows a clear polarisation between the least affluent and most affluent when it comes to cutting back across retail, leisure, travel and hospitality sectors.

The most affluent are five times less likely to adopt cut back behaviours, with only around one in ten high income households dining out less often, cutting back on luxuries, or switching to own-label products, versus around 60% for the least affluent (Fig. 10).

This is significant because although the most affluent account for only one fifth of consumers, they are responsible for over 40% of total household spending.

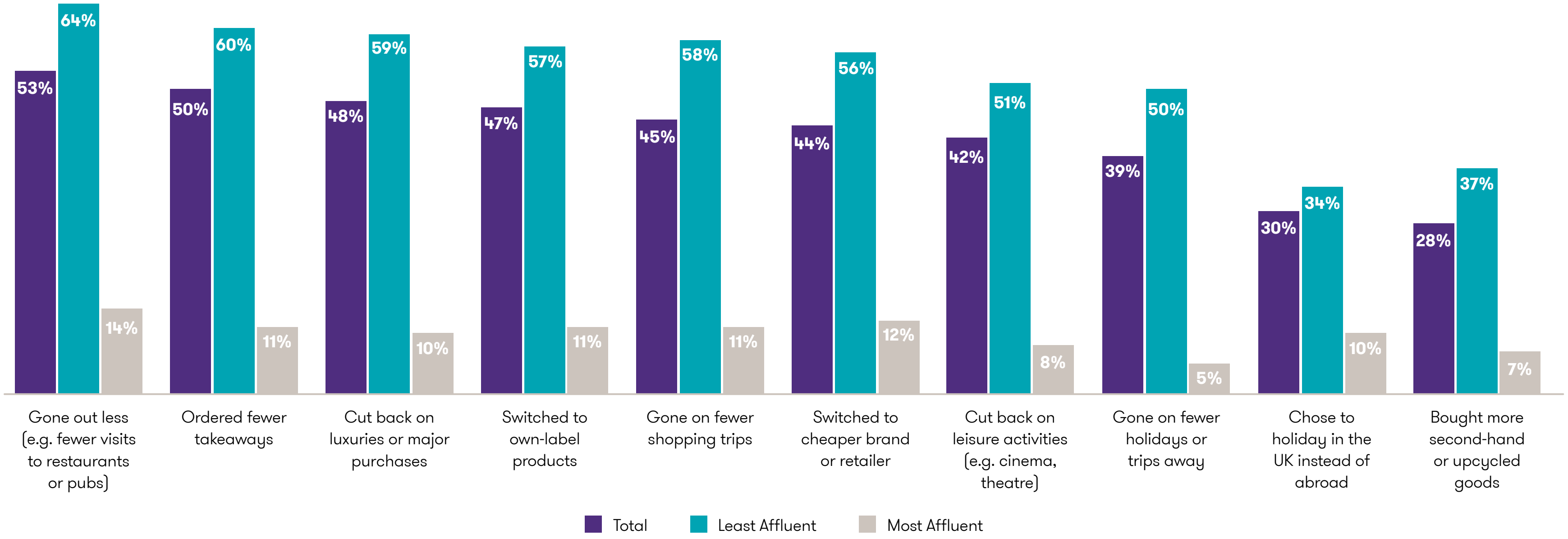
"For those brands targeting more affluent consumers this is undoubtedly good news. And for those considering going after a more affluent customer – it's a change worth exploring.

Despite being a relatively small segment in terms of overall numbers, they account for nearly 40% of total household spending. They represent a clear strategic opportunity to market to in order to offset declines from other segments."

Nicola Sartori, Head of Consumer

Fig 10: Polarisation in cut back behaviours by household income

Since the start of the year, have you done any of the following in response to the increased cost of living?



Source: Retail Economics, Grant Thornton

Sector spending priorities

Looking ahead, Fig. 11 shows consumers' spending priorities for the next 12 months across retail, leisure and hospitality based on their net spending intention for each category. The research identifies three types of spending from the data:

1 Resilient recession-proof: grocery, pets and personal care

These essential items are the only categories to demonstrate positive net spending intention over the year ahead.

Grocery stands out with the highest net spending intention of +11%, reflecting expectations of higher food prices. Additionally, there are also beneficial opportunities for retailers as households eat out less, substituting restaurant meals or takeaways with at-home consumption.

Even across these essential areas, cut back behaviours are still very prevalent, with shoppers trading down, switching to discounters, shifting to private label items and reducing basket sizes. The resultant competition for customer loyalty is intensifying.

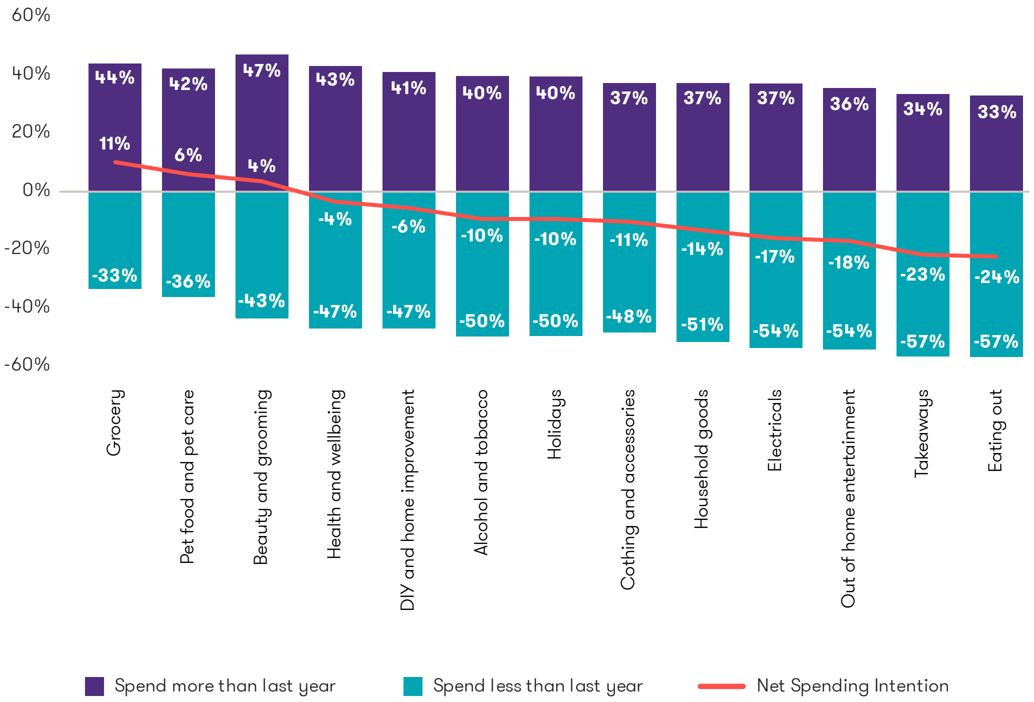
"Where we've seen businesses retain their customers is by offering something that gives immediate satisfaction; cashback schemes or other instant loyalty rewards. In the cut back economy you need to focus on that instant gratification.

