VALUE-BASED INNOVATION: HOW BRANDS CAN THRIVE IN TIMES OF INFLATION

Ogilvy Consulting

Contents


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Executive Summary

By April 2022 few of us in the business world need reminding that the UK is experiencing its worst inflation in decades, or that wage stagnation and higher NI taxes are compounding the squeeze on disposable income for the UK consumer. Continued supply chain disruptions brought about by COVID-19 are now being exacerbated by the invasion of Ukraine. The impact of Brexit, seemingly on hold during the lockdowns, is rearing its head anew. If we believe the daily headlines, things will almost certainly get worse before they get better.

Of course, nothing impacts the fortunes of retailers like consumer spending, and with less disposable income available, brands are looking for larger slices of a smaller pie. While things like promotions and feel-good messaging will be the first resort, it's increasingly clear these efforts alone no longer go far enough to make the kind of difference to consumers required to retain loyalty and maintain (or grow) consumer share of wallet.

In this paper we look at some of the views around inflation from across a range of qualified opinion holders – economists, bankers, government representatives, behavioural and social scientists, marketers, and of course consumers. Among a broad range of diverse and insightful opinions, what we largely found was a preponderance of 'common practice' based on decades of precedent, and not a lot of thinking about how this wave of inflation is different from others because of significant recent changes in consumer attitudes and expectations, and brands' ability to meet them.

The short version of the findings is that brands who want to successfully weather this period of high inflation should be moving beyond the traditional promotions and messaging strategies and embracing **Value-based Innovation** that delivers meaningful, positive impact on consumers, the business and the brand. On the following pages we'll describe why this is, and also how brands can engage quickly to activate their own Value-based Innovations in the short term.

Expert views on inflation

One of the key questions that consumers and brands alike are asking is how long will this inflationary period last? **Economists and governments** remain divided on their views.

Some feel that this period of inflation will persist and believe we will see a prolonged period of high inflation and related wage increase pressures. In this instance, economists, such as Charles Goodhart, Professor at London School of Economics, are recommending policy makers take corrective action to reduce aggregate demand in the hopes of curbing inflation. Some national financial regulators (like the Bank of England) are already raising interest rates, for example.

However, more generally, it is perceived that the current period of inflation will be transitionary and reflects the impact of the various global crises that have taken place (and continue to take place) over the past two years. Those in this camp, such as Paul Krugman, Economist at the New York Times, are reluctant to recommend any drastic changes in policy that may tip the economy into a negative spiral, or delay recovery.

The consensus among **management consultancies**, perhaps not unsurprisingly, is that approaches to inflation can in fact strengthen customer relationships and overall margins. However, as mentioned by McKinsey in "Five Ways to ADAPT Pricing to Inflation", businesses should tread carefully and consider this on a case-by-case basis. Blanket price rises should be avoided, as these have potential to damage customer relationships, decrease sales and hurt margins. Instead, tailored approaches to address customer pain points would be more effective.

Meanwhile, **the media** plays an outsized role in the inflationary discussion, frequently claiming that big corporations drive inflation. Businesses are increasingly slated for 'loving inflation' as it means they can voluntarily raise prices and pass on those costs to the consumer. And we know this as companies' net margins are rising to record highs, as noted by Dion Rabouin, reporter at The Wall Street Journal.

How consumers perceive and react to inflation

"Consumers don't think how they feel.

They don't say what they think and they don't do what they say."

This evergreen observation from David Ogilvy sums up the quandary brands face when trying to quickly react to external disruption. Fortunately, there are not only some observable behaviours that provide insight, there are a number of “hidden insights” to be uncovered if we listen to consumers in the right way

