Advance Look

Richard Rawlinson
Natasha Kuznetsova
Zac Peake
Ian Pate

The Morning After the Night Before

U.K. Consumers in the Recession

Consumers have already endured six months of financial crisis and now recession. It has affected their personal situations, their outlook, and their spending. Behavioural changes have affected almost all consumer goods sectors, but as the recession deepens, the easy economies have been made and the questions now become: What more will consumers do? How wide and how profound will consumer behaviour changes be?

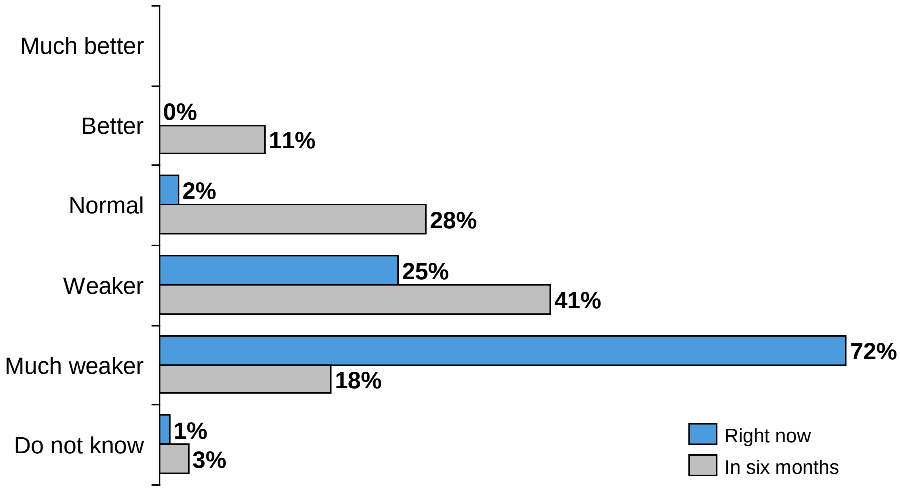
A recent Booz & Company survey of 1,800 U.K. consumers focused on these spending patterns, including the changes that consumers have already made and are expecting to make as the recession continues. The overwhelmingly negative outlook on the economy and uncertainty about personal financial security are leading consumers to broaden their cost-saving measures. These stretch from daily economising on essential purchases to trading down to lower-cost brands; from delaying or reducing frequency of purchases to more aggressive comparison shopping. In the six months to come, consumers are prepared to take even more severe measures, including switching to lower-end retail channels and cutting spending on certain discretionary items. The significant wealth effect makes this recession even more dramatic than those in the past, as housing prices continue to fall at a rapid pace while equity markets, which fell in value by more than 30 percent in 2008, continue to decline.

For consumer marketers and retailers, current and expected changes in consumer behaviour have many implications. Pricing and marketing actions that worked six months ago may not work today, and another fresh response will be needed six months from now. Retailers and manufacturers that have a faster, deeper understanding of emerging needs—and make use of new offers, new products, repositioned brands, and dynamic pricing—will benefit the most from the downturn.

Negative Views on the Economy

U.K. consumers are well aware of the crisis: An overwhelming 97 percent believe that the economy is weaker or much weaker than normal and, more significantly, five times as many think it will get worse rather than better over the next six months. (See Exhibit 1.)