Private label is so important to consumers because that's where they're seeing value for money on day-to-day goods. We need an investment in private label goods that will really support a wide range of consumers. Dine-in offers are also really special to a customer because when they can't afford to eat out as much or invest in other areas of hospitality they want to bring that experience home."

Camilla Williams, Associate Director, Transformation Consulting

Fig 11: Consumer spending intentions by category

How do you intend to spend on the following categories over the next 12 months?



Note: "Spend the same as last year" was also an option for respondents
Source: Retail Economics, Grant Thornton

2 Challenged discretionary categories: eating out, takeaways, and out-of-home entertainment

Hospitality stands out as a key area where consumers are prioritising cutting back. There's significantly reduced spending intentions for eating out, takeaways, and out-of-home entertainment.

Following an initial surge in spending after pandemic restrictions, demand has since softened due to rising costs. Operators have been forced to pass on significant increases in food and energy bills to customers, making going out more expensive.

Despite venturing out less often, consumers increasingly demand quality when they do. They're not necessarily looking for cheap options, but value for money.

Their expectations for venues have risen, particularly in terms of food quality and service. This shift reflects a broader trend away from frequent to less frequent drinking, replaced by higher-spend dining experiences, and the rise of competitive socialising. Hospitality and leisure businesses face the challenge of striking a balance between quality and value when appealing to consumers who are prioritising essential needs over non-essential activities.

"Consumers want more than they previously had. What leisure businesses need to focus on is making sure their services are accessible to all income brackets. Where we're seeing the most success at the moment is those leisure businesses that have a higher income customer base. It's really important to widen it."

Camilla Williams, Associate Director, Transformation Consulting

3 Experiences-first: holidays preferred over retail pleasures

Holidays emerge as the top priority among discretionary categories; surpassing clothing, electricals, and household goods in terms of net-spending intention.

Consumers of all ages are opting to cut back on non-essential shopping trips and big-ticket retail purchases, ahead of sacrificing plans for a holiday or trips away (Fig. 12). A significant proportion of consumers highly value experiences, directing discretionary budgets towards creating memories instead of non-essential retail purchases.

While some will opt to travel less frequently, most consumers remain determined to go on holiday. Younger generations are embracing clever spending strategies, such as traveling during off-peak seasons, booking last-minute deals, and opting for cheaper short-haul destinations. Rather than cancelling or postponing holidays, they're finding ways to compromise and travel on limited budgets.

"All indications are that the post-COVID-19 bounce in travel will be sustained because that's where people are prioritising, and over the next 12 months travel will be one of those pockets of the sector where confidence does come back, bringing more access to capital and strong M&A.

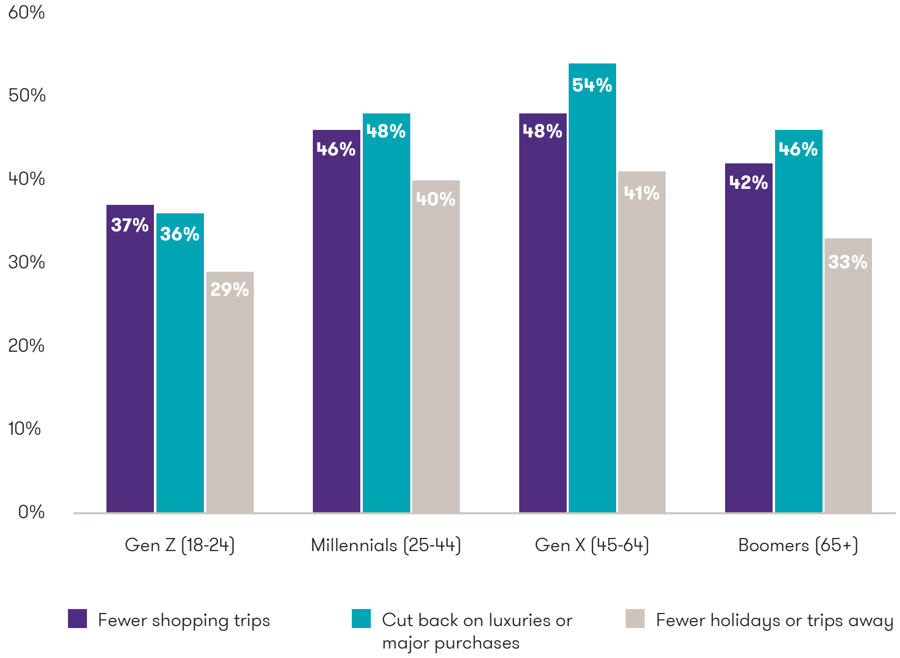
Yet inflation, recruitment issues and borrowing costs will continue to create a tough trading environment for the sector.

Accurate forecasting and strong cost-controls will be necessary to see success as well as pivoting in certain cases to provide greater value-for-money for consumers."

Nicola Sartori, Head of Consumer

Fig. 12: Cut back comparison: Consumers prioritising travel over discretionary retail

Do you plan to do any of the following this year in response to the increased cost of living?



Source: Retail Economics, Grant Thornton

Shifting consumer values

Against a tumultuous environment for consumers and businesses, consumers are re-prioritising their values and making more considered choices about which brands, products, and services to align themselves with.

93%

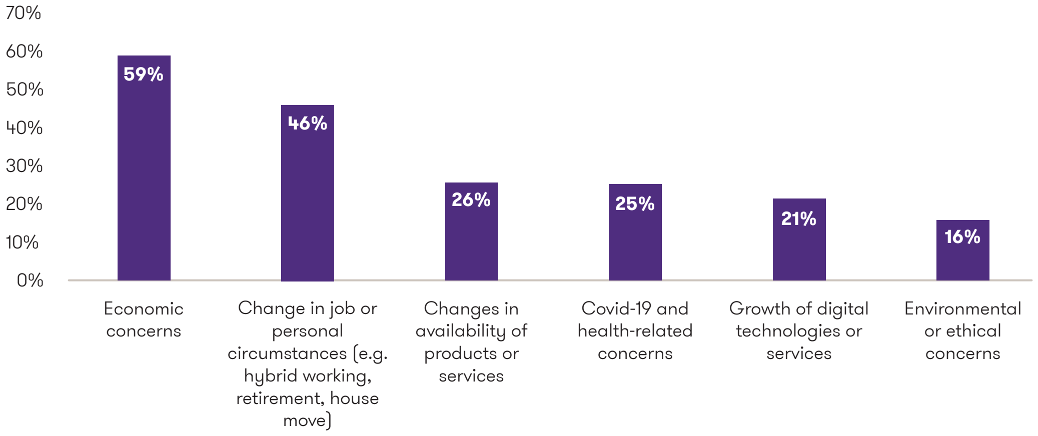
Nine out of ten (93%) consumers now recognise a fundamental shift in their purchasing priorities compared to pre-pandemic times

This reflects their exposure to new customer journeys and economic and social disruptions which altered lifestyles and reshaped their perspectives (e.g. economic volatility, changing working habits, increased digital capabilities, and heightened environmental consciousness).

