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Death in the Middle: Why Consumers Seek Value at the Top and Bottom of Markets

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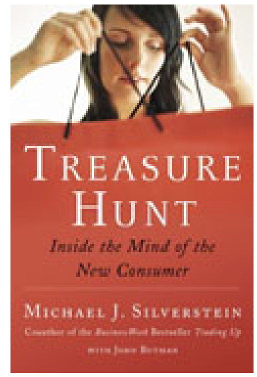

"In the U.S. and around the world, the consumer markets are bifurcating into two fast-growing pools of spending," writes author Michael J. Silverstein in his new book, Treasure Hunt: Inside the Mind of the New Consumer. *"At the high end, consumers are trading up, paying a premium for high-quality, emotionally rich, high-margin products and services. At the low end, consumers are relentlessly trading down, spending as little as possible to buy basic, low-cost goods and services." Between both piles lies a vast range of mediocre, medium-range products that Silverstein claims is doomed to decline. What implications does this have for companies and their brands? David Reibstein, a Wharton professor of marketing, discussed that question with Silverstein, a senior vice president of The Boston Consulting Group.*

Reibstein: How did this book come to be written?

Silverstein: Three and a half years ago, I co-authored a book with Neil Fiske called *Trading Up: Why consumers Want New Luxury Goods... and How Companies Create Them. Trading Up* is the story of how middle-class consumers around the world are buying products at 50% to 200% price premiums in categories like homes, cars, vacations and food. We call these new luxury goods. Following the release of that book, we began doing a lot of work helping companies understand this premium segmentation. It's a very rich opportunity, with more than $600 billion in sales in the U.S. in homes, transportation, dining, travel, food and beverages, personal products and services apparel, and home goods.

I spoke with some 10,000 people during the past couple of years. Many people would come to me after my presentations and say, "We loved *Trading Up*, we think it's very insightful, but it's only half the story. You didn't get it all." So I listened. Most of the people approaching me were women, who were heavily into purchasing and acquisition of goods and taking care of their families and very interested in maximizing their budget. The part of the story that they said we missed in*Trading Up* was basically the trading down side. It was true that consumers were trading up to premium products, but they were also trading down to low-cost products and services, and avoiding the boredom and low value that increasingly characterize the middle. This polarization was reshaping the consumer goods market.

Two years ago, we began our second wave of major research around trading down. We looked at how consumers spent their money, as they traded up or down. We asked in what categories consumers were trading down and why. We also looked at differences across households, by gender, age, income, and geography. We made it a global research project and looked at Europe, Asia and the U.S.

We came to the conclusion that trading up and trading down were big opportunities for companies and for consumers. The amount of spending on trading down was approximately twice the amount of trading up. Both ends of the market offered huge opportunities. Markets were bifurcating, which meant that the top and bottom were growing and the middle was in horrible decline -- and that is creating quite a few casualties. In every category we looked at -- and we studied 30 of them in detail -- there was this war. The war was for this consumer to either trade up or down or to evacuate. In the car business for example, the middle market has shrunk by 12 market-share points. In the television market, it has shrunk by 40 points. In the U.S. washer market, the middle market has declined by 16 points, and on and on.

Those findings led to this book, *Treasure Hunt.* We thought about calling it *Trading Down,* but in fact from a consumer's point of view, it's not really trading down. It is about consumers living a rich, balanced life, being careful with their money, and buying a handful of products where they trade up and others where they trade down.

It's about consumers comparing, contrasting, experimenting and bargaining. It's about relentless behavior that is primarily female. It's about the female head of a household operating in many situations like a purchasing agent, separating truth from charade, and marketing claims from real benefits. It is a powerful force in the global economy, creating both opportunity and threat.

Reibstein: We do see growth at the top and at the bottom. But it's not like the middle has gone away.

Silverstein: The middle is still very large, but it is declining. If the bottom end of the market is at $1.2 trillion and the high end at about $600 billion, the middle market is around $1.5 trillion. If you believe what our research suggests, the middle is going to decline at 5% or 6% a year over the next five years. The top is going to grow at 10% to 12% and the bottom is going to grow at 5% or 6%. If you are in the middle, that amount of volume loss can be devastating. It fundamentally requires you to shut plants, change your overhead structure, and get out of categories. A big company that is facing this death in the middle is Kraft, which we have referenced in the book. Fundamentally this is in the cheese category. Consumers are buying private label cheeses that are 20% to 25% less expensive than the Kraft brand, or they are buying expensive romance cheeses, imported from Europe, for which they pay $12 to $15 a pound.