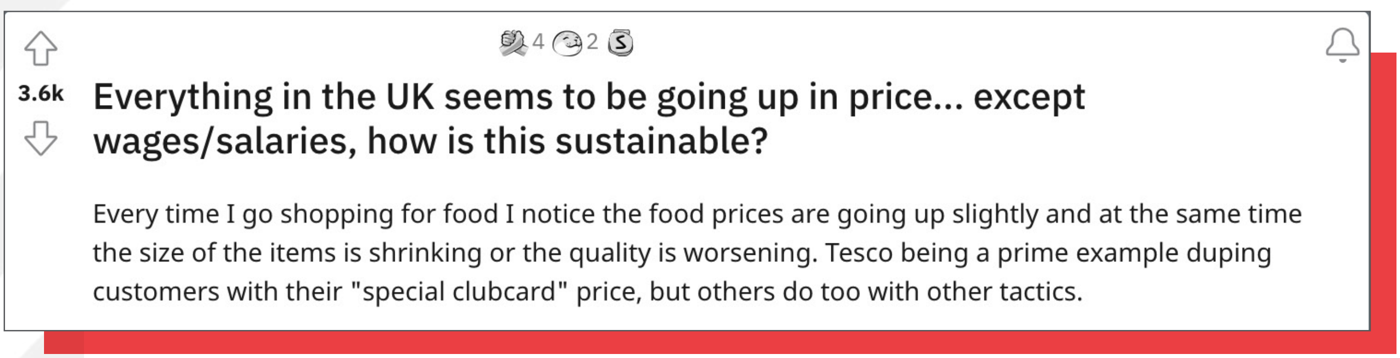
Common consumer behaviours

Inflation impacts different aspects of society in considerably different ways. Prolonged exposure to 'high inflation pressures can have lasting effects on people's outlook on life and how they engage with brands. AAccording to Eldar Shafir, author of Scarcity: Why having too little means so much, people tend to cut back on costly pastimes, leaving them with the feeling that they are missing out in life. Brands need to reflect this shift in emotion and behaviour when they engage with customers.

During inflationary periods, consumers become increasingly price sensitive, and this sensitivity generally becomes more acute at lower income levels. Price sensitivity tends to be most pronounced for staple items, with many consumers willing to shop around for the best price. Others will cut down on non-essential products and services or downgrade to cheaper alternatives, presenting both opportunities and risks for certain brands.

Luxury consumers are becoming more concerned about overtly portraying their wealth, and are likely to engage less in conspicuous consumption, investing more in hard assets (e.g., real estate and crypto) than soft assets like luxury accessories.

As is common in crises, people tend to look to assign blame – or at least causes – and as mentioned above, the media drive this behaviour. This has manifested in widespread feelings of mistrust towards large corporations, which consumers feel are profiting from inflation. Consumers are more keenly aware of "price games" like the of bundling products for false price breaks, reducing product (e.g., portion) size while maintaining the same price, or unfairly increasing costs on value offerings, and are publicly vocal about brands that they perceive to be engaging in them.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Everything in the UK seems to be going up in price... except wages/salaries, how is this sustainable?

Every time I go shopping for food I notice the food prices are going up slightly and at the same time the size of the items is shrinking or the quality is worsening. Tesco being a prime example duping customers with their "special clubcard" price, but others do too with other tactics.

The unpredictable nature of inflation, and the lack of understanding around when prices will stabilise again, is forcing shifts in consumer behaviour. Many consumers will not have experienced prices rising at the pace they are today in their lifetimes and therefore don't know what to expect for the future.

As a consequence, consumers are looking for clear information and reassurance from governments – and brands – to support them at this time. As with government messaging, brand messaging that is not backed up with meaningful action is received with increasing cynicism.

Common 'hidden insights'

Consumer language analysis allows us to reveal the 'hidden insights' behind how consumers are talking – and feeling – about inflation. Rather than using focus groups, we have analysed the natural language in consumer conversations around inflation and rising prices – using a tool called Relative Insight – and this reveals four key themes:

Frustration

Consumers are frustrated by the inequality of inflation – that rising prices disproportionally affect those who are already financially struggling the most.

"This time last year, the cheapest rice at the same supermarket was 45p for a kilogram bag. Today it's £1 for 500g. That's a 344% price increase as it hits the poorest and most vulnerable households."