Exhibit 1
Economic Outlook Now and in Six Months

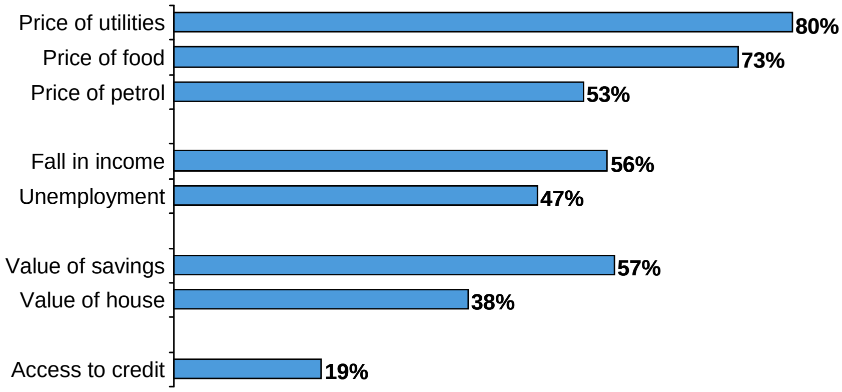


Source: Booz & Company Consumer Survey, February 2009

Many consumers worry about potential loss of income as well as the decreasing values of their houses and savings. Even more are worried about price inflation of essentials like utilities, food, and fuel. (See Exhibit 2.) Credit access to finance new purchases concerns consumers the least as they wake from the spending frenzy of the past decade.

This substantial concern about price increases on everyday items is, no doubt, the ripple effect from high inflation rates that hit consumers in 2007 and 2008. Despite a much lower inflation prognosis (Consumer Price Index 0.77 percent for 2009 vs. 3.61 percent for 2008[1]), Bank of England surveys found 61 percent of consumers still expect inflation over 1 percent, and 21 percent of those think that inflation will exceed 5 percent in 2009[2]. Complicating perceptions is the spectre of imported inflation; sterling's fall against other hard currencies could exacerbate inflation figures. Some signs of that are already visible to consumers buying foreign holidays or imported electronics. For example, Apple announced price increases of more than 20 percent in the U.K. on the back of the falling British Pound despite a predicted large decline in computer industry sales.

Exhibit 2
Current Economic Situation: Respondents Concerned or Extremely Concerned



Source: Booz & Company Consumer Survey, February 2009

The Wealth-Pain Connection

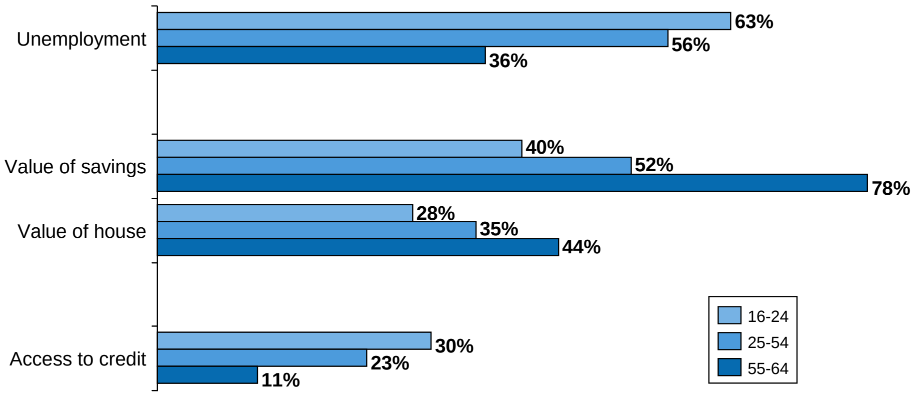
Another major economic factor is the way household debt has increased at the same time as asset price declines have affected household wealth. The U.K. household debt-to-income ratio rose from 83 percent in 1991 to 175 percent today. Debt, in this context, is defined as all household debt, and income is disposable income. While assets such as housing, investments, and pension funds are larger than they were at the beginning of the same period, their value has also fallen substantially and may go lower.

As these balance sheet changes flow through to consumer spending, they affect different consumers in different ways. For example, people approaching retirement have seen the income from savings and the value of assets such as homes, pensions, and investments plunge, posing a real threat to their income and retirement plans. (See Exhibit 3.) On the other hand, consumers who plan to buy property and have no significant financial assets benefit from lower asset prices

[1] *Global Insight CPI Forecasts for the U.K.*
[2] *Bank of England - Consumer Attitudes (November 2008)*

and low interest rates. Once confidence in their employment status returns, members of this group will resume spending.