Reibstein: That is what I find fascinating -- the implications of your research for specific brands. What do they need to do to either get with the program or get out of the way?

Silverstein: Well, we can talk some more about Kraft. If Kraft awakens -- and it is a sleeping giant -- it will realize that cheese is a very positive category that consumers love and crave. What they are looking for are companies that provide them with a product that has ease of use and convenience. In the shredded cheese category, there is Sargento -- and it is doing very well, thank you -- Kraft has basically given that market to them. In the car category, BMW has less than a 2% global share, but its market value is higher than General Motors, Ford and Chrysler combined.

Reibstein: Take a company like P&G. What are the implications of your research for some of their best-selling brands?

Silverstein: Well, what is interesting about P&G is that they recognized there was a phenomenon happening called "trading up." It was the largest single company buyer of that book, by the way, according to Amazon. P&G has basically gone through every one of its categories and said, "How can we add new value, how can we innovate, how can we get underneath the needs of the consumer and basically change the category representation?"

A good example would be Oil of Olay. If you remember, back in 1980 Oil of Olay sold in a little bottle for about 22¢ an ounce. It had one form -- you did a little dab on your skin and that was it. If you were to go to the drugstore today, you would actually see that Oil of Olay is a section. It looks at all the different skin care problems that women have and says, "We have a solution -- and it's a value-added solution." Another example is the Oil of Olay Daily Facial . It's not really a facial; it's a pad with a special ingredient. They charge $1.50 for it, and the woman says to herself, as she is applying the product, "God, I'm going to be beautiful tomorrow!" She feels more beautiful and she feels like she is taking care of herself.

This has been a systematic process at P&G. It has happened across all categories. They've done it with Tide, in dishwashing soap, the whole product line. Now, they've bought Gillette, and that is probably the most expert company in doing this for men. I don't know whether you've seen the fusion blade -- it is supposed to prevent you from being cut to pieces.

Reibstein: Crest has introduced a product called Crest Vivid White. They've done it under the Crest name, which is the premium toothpaste brand, so this is exactly what you are talking about. Still, the vast majority of their volume is in the middle market. Even though the market may be getting bifurcated, as you say, I think that it is really important to get across that the middle still exists. While it is shrinking relative to the other areas, it still represents a huge portion of the overall market.

Silverstein: It does, but it's huge and declining...and that really is the problem. We do a tracking study with consumers, and we asked a standing panel of approximately 2,000 households how are they feeling and what are they doing. We received some really incredible results. These numbers are not intuitive: 72% of consumers feel in control of their finances; 73% are saving money every month; 70% believe that they will be better off and have higher income in the future; and half, a full half, believe that they enjoy a higher standard of living as a result of their smart shopping behavior. Some 92% of people tell their friends when they get a great deal, and only 8% pretend that they paid full price. In terms of this exploration of the market, consumers say treasure hunting is exciting, fun and makes them happy.

Reibstein: Have you spent any time with the people at Costco? What is interesting to me is that they describe their store experience as a treasure hunt. It is interesting that they use the exact terminology you are using.

Silverstein: I did not know that specifically, but consumers believe that cheap is good. They realize that being a savvy shopper is important and that they can contribute to their savings rate by buying better goods cheaper, and many of them use Costco. Costco is a fantastic treasure hunt store -- it's about trading up and trading down, under one roof. It's one of the few retailers in the world that can do it. It hooks people in and they end up actually spending their savings back into the store.

We have done shop-alongs with consumers in Costco. During the shop-along, the consumer knows what she wants to spend -- $200. She has a list of items she wants to buy: meat, canned goods, frozen items, paper products, and some drinks. Then it sort of clicks in her head that she has spent $180 and that was at least 10% less than if she had bought these products at a supermarket. So she pats herself on the back and says, "I can go to the wine section and buy that $20 bottle of Kendall- Jackson that I've never given myself."