Consumer, Twitter

Fear and dread

Consumers are shocked at how much energy bills and grocery prices are rising in recent months. According to StepChange Dept Charity, the average arrears debt per client increased by £150 for electricity and £78 for gas between 2020 and 2021 alone. Consumers dread what's going to happen in the future and are fearful of how they will continue to afford what they need.

"I was shocked how much I had to pay for the last two big shops. I think I will have to start cutting down on any non-essential treats and meal plan better for cheaper options"

Consumer, Mumsnet

Lack of trust

Consumers are getting wise to supermarket price hikes and price 'games'. For example, retailers raising the prices of low value staples, promotional offers that aren't better value, or shirking product sizes to maintain prices.

"I can't stand when brands disguise loyalty cards as a magic card to makes things cheap, when in fact you're just buying at a normal price or paying 50% extra if you forget to bring the card."

Consumer, Reddit

An 'us versus them' mindset

While consumers use collective pronouns when talking about issues relating to inflation, suggesting a collective sense of stress, they don't appreciate when organisations reflect this in advertising. Consumers feel that organisations neither relate to what they are going through, nor feel the same pain.

"We're either in this together, or we aren't (spoiler: we aren't). I know the price differences between the tiers of good is different because of logistics, but it really did help illustrate how already struggling people are worse off"

Consumer, Mumsnet

Behavioural science insights

"Inflation is not only an economic phenomenon, it's also a psychological one, because it's a psychological proxy for things being out of control."

William Galston,
Political scientist, The Brookings Institution

We can make sense of much of how people respond to unexpected external occurrences with behavioural science. For example, as humans, we have an instinctive fear of the unknown. In behavioural science, this is known as *'ambiguity aversion'* and it's driven by the fact that we prefer known risks, over unknown ones. The current economic climate that we find ourselves in today is highly uncertain, which is leading to a great sense of unease surrounding inflation.

To deal with this unease, consumers seek out information and exert control where possible. Consumers will often use everyday supermarket products as their economic frame of reference and those feeling the strain will modify their behaviour, which is why we see them cutting back on non-essential items. Information that contradicts current perceptions and beliefs is likely to be filtered out, in line with a confirmation bias.

This is one of the reasons why public expectations of inflation are among the biggest drivers of inflation itself. When consumer confidence plummets, banks, retailers, and governments often respond in ways that can lead to negative spirals, with rising prices and reduced lending leading to reduced consumer spending.

"As humans, we're constantly making comparisons between ourselves and others. We compare up more than we compare down, leading to a treadmill of hedonic consumption. A recession forces us to think about what is really important."

Rory Sutherland,
Vice Chairman, Ogilvy

Extraordinary times call for an even deeper understanding of, and focus on, the psychological drivers of consumer behaviour. Knowing that consumers are feeling fearful and unsettled, brands that want to be perceived as helpful need to help increase the perception of consumer control and mitigate the uncertainty.

Demonstrating operational transparency is one to way to help ascribe control. Costly signalling – visibly exerting effort or incurring costs to help the consumer – can also build long term trust and customer loyalty.

How brands respond and how they should

There are some standard approaches that brands traditionally employ during times of uncertainty or rising costs, and we are currently seeing these in the market. While these may sometimes be effective, they can often lead to negative consumer sentiment or a devaluation of brand equity, so if implemented, must be done so with extreme care.

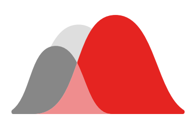
What brands are doing

Price increases:

This is the approach that brands generally take to tackle increase costs while maintaining margins. This approach keeps shareholders happy but, in most circumstances consumers react negatively. Given that consumers are highly price sensitive at the moment, this approach may lead to a reduction in customer spend or defection to competing brands.

Margin cuts:

Organisations can sometimes absorb the costs of inflation through cutting their profit margins to maintain prices. While in principle this might lead to positive public sentiment, it can be challenging to convince consumers that the organisation is helping shoulder the burden when they see no change in price tags.



Cost reduction:

Cutting costs is an option that can be employed by brands to counter rising costs without explicitly passing them on to the consumer. However, this option may involve cutting corners, reducing the size or quality of the product or reducing customer service or support, all of which may cause consumer frustration and have a detrimental effect on the brand now and over time.