As consumers make purchasing decisions with new values, it's critical for retail, leisure, and hospitality businesses to deeply understand and adapt to these evolving needs and preferences.

Fig 13: Tumultuous times for consumers

What factors have had the biggest influence on your spending habits over the last three years?



Note: respondents could select multiple options
Source: Retail Economics, Grant Thornton

Consumer value cohorts

Our research identifies five distinct consumer value segments that reflect changes in consumer perceptions and priorities when it comes to spending on retail, leisure, and hospitality products and services over the past three years (Fig. 14).

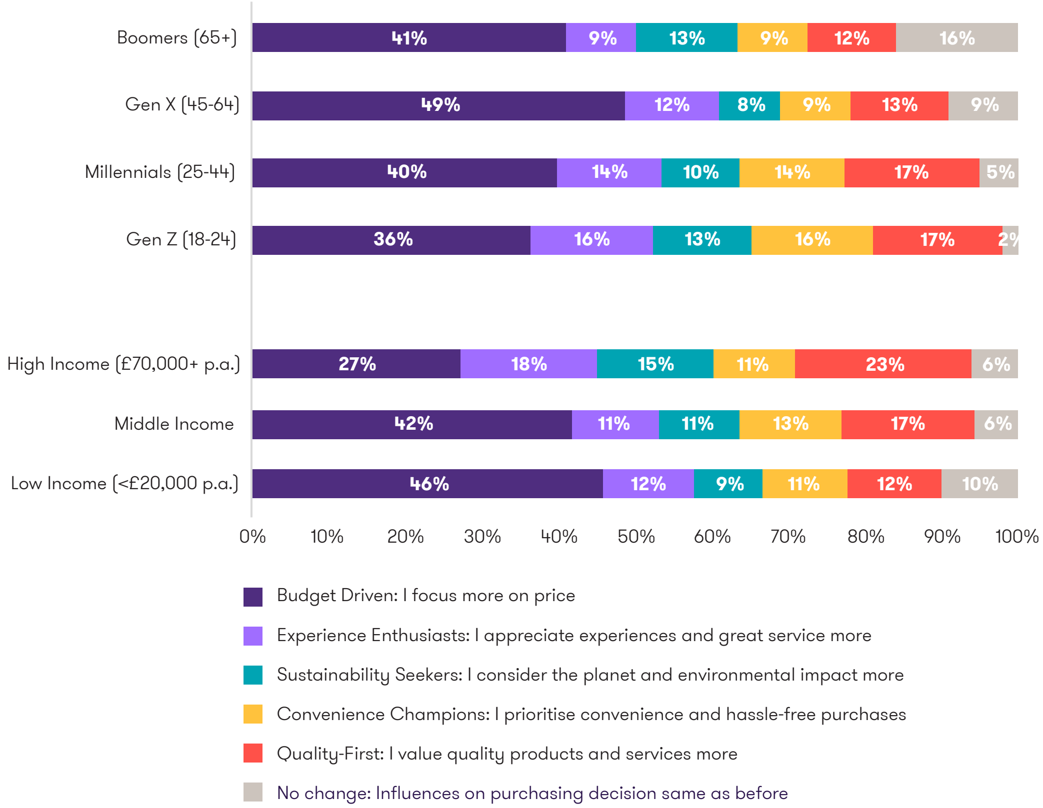
The dominant consumer-value segment that has emerged in a post-crisis era is the 'Budget-Driven' segment, comprising 43% of consumers. This segment's increased focus on value-for-money compared to pre-pandemic times reflects the prevailing economic concerns and the widespread 'cut back' mentality.

Notably, even among high-income consumers, 29% acknowledge paying more attention to prices than before. This demonstrates that cost of living concerns and rising interest rates transcend income instilling a sense of financial cautiousness within most consumers.

For consumers, greater focus on price doesn't mean sacrificing other values. Quality (15%), experiences (13%), convenience (12%) and sustainability (10%) have also risen in importance for many consumers, becoming more influential purchasing factors since the pandemic. This creates a challenging context for many brands as consumer expectations are higher than ever.

Fig 14: Value cohorts

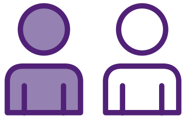
Compared to before the pandemic, how have your priorities changed when making a purchasing decision?



Source: Retail Economics, Grant Thornton

Cost seen as barrier to sustainable values

Many consumers struggle to reconcile financial pressures with the need to live affordably and more sustainably.

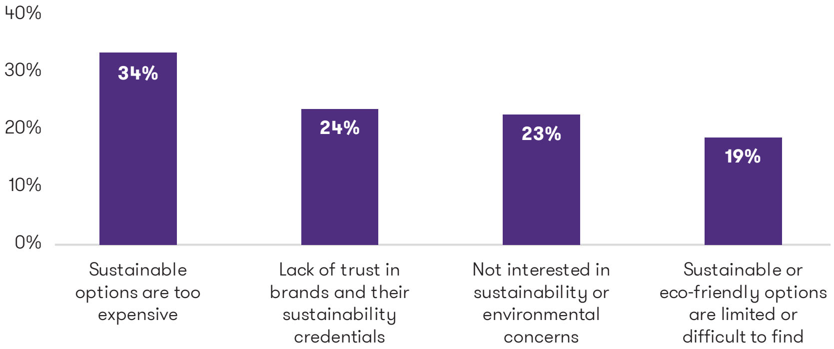


One in two consumers have never consciously purchased a sustainable product, service or experience, rising to 61% for our Financially Distressed shopper cohort

Rather than a lack of interest in sustainable practices, the primary reason given by those who've never actively sought out a brand with sustainable credentials was *price point*. Among these shoppers, over a third (34%) consider sustainable options too expensive, while almost one in four (24%) cited concerns about greenwashing and a lack of trust in brands' sustainability claims.