Personally, it's an experience -- the treasure hunt at Costco. We have a home in Naples, Florida, and there is a Costco just down the road from us. I went there with my wife on a Sunday afternoon. They sell a great pumpkin pie for $5.99, and we went just to pick up a couple of pies. I dropped her off. The parking lot was crowded; it was a real scene. About 10 minutes later, I walked into the store. She was standing there with a cart and putting in a piece of art. I looked at her and said, "What are you doing?" She said, "Well, they have original prints here. This one is a Miro." So instead of buying just two pumpkin pies, we bought the two pumpkin pies and one Miro.

Reibstein: We hear so much about micro-segments. First of all, segmentation is alive and well, but it might be going down -- even eventually getting to a segment of one.

Silverstein: I don't think that the segment of one is dead, but it is very difficult to execute.

Reibstein: Let me interrupt before you jump there. I don't want to dwell on whether we can implement the segment of one or not. Let us focus on the concept of segments. While it's hard to implement segments of one, lots of people have thought about multi-segments. I'm wondering if, when we talk about the bifurcation, that gets us away from thinking about the refinement of segmentation and into thinking that there are these two large groups at the top and bottom of the consumer market. Help me think through some of that.

Silverstein: Well, our book has a series of individual consumer stories -- and even consumers of the same age, income and demographics trade up and down in different categories. That is a big finding.

We also find that a small group of users tries the dominant share of volume. It's 10/80 as a typical representation -- 10% of the users are trying to get 80% of the volume in these trade-up and trade-down categories. They are very heavy users, almost daily users. We call them the "apostles" -- and they basically help a brand. They cause you to put your arm around your buddy and say, "You ought to try this." We are talking about a big movement in the economy in terms of trade up and trade down.

Within each individual category, there is a daily battle and it is: "Are you going to win me?" Am I going to buy Kellogg's cereal or General Mills' cereal? If I'm going to buy Kellogg's cereal, you will have to tell me why. So, I'm agreeing with you that segmentation is the way to go. It's about concentration of resources against a small number of like users, with like habits and like habituation. It's about creating programs that cause them to affiliate and to connect.

Reibstein: It's very clear to me that we have customers who jump from one group to the next, and that you are not always in one segment. What I was wondering is if your research takes us down the path of saying, "Don't think about segments any more."

Silverstein: What our research strongly suggests is that we should think about and understand the heavy users and their purchase pathway. What got them to that position? What are the drivers of their future behavior? How do you hold on to them? How do you get them to embrace your brand and to recommend your brand? That is an off-shoot of segmentation. I think a lot of people do big graphic segmentation studies. Frankly, I have found them not worthless, but not helpful either.

Reibstein: I find them worse than not helpful, because I think sometimes they can be distractive.

Silverstein: For big companies, they basically become red herrings. But on the other hand, all our research says that there is an age, gender, and income segmentation that is possible in most categories. The last time I was at Wharton, I gave a presentation. There were 650 kids in the room, it was in one of the big halls, it was fun and they were great kids. One of them said to me, "So what do I buy?" I looked him straight in the eye and said, "Well, I can tell you that you trade up in electronics, that you are looking for a big screen TV, and that you have two iPods. One is in your pocket and one is at home." I basically laid out everything about how he spends his money.

For affluent, educated young men, you can define quite precisely what categories of goods they are buying. What we have found is that for almost every age, geography and gender, you can figure out what's hot, and what's not and why.

A good example of somebody who applied segmentation with fantastic results is Lew Frankfort at Coach. The company was spun out from Sara Lee when they decided that they wanted to get a more structured group of brands. Sara Lee had about $500 million in sales, and Lew had run their sports apparel business in the Carolinas. He wasn't an expert in pocketbooks, but he went to the Coach store on Madison Avenue and he watched the traffic. He saw how women thought about handbags, accessories and purses. And then he began to do some research to figure out for his core consumer -- how many items did she buy a year? And the answer was, she basically bought one purse a year.

One purse a year for $200 is a nice little business, but it's not a growth business. So he asked himself, "How many dresses do they buy? How many skirts do they buy? How many times do they go shopping?" He then decided that he needed to provide a range of fashion and make personal accessories a fashion business. He said, "I need to create excitement, energy and drive traffic. I need to make sure that when she goes to the mall, that she goes to my store." And that is what he did.