What leaders in the field are doing

John Quelch, Professor at Harvard Business School, believes that one of the best ways to reduce business risk during a period of inflation is to invest in building and maintaining a strong brand. But what that means remains up for discussion. Category leaders tend to relate their responses back to the brand and its purpose, reaffirming to consumers why the brand matters and reinforcing an emotional connection to it. Leaders that respond in ways that are true to their brand purpose can help to maintain customer purchasing motivation, often demonstrating an attuned response through their creative marketing and communications:

- During a time of a minor inflationary pressure in 2016, IKEA found a creative way to present the value and affordability of its products. Images of standard household purchases, such as coffee cups and milk cartons, were added to reflect the price of their products, framing goods as more affordable.

- The British furniture designer, Neptune, clearly articulates the reason for its price point to its customers on its website. It aligns pricing to its core business values and demonstrates its focus on quality and fairness.

- Who Gives a Crap, "The Feel Good Toilet Paper Company", has been transparent in its pricing communication, with a responsible, yet still playful tone of voice. By communicating to customers individually, addressing them directly from the CEO, and giving advanced notice of price increases, they remind consumers of their value and their ethical brand promise.

Just as we found that ecommerce businesses were well poised to flourish during the COVID-19 lockdowns, there are some companies whose business models are well suited to weathering times of inflation.

- Hello Fresh's brand focuses on providing in-season, local produce to its consumers. The company's business model is better suited to inflationary times, as by adjusting recipes based on market conditions, it can maintain margins despite fluctuating procurement costs.

Brands that prosper during times of inflation also have been known to engage in *activities beyond communications*. Resilient brands have the courage to change business practices to ensure that the costs of inflation are not passed directly to consumers. They back up their claims with tactics that prove the company is on the customer's side.

- Octopus energy has communicated energy price rises with consistent straightforward messaging and an honest tone of voice, coupled with energy saving tips that are pitched to be helpful, not patronising. But the company has also become an outlier by going a step further recently, giving out 5,000 electric blankets to customers most in need. Its response contrasts to the many other energy companies that have been opaque in communications and are yet to actively adapt to help customers.

- Iceland has reduced the price of all of its frozen and fresh vegetables worth under £1 to 1p in an attempt to ease costs on struggling families. Iceland used this approach at Christmas and Easter to demonstrate that they really understand the struggles of their customers at the times that mean the most to them.

- Burger King France has recognised the challenge that rising fuel prices presents to its customers. It has promised that if the prices at the pumps rise above €2, it will lower the cost of their Whopper sandwich for a week. Burger King recognises that it cannot materially influence the impact of inflation on consumers but wants to show support for its customers. Tying the price cut to rising petrol prises demonstrates an awareness of consumer' current struggles.

As small as these initiatives may seem, they are quickly revealing that the answer to the much-asked question of how best to respond to inflation in 2022, is as much about what brands do to impact customers lives, as it is about what they say.

While there are no cookie-cutter approaches, we've come up with a simple framework that can help guide your thinking, and ultimately action, around Value-based Innovation.

Frameworks brands should use to come up with their own solutions

Value-based Innovation can help brands respond to inflation through the P.E.A. framework, a simple way to consider not just what might be done, but how to act in way that has real impact on consumers. It begins with the fundamentals of aligning first to the Brand **Promise**, and then deepening consumer understanding to build **Empathy** into any response, before generating **Actions** that go beyond communications. At its core, Value-based Innovation is about having meaningful and positive consumer impact through creative business and marketing initiatives.