Fig 15: Price seen as barrier to sustainable shopping

What is the primary reason for having never chosen a product, service, or experience specifically because of its sustainability?



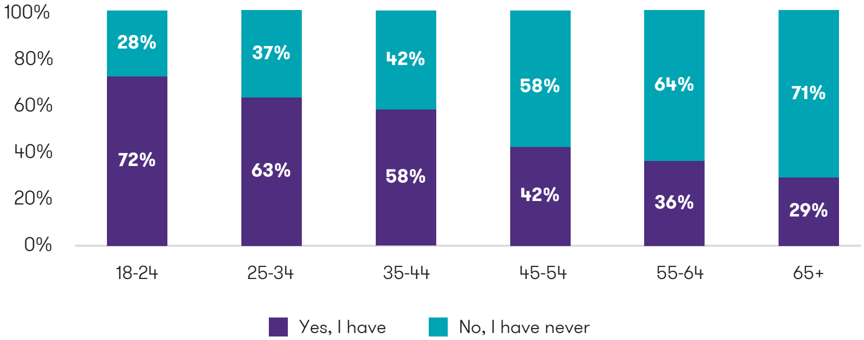
Note: includes only respondents that have never consciously made a sustainable purchase
Source: Retail Economics, Grant Thornton

There's a clear generational divide in the willingness to spend sustainably. The perceived higher cost of sustainable options hasn't deterred younger consumers (who demonstrate the strongest aspiration for sustainable living).

72%

Almost three-in-four (72%) Gen-Zers have chosen to purchase a sustainable option, compared to just 29% of Boomers (Fig. 16)

Fig 16: Have you ever chosen a product, service or experience specifically due to its sustainability or environmental credentials?



Source: Retail Economics, Grant Thornton

"It's essential that businesses do not lose sight of their sustainability obligations. Consumers have set minimum standards in terms of their expectations of brands, and those that can't live up to these risk being alienated."

Richard Lim, Chief Executive of Retail Economics

Blurring channels and creating unified customer journeys

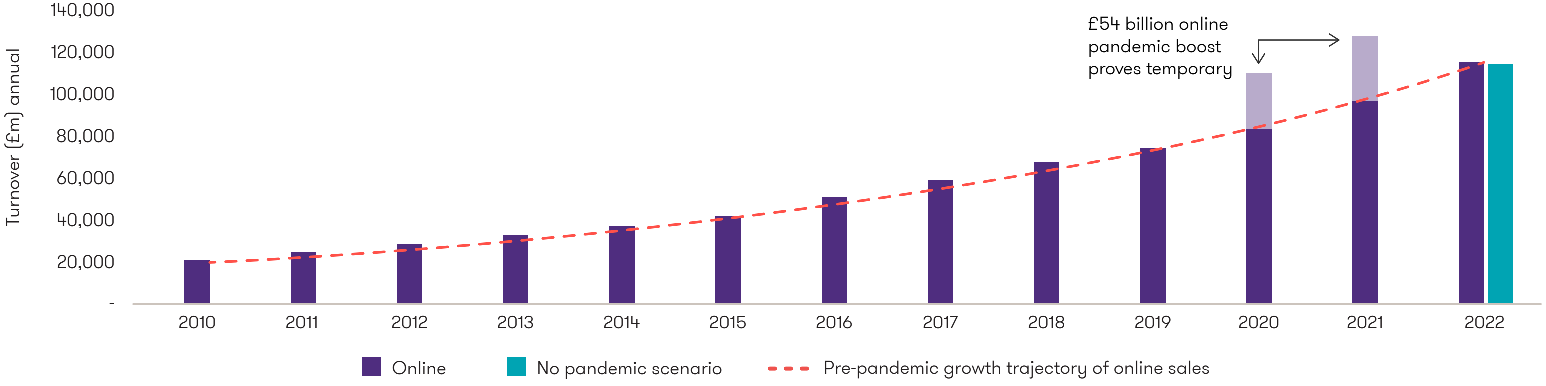
Online 'blip': Cost of living concerns dampen pandemic sales boost

The retreat of online sales from lockdown boom periods was expected. However, the speed and magnitude of the resurgence of physical stores has caught many off guard, particularly pure online players who had heavily invested in the assumption of a permanent shift to online post-pandemic.

As Covid-19 impacts fade, our research shows that UK online sales have settled at a level that would have otherwise occurred in a 'no pandemic' scenario (Fig. 17). Claims of a significant acceleration of online sales by five or ten years during the pandemic were wrong.

Overall, the £54 billion online sales boost witnessed during the pandemic can be seen as a temporary 'blip' driven by unprecedented circumstances, rather than a permanent phenomenon.

Fig 17: £54 billion online pandemic boost fades as consumers return to stores



Source: Retail Economics, Grant Thornton

Re-emergence of physical stores

Prevailing cost of living concerns within the Cut Back Economy have accelerated store retrenchment for many consumers. As such, the squeeze on incomes has prompted consumers to reassess the shopping channels they use in search of the best deals.

Five key reasons why in-store trumps online for cost-conscious shoppers:

1

No delivery or returns fees
Retailers have started charging for online delivery and returns (eg, Zara, Boohoo), even in categories previously offering free services.

2

Store-exclusive discounts
Physical stores with end-of-aisle discounts, localised markdowns and near end-of-date or clearance items, offer shoppers unique opportunities to benefit from physical formats.

3

Disciplined spending
Many consumers find it easier to manage their spending in bricks-and-mortar stores. This removes the temptation of online offers or digital payments, making the physical act of spending more 'tangible', particularly when using cash. One-in-five use cash as their preferred payment method, helping them to track and limit expenditures – particularly for those on low incomes.

4

In-store validation
Consumers value the opportunity to physically evaluate and validate purchases, especially for higher-priced or difficult-to-assess items. In-store shopping offers a tactile experience-instilling confidence and assurance. The ability to try on clothes also significantly reduces 'wardrobing' (ordering multiple items online with the intention of returning).

5

Negotiation opportunities
With in-store, consumers can easily negotiate on price, particularly for big-ticket items like furniture. Even with no room for negotiation, in-store customer service enables consumers to quickly address concerns, seek refunds or exchanges, or receive assistance with repairs or troubleshooting, further minimising additional costs.

Online: increased competition and headwinds

Online retail has become a crowded, and costly, marketplace. This has sparked a sea-change in physical retail.

Online pure-plays, despite a lower barrier to entry, find themselves grappling with a myriad of new challenges. Soaring marketing expenses, rising business rates on warehousing, increased rivalry from multichannel retailers, and a consumer base increasingly seeking respite from the relentless wave of digitisation characterise such threats.