For his core consumer, the number of pocketbooks and purses purchased each year has increased from 1 to 4.4. This is one of the most dramatic stories out there in retail. He has gone from $500 million in sales to $1.7 billion, and his gross margin is 76.5%. His market value is about $14 billion. It's all about concentration: He has three core consumer segments to whom he appeals. The first is young, fashionable women who want to have a purse or a pocketbook to match every outfit. Second, there are older, more professional women who actually don't like to buy clothes any more because they're size 14 or 16, and they know that they're not going to get compliments, but they know they will get compliments on the new bag they are carrying. And third, there are the suburban women who shop at his factory outlets and want to buy a product that is classic, well-designed and highly durable, at a bargain.

Reibstein: One thing I couldn't help but think about while listening to you was C. K. Prahalad's book, *The The Fortune at the Bottom of the Pyramid*.

Silverstein: I have read it, and it is a good book. There is a big difference, though. I mean, he is talking mostly about the third world.

Reibstein: That's right, which is why I wanted to ask you to relate what you have done to his book. Also, how much is the phenomenon that you are talking about U.S. specific vs. global?

Silverstein: Our books are totally different. Prahalad's book is about opportunities in the third world. I think that it is an interesting book, but it is somewhat unproven that in fact you can make a lot of money at the bottom of the pyramid. The only company that I know that really makes a fortune is Unilever. It is one of the most profitable and most interesting companies in the world, but a very unique company. The vast majority of the companies selling bottom of the pyramid goods in China are breaking even or only slightly profitable.

This phenomenon of the middle class is a global phenomenon. It is largely in the western world where you have those who have earned their way to higher incomes through education. This was an important finding in both *Trading Up* and *Treasure Hunt*, that education is the primary driver of real income growth. And you have populations that are savvy and sophisticated about buying products. They are the kind of people who go to the internet and research products before they buy them.

In fact, we see the emergence of what we call the SKU buyer. These consumers are buying a specific stock keeping unit, and they are looking to acquire it at the lowest possible price. They know they want to buy a BMW 330I, its product characteristics, what attracts them to the car, and what their current car is worth. When they go to the dealer, they have a print-out that they show the salesperson and they tell him, "This is the price."

This is happening all over the world; it is not only a U.S. phenomenon. In Mexico, 2% to 5% of the population has some money to spend on highly branded new luxury goods, they're doing it, it's a nice little market and it's grown rapidly. And I believe that over the next 20 years it will grow dramatically. You're going to see consumers move from very low subsistence incomes to low cost incomes and you'll see a tremendous boom in the middle market in Mexico, for example.

Reibstein: This is basically my last question. Are you going to end up suggesting that what companies need to do is that they need to be developing products for the tails? Is that where the growth is, sort of the phenomena of what you described that P&G is doing?

Silverstein: There are two choices that companies have. If you're in the middle market, you have to understand that you fundamentally can't do both things. You have to decide who you are and whom you serve. It's very much the Warren Buffett model of running a company, which is to delay or reduce spending and focus in on delivery of a very successful pricing formula. That's one way. The other way is to turn up the heat on innovation and to think about the emotional characteristics of consumer needs and to give them goods that they can crave, goods that will allow them to celebrate their lives and celebrate their success.

Reibstein: I think that this is a very compelling story. Any final thoughts?

Silverstein: I think the most important thing is the optimism and sense of success that consumers feel as a result of this phenomenon. And you don't see this very much in the popular press. If you read the *New York Times* you may think that Americans are angry and dissatisfied with their lives and they don't save a dime. I think that our research actually says that they are really very optimistic about the future.

In the book we have a character named Sarah. Sarah has a propensity to drop into tears in a second. But we spent about 14 hours interviewing her and watching her in her home. She is an incredibly devoted mother, loves her three girls, loves her husband and is happy in her suburban life. She thinks that all of the three girls are going to be college educated and will go on to graduate school. They will have come from a home where there's a lot of love and lots of support. If there is anything that the girls really need they will get it. And this is on the combined income of her and her husband.

He is a school teacher and she is a part-time nurse and their combined family income is right around $100,000. They live in a house that has a $325,000 value and they have a $240,000 mortgage -- but they make the budget balance every month. They go on vacations, they buy things, they buy durable goods, and they keep their cars in good repair. He has a couple of hobbies. I think that *Treasure Hunt* is a celebration of how happy and fulfilled the low-cost consumer is. And you don't read about that, you don't get that sense. In fact, they view themselves as in the driver's seat and in charge.