Brand Promise

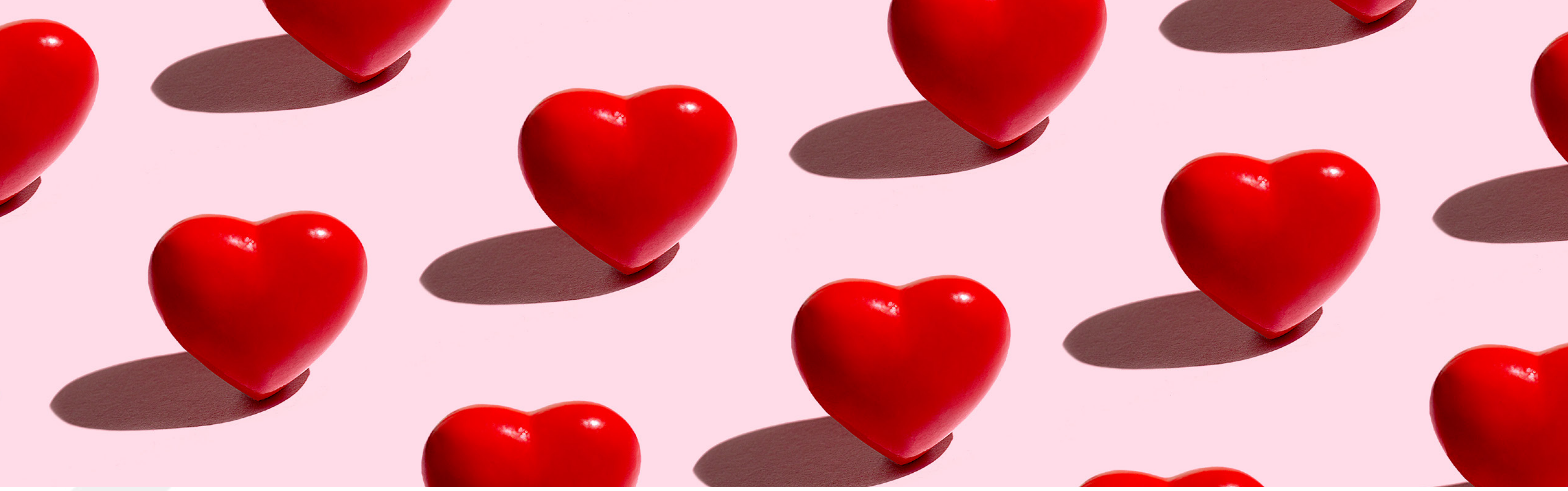
Brand promise refers to the value / experience consumers can expect to get from a brand. It is an enduring factor of who they are and should always remain true.

Whatever they do, brands must root their responses in their brand promise. Some brands will be able to respond in more immediate and direct ways, as their brand promises will already lend themselves to inflationary times (think ‘Every Little Helps’ from Tesco). Others will need to do more work to re-interrogate their brand promises and find connection points to the current situation.

The critical determinants of success will be speed and stretch – how quickly a brand promise-informed response can be brought to market, and how much permission the brand has to stretch into a new posture that consumers view as both authentic and helpful. If a brand doesn’t have the permission, its efforts will most likely fail.

"Navigating the rapidly changing context is critical to retain brand relevance but if a brand doesn’t define and respect its anchor points, then it will always feel at sea"

Emily St. Clair-Johnson,
Consulting Partner, Ogilvy Consulting



Empathy

Empathy at a time of inflation refers to developing a true understanding of customers' needs in this new economic context..

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The topic of empathy comes up frequently in recommendations about how brands can navigate inflation. And indeed, it would seem academic that brands able to demonstrate that they understand the plight of the consumer tend to weather difficult times better than those that don't. But in the annals of business and marketing there have been very wide diversions of how this principleis applied.

To truly understand customers, brands must get beneath the surface of simple demographics and use new approaches to segment psychologically. Over 95% of consumers' daily decisions are made automatically using 'System 1' thinking*, the automatic and more emotional mode of thinking*. Which is why understanding consumers' decision-making biases using behavioural insights and approaches like Cognitive Profiling leads to richer insights and greater empathy from which to develop new approaches to value.

"Brands that use big data to respond empathetically will fail if they don't have a real understanding of the drivers of human behaviour."

Daniel Bennett,
Consulting Partner,
Ogilvy Consulting's Behavioural Science Practice,
Ogilvy Consulting

'System 1' thinking refers to the fast, instinctive and unconscious responses that make up 90% of our daily decisions (Kahneman, 2011)

Action

Action refers to what a brand can do to make a real impact to their customers, when they need it most.