The upturn on the high street is also being partially driven by continuing shifts in consumer behaviour after lockdowns pushed shoppers online. Humans are inherently social creatures, and demand for social and leisure experience represents a major opportunity for businesses that are prepared to invest in their physical presence.

This is expected to provide a boost for retailers with physical stores that have suffered market share losses to pure online players (absent of costs related to physical stores and lower customer acquisition costs).

Now, while cost of living concerns have dampened the initial surge in demand for leisure occasions post-pandemic, but meaningful in-person experiences remain a priority, driving people in store and to social venues. Meanwhile, value retailers, who typically don't operate unprofitable online channels, are benefitting from more cost-conscious consumers opting to shop with them.

However, this doesn't mean the shift to online has stalled or that digital channels aren't an important route to market – the pandemic converted many 'digital agnostics' and boosted online shopping in sectors such as food and furniture where penetration was low.

It's about getting the balance right and offering the convenience of the omnichannel experience that consumers now expect. The key challenge is how to do this profitably. Retail and consumer businesses will still need to invest in technology – delivering not only exceptional experiences, but also driving down costs, especially in an inflationary environment.

The online and offline worlds continue to blur. Customers want to leverage all channels for maximum benefit. For omnichannel retailers who get it right, the future is positive – for single channel operators, less so.

Investing in the right digital touchpoints: why understanding your customer behaviour is key

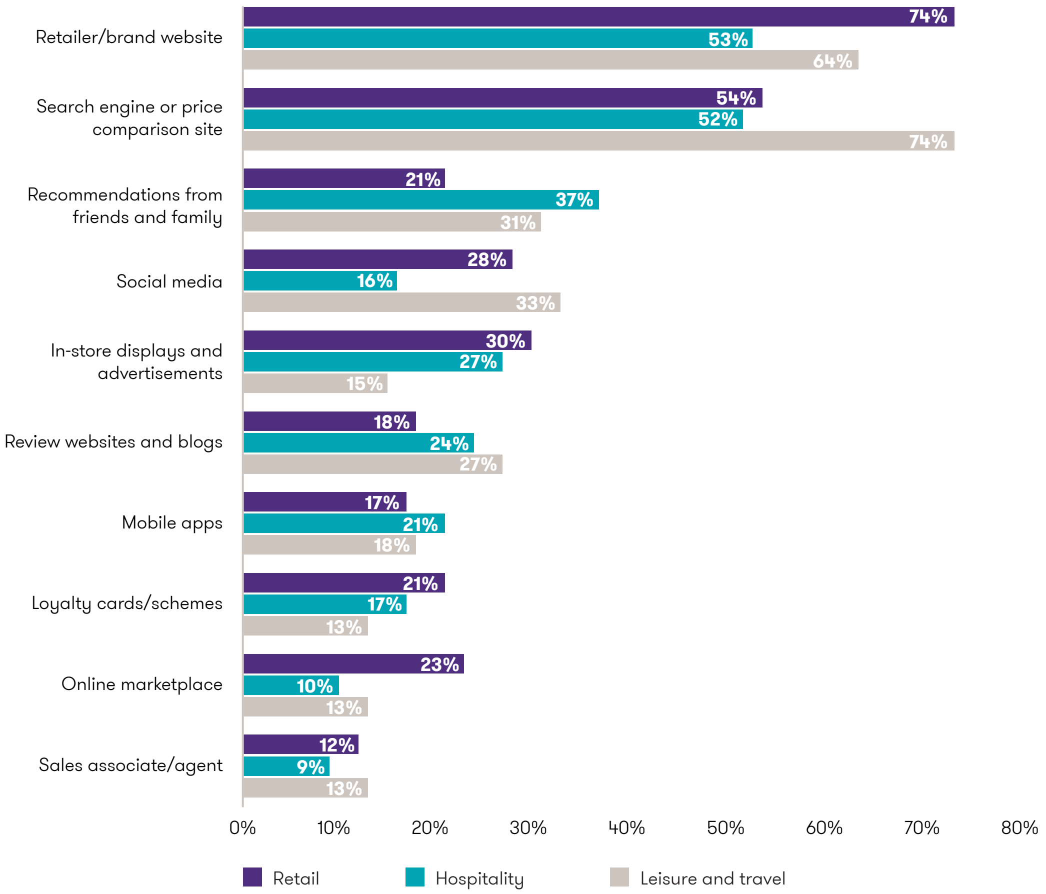
The shift online may have proved temporary at the point of sale, but this overlooks the growing significance of digital throughout the entire customer journey. Consumers increasingly depend on digital tools and platforms from pre-purchase research to post-purchase fulfilment and after-sales service.

In today's cut back environment, consumers invest more time in researching for better value, with **69% spending more time browsing and researching products, dedicating an average of four hours per week to comparing prices and finding the best deals**. Digital touchpoints like brand websites, price comparison sites, and social media platforms play a critical role in providing information and inspiration, empowering consumers to make informed decisions and enhancing their browsing experience.

As consumer spending remains cautious, retailers must prioritise their digital presence, offering transparency, facilitating comparison shopping, and delivering personalised experiences to meet evolving customer preferences.

Fig 18: Digital touchpoints key to more considered customer journeys

Which of the following do you typically use to help with your purchasing decision (i.e. browse, research, gain inspiration)?



Source: Retail Economics, Grant Thornton

Omnichannel behaviours

Channel behaviour in different sectors reflects varying customer journeys, influenced by factors such as price point, frequency of purchase, ease of delivery, the significance of 'try before buy', and more.