An empathetic response certainly involves empathetic communications but should rarely be limited to communications alone. Communicating directly to customers about what is happening and the impacts on them is a fundamental to any inflation response. To do this effectively, a level of transparency and honesty is critical to help customers feel a sense of control and trust. Yet, whilst most brands understand this idea and will engage in efforts to some extent, few go beyond communications.

Empathetic action is seen less often because it means adapting in a way that requires doing new things; meaningful behaviour as opposed to just meaningful communications. The ultimate goal of action is to create value that is specific to consumers' needs. During an inflationary period, brands need to think about value differently and be creative about the value they can offer.

This may mean moving from tangible to less tangible value, focusing on the added benefit a product or service provides, or reconfiguring the production or distribution process to extract more value from it. Rather than being equated with price alone, value can be highlighted for example by demonstrating the durability of a product (quality), the positive impact it can have on the environment (sustainability) or building a sense of community between customers (connection).

Whatever it is, the solution needs to be rooted in both the brand's promise and an empathetic understanding of the consumer. This is how we arrive at **Value-based Innovation** – by uncovering what consumers truly need and acting in a way that makes a difference and is in keeping with the brand promise. Octopus energy giving out free electric blankets is a prime example of a brand innovating to drive value in this way.

We can also learn from brands that have modelled Value-based Innovation during previous crises:

- Morrisons set up a dedicated customer call centre during COVID-19 lockdowns for orders to be taken over the phone so that vulnerable customers who didn't shop online could still order food.

- TELUS donated over 10,000 prepaid devices and SIM cards (valued at $1.2m) to healthcare workers, social workers, COVID-19 patients and isolated seniors.
- United Airlines and Delta Airlines were first to waive change fees for flights in August 2020, demonstrating value through flexibility.

- UK retail banks allowed people affected by the coronavirus outbreak to defer mortgage and loan repayments as mandated by the government, supporting those in need through practical help – and some, like Halifax, made the requisition and approval process incredibly simple online to make it easy as well.

- Airbnb was quick to offer support to those in Ukraine, providing temporary housing in surrounding countries for up to 100,000 Ukrainian's and encouraging people to book accommodation directly with hosts in Ukraine, with no expectation of staying, as a means of direct donation.

- We see clearly how brands – and consumers – have benefited from Value-based Innovation over previous crises, but while inflation is a significant concern today, most brands have been slow to demonstrate an equivalent level of empathetic action so far.

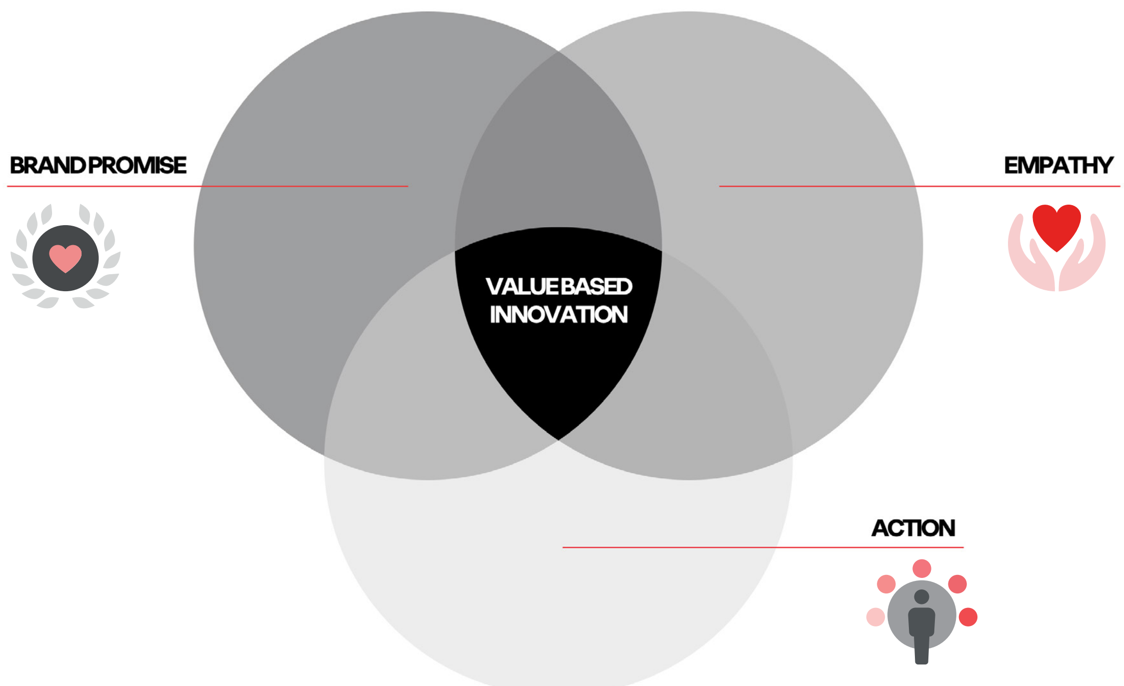
Right now, there is a real opportunity for brands to adopt a creative approach to value, and to embrace Value-based Innovation, which can be done both quickly and inexpensively. One method might be engaging in brand partnerships. For instance, if energy companies were to partner with DIY home improvement retailers and provide home insulation advice, this would be an impactful way to help consumers deal with rising energy costs.