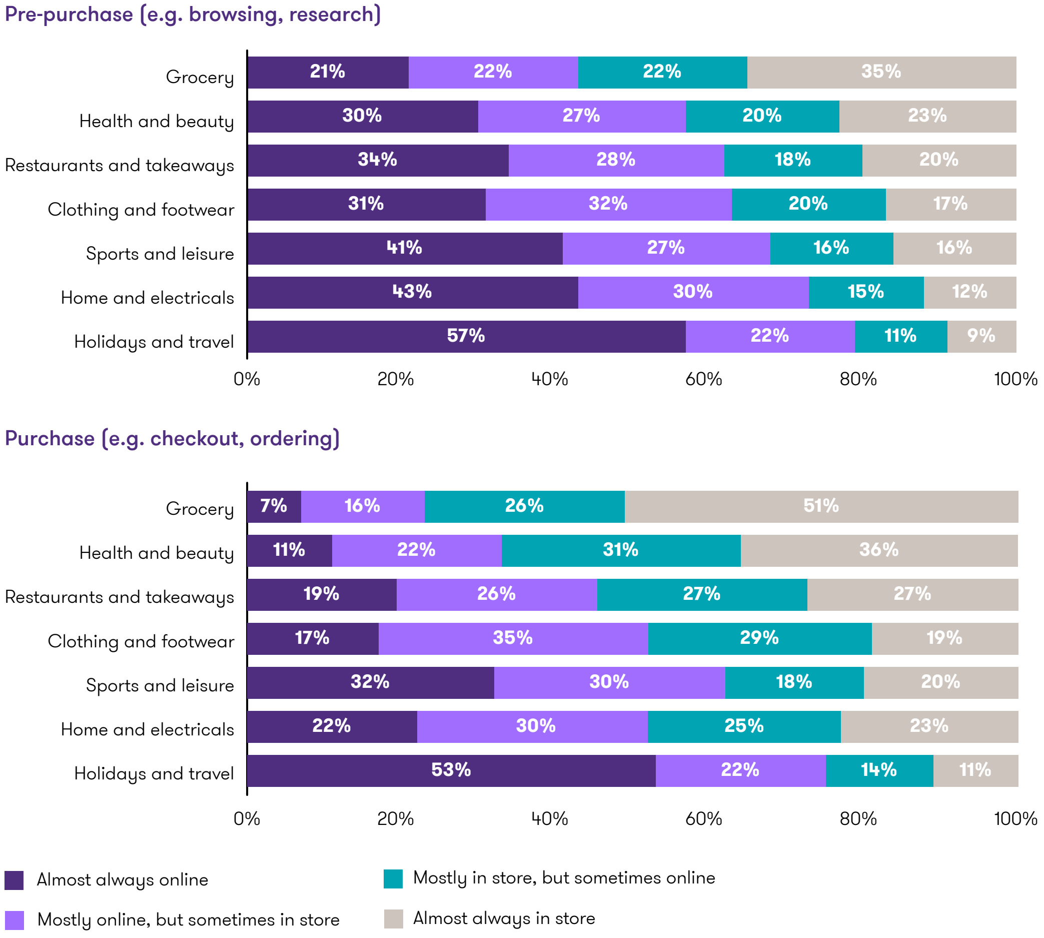
Pre-purchase: across all retail, leisure, and hospitality sectors, consumers generally prefer to browse more online than physical channels (Fig. 19). The proportion of Online-first shoppers at the pre-purchase stage ranges from 57% for health and beauty, to 79% for holidays and travel.

Grocery is the only sector where a net proportion of shoppers prefer the physical channel for both browsing and purchasing, reflecting consumers' desire to touch and feel fresh produce with immediate access to purchases.

Purchase: During the transaction stage, there's a significant shift to physical channels in most sectors. For example, sectors like beauty and household goods see most consumers adopting a store-first approach. This preference can be attributed to the importance of tactile evaluation, the immersive in-store experience, and store assistants providing excellent customer service.

Holidays and travel is the only sector that shows a clear preference for digital at the purchase stage. Only one-in-four consumers use a physical travel agent, with over half almost exclusively booking online without human interaction.

Fig 19: Online critical at pre-purchase stage of customer journey



Source: Retail Economics, Grant Thornton

A seamless customer journey: the route to success

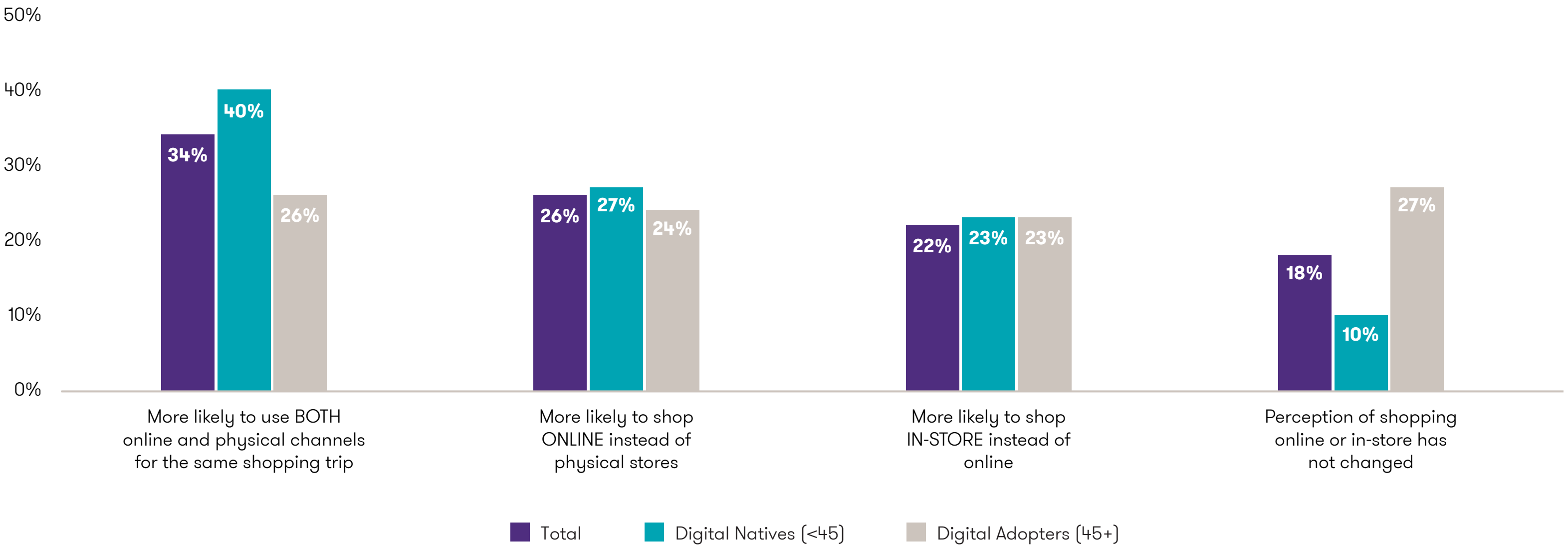
Success in the future lies in unified commerce. Here, consumers unconsciously flit between digital and physical channels on their complex paths to purchase. Since the pandemic, consumers' perception of channels has evolved. Rather than shifting more online or in-store, over a third now say they're more likely to use both channels for shopping. This trend is particularly prominent among digital natives (under 45 year olds who have grown up with digital technology), with 40% of of them under 45 years old embracing this blended approach.

"This blurring of channels underscores the need for retailers to embrace unified commerce and provide a cohesive and integrated shopping experience that merges the best of both digital and physical touchpoints in the customer journey."

Alan Dale, Head of Business Consulting

Fig 20: Consumers more likely to be omnichannel shoppers post-pandemic

Has your perception of online and physical shopping changed since the start of the pandemic and cost of living crisis?



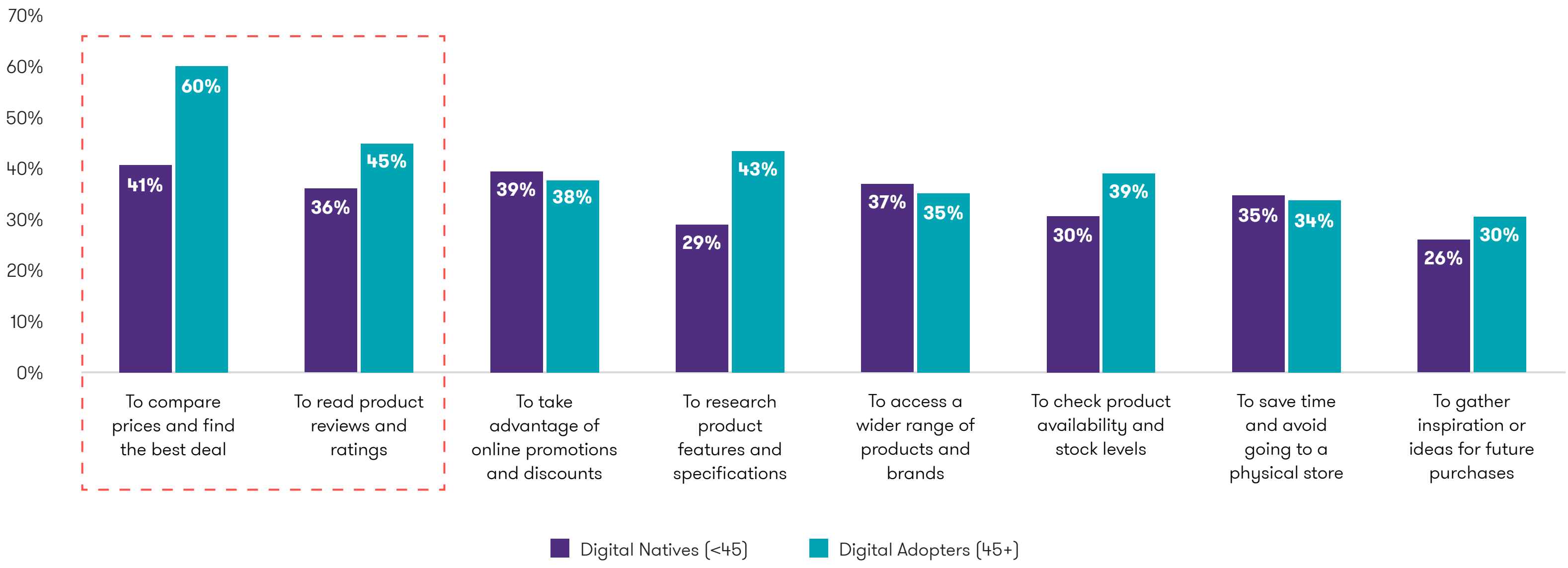
Source: Retail Economics, Grant Thornton

Interestingly, the perceived benefits (and purpose) of online and physical channels vary across different generations, highlighting the need for brands to tailor their offerings accordingly.

For Digital Adopters (aged 45+), online channels hold the strongest value as research and price comparison tools. For younger Digital Natives who are often time-poor, the choice and convenience offered by online shopping is a key driver.

Fig 21: Digital Natives vs Digital Adopters: Over 45s use online for research and price comparison

What are the main reasons why you shop online?



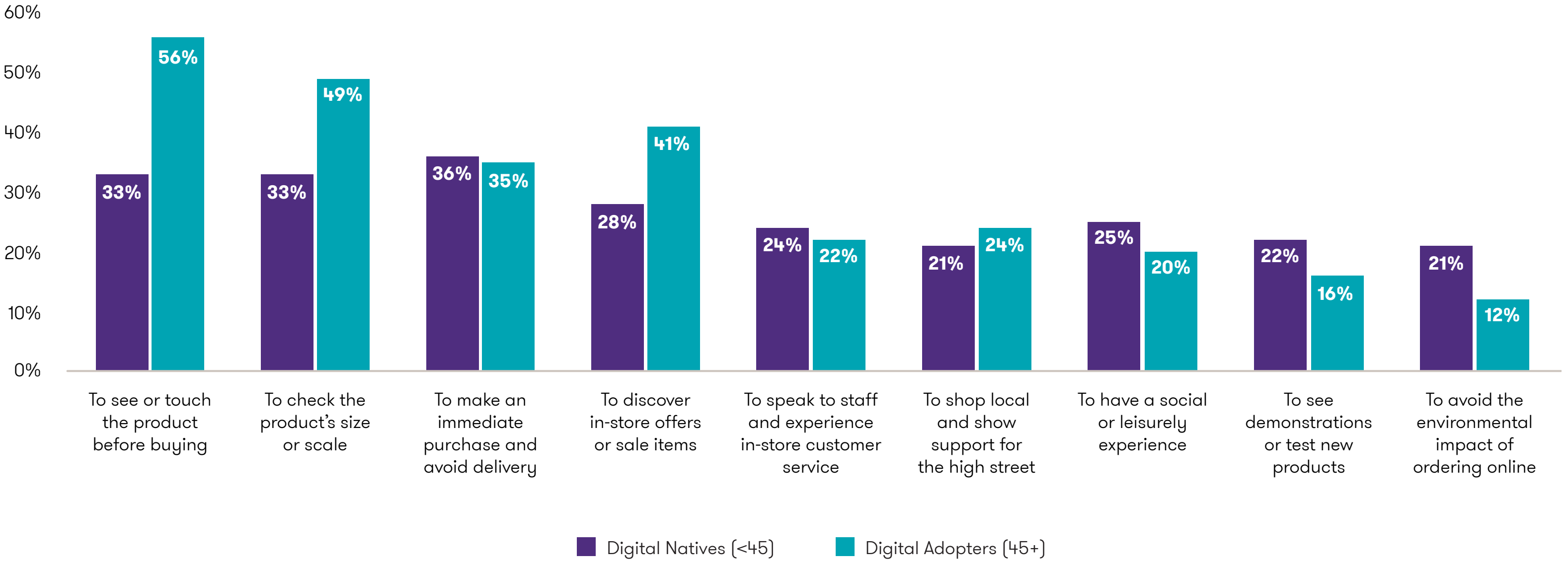
Note: respondents could select multiple responses
Source: Retail Economics, Grant Thornton

Regarding shopping in-store, younger generations place more value on immediate gratification and immersive experiences. They appreciate leisure opportunities, product demonstrations, and even sustainability benefits in avoiding environmental impacts associated with online deliveries. Conversely, older generations prioritise more functional aspects of the in-store experience such as the ability to try products before purchasing or feel fabric textures.