"Value-based Innovation casts aside the puffery of purpose-led marketing to help marketers, companies and people unlock more value from the products and services they want and need at a time when they can least afford them."

Mark Dewings,
Principal
Ogilvy Consulting

How brands can approach Value-based Innovation

Unlocking Value-based Innovation through the P.E.A. framework



Value-based innvation lies at the intersection of brand promise, empathy, and action

Businesses, the ball is in your court

In spring 2022, many people and families are living through the worst economic periods in their lives. They are being priced out of the things they consider to be staples, increasingly worried about existential matters, making chocies they never had to before. And as of May '22, we don't see any relief in sight.

Many brands have already made their positions clear, falling back on the kind of empathetic messaging that's always been in their inflation playbook. Some of them are being met with increased cynicism. Those who are misreading consumers and falling back on cute or patronising messages are being penalised instantly on social media.

But some brands have understood that if they want to be the best at delivering value and relief and comfort, they have to be the best at knowing what their customers really care about. And they know that quick action that drives meaningful impact is required now, today. Those who have taken this path are already reaping the brand and business benefits. For those who are not the window for action is narrowing.

How Ogilvy can help

Ogilvy offers a series of iterative, collaborative workshops with cross functional stakeholders that are geared toward driving impactful, yet quick-to-implement, ideas that will make meaningful differences to their customers' lives. Combining experts from brand strategy, business transformation, communications and behavioural science, these workshops are designed to assess how a brand is currently performing against the P.E.A. framework and define what Value-based Innovation looks like for them.

Our workshops generally include a range of different techniques / exercises, that help to drive Value-based Innovation within our clients' businesses, such as:

- Design thinking exercises like 'How Might We' provocations to stimulate exploration and reinterrogation of the Brand Promise.
- Empathy mapping and ecosystem analysis exercises to ensure our ideas are as customer-centric and effective as possible.
- Lateral Category analysis to illustrate how brands (both within and outside the category) have overcome psychologically-similar challenges and the actions they have taken, to see what we can learn and take inspiration from.
- Techniques to ensure all participants have a voice and are motivated to contribute in every session.

The outputs of these workshops include both quick win tactical ideas with measurable outcomes that brands can implement today, as well as mid-term business strategy to help brands move from reactive communication to actionable, Value-based Innovation that can future-proof for the long term.

During times of inflation, deploying Value-based Innovation through the P.E.A framework can help your organisation to not simply weather the storm, but lead throughout. Those that adopt it will see outsized benefits as consumers reward the brands that demonstrate empathy and action during difficult times when this period of inflationary pressure finally abates.

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