To effectively cater for differences in generational preferences, brands must ensure that their digital and physical propositions align with these specific needs and expectations. By understanding and addressing the distinct values of their customers, they can create a seamless and personalised shopping experience that resonates with consumers across all touchpoints.

Fig 22: *Younger generations value immediate gratification and experience of physical shopping*

What are the main reasons why you shop in-store?



Note: respondents could select multiple responses
Source: Retail Economics, Grant Thornton

Financial resilience and strategies for success

As retail, leisure, and hospitality businesses face continual challenges within the cut back economy, it's crucial they adopt resilient, long-term strategies that go beyond the current economic climate. In this final section, the research identifies five key themes that businesses need to focus on.

Cost management and efficient business models

In the face of constantly evolving consumer behaviours and shifting market dynamics, businesses must evaluate their business models and consider comprehensive transformation to deliver true customer-centricity.

This includes adopting flexible and agile approaches to accommodate shifting demand patterns, optimising supply chains to improve efficiency, and leveraging technology to enhance customer experiences through a unified and seamless customer journey. By transforming their operating models, businesses can respond effectively to market shifts and better meet customer needs while optimising costs and maximising value.

With margins under sustained pressure, effective cost management is crucial. This requires identifying areas of inefficiency, optimising resource allocation, and implementing cost-saving initiatives without compromising on quality or customer experience. By streamlining operations, negotiating favourable supplier contracts, and leveraging technology to automate processes, businesses can enhance their profitability and protect their bottom line.

Digital skills and transformation

Digital transformation is imperative for retail, leisure and hospitality businesses to stay competitive in the current landscape and beyond.

Investing in digital skills and capabilities is essential for enhancing operational efficiency, improving customer engagement, and driving innovation. This includes developing omnichannel solutions, investing in game-changing technologies such as AI and using data analytics to gain insights into customer preferences and behaviour. By embracing digital transformation, businesses can create seamless omnichannel experiences and differentiate themselves in a crowded marketplace.

"Having the systems and skills to get data and turn it into real insight is key for enabling businesses to flex their operating models, products, and services to the changing needs of the market."

Alan Dale, Head of Business Consulting

M&A, strategic partnerships and investing in growth

In turbulent times, collaboration and strategic alliances often play a critical role in driving growth. Exploring merger and acquisition opportunities, forging strategic partnerships, and investing in innovative solutions can enable businesses to access new markets, diversify offerings, and deliver competitive advantages.

Acquisition opportunities will arise as inflation and interest rate hikes put more businesses under financial strain. Economic volatility will encourage many retail and leisure businesses to look more closely at whether their non-core assets should be put up for sale. For better-capitalised companies, this opens opportunities to add new capabilities, invest in strategic growth areas or build scale to gain market share.

Strategic partnerships are often necessary to ‘plug’ in-house skills shortages (eg, with tech companies, logistics providers, or other consumer brands) and to tap into third-party networks and knowledge bases to accelerate capability and capacity. Businesses need to maintain alertness in spotting win-win situations.

ESG, brand trust and reputation

Within the cut back economy, many consumers still remain conscious of sustainability and ethical considerations – as do investors.

Retail, leisure, and hospitality businesses must prioritise ESG initiatives to build brand trust and reputation. This may involve closer examination of net zero carbon strategies, adopting sustainable sourcing practices, reducing environmental impact, promoting diversity and inclusion, and supporting local communities. By aligning their brand values with sustainable practices, businesses can attract socially responsible customers and enhance their competitive advantage.

"Customers have growing ESG expectations from organisations. There's increasing awareness and communication of environmental and social impact – this results in more emphasis throughout the supply chain. Organisations are using this momentum to also reduce costs, improve service, increase staff retention and optimise business performance."

Raj Kumar, Head of Environmental Advisory

Enhancing value from internal audit

Internal audit functions are critical for businesses to provide assurance and improvement around financial, operational and technology risks and programmes.

By optimising internal audit, businesses can enhance governance and risk management and gain valuable insights into the design and operational effectiveness of the functions, processes and programmes which manage key risks and help realise opportunity. Leveraging subject matter experts, technology and data analytics enables leading functions to deliver a value adding approach which supports business strategy and execution.

"To remain competitive retailers are adapting their businesses across people, process and technology and constantly seeking ways to engage more effectively with consumers and their own workforce."

Eddie Best, Partner, Business Risk Services

Conclusion

The cut back economy continues to exert its unyielding influence on consumer behaviour, presenting formidable challenges for retail, leisure, and hospitality businesses.

The UK economy has managed to avoid recession (as of July 2023), but inflation remains a concern, projected to endure longer than anticipated, accompanied by sharply rising interest rates. These factors continue to erode consumers' disposable income, with £15 billion of pain still to come, leading to cautious spending habits.

Consumer confidence remains fragile, with persistent intentions to cut back on non-essential purchases. This benefits businesses with value propositions operating with omnichannel modalities. The £54 billion online sales boost during the pandemic looks temporary. Channel rebalancing has favoured in-store as shoppers seek affordability and in-person experiences. However, the complexity and consideration of customer journeys has increased, with online still hyper-relevant for consumers wanting to leverage both channels to manage spending.

To navigate these uncertain times, it's crucial for businesses to adopt long-term strategies. Five areas have been identified in the research to guide businesses towards success:

1. cost management and efficient business models are essential to optimise operations, enhance profitability, and protect the bottom line;
2. digital skills and transformation are imperative to stay competitive and create seamless omnichannel experiences;
3. exploring M&A opportunities, strategic partnerships, and investments in growth can open doors to new markets and competitive advantages;
4. prioritising ESG initiatives to build brand trust and reputation is crucial in an environmentally and socially conscious landscape; and
5. enhancing value from internal audit processes strengthens risk management and operational effectiveness.

By embracing these strategies, retail, leisure, and hospitality businesses can adapt and lay sturdy foundations for sustainable growth in the cut back economy. Deeply understanding and addressing key challenges and opportunities within the evolving cost of living crisis can better position brands for success in 2023 and beyond.

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About Retail Economics

Retail Economics is an independent economics research consultancy focused on the consumer and retail industry. We analyse the complex retail economic landscape and draw out actionable insight for our clients. Leveraging our own proprietary retail data and applying rigorous economic analysis, we transform information into points of action.

Our service provides unbiased research and analysis on the key economic and social drivers behind the retail sector, helping to inform critical business decisions and giving you a competitive edge through deeper insights.

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