Exhibit 3
Personal Economic Indicators: Respondents Concerned or Extremely Concerned

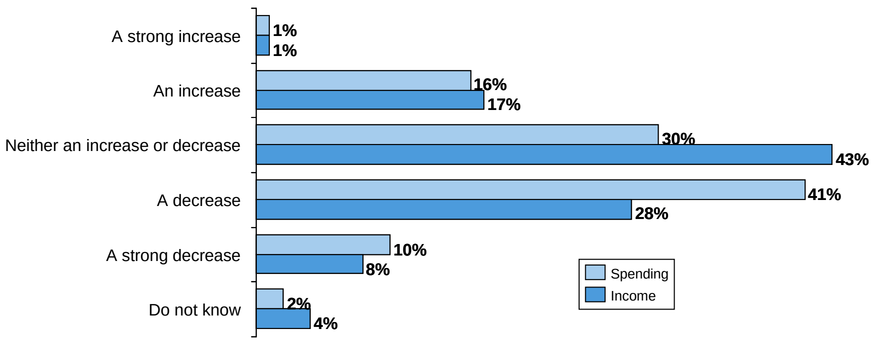


Source: Booz & Company U.K. Consumer Survey, February 2009

From Everyday Economising to Spending Cuts

Sixty-three percent of consumers have already reduced spending over the last six months, and 51 percent of consumers plan to make further cuts over the next six months. This is a matter of confidence, not income: Only 36 percent of respondents expect a reduction in income over the next six months. Significantly, consumers also believe these savings measures need to be introduced just to stay on top of increasing everyday prices and to insure against an uncertain future. No doubt intense media coverage of the continued financial turmoil has an effect, as does lack of clarity about (and lack of confidence in) how and when the economy will recover. (See Exhibit 4.)

Exhibit 4
Expected Change in Household Income and Spending



Source: Booz & Company U.K. Consumer Survey, February 2009

During the initial stages of the economic downturn, consumers were quick to adopt a range of savings measures across three broad categories:

- **Economising** through small changes to everyday spending;
- **Trading down** in brands and shifting to cheaper products. This includes shifting channels to hard discounters, for example; and
- **Cutting** purchases and deferring spending.

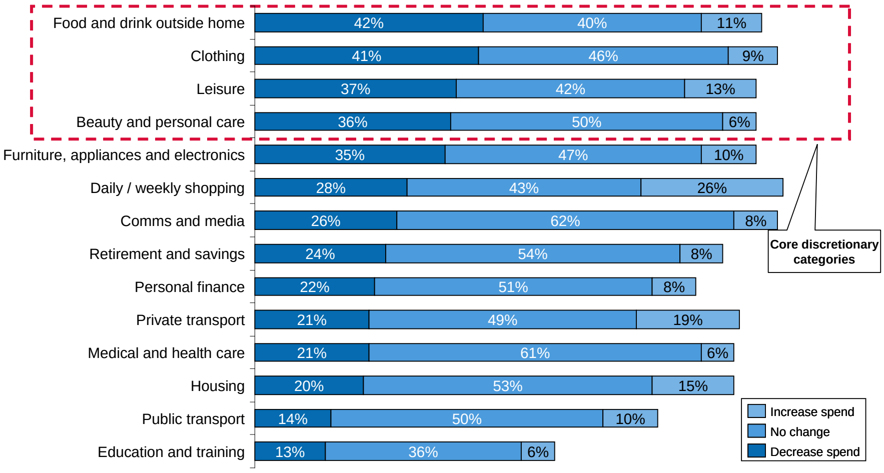
Consumers have differentiated between essential spending (e.g., food and clothing) and more discretionary spending (e.g. eating out). We also see that changes made early in the recession differ from those consumers are now planning as the recession develops and deepens.

Each consumer's behaviour is shaped by his or her individual financial situation. To craft an effective response, retailers and manufacturers need to understand the changes at a more detailed level of segmentation, including income, life stage, region, and so forth. Combined with the dynamic nature of the recession and further shifts in consumer behaviour, this poses a set of significant challenges that retailers and manufacturers will need to address. As the competition for consumer budgets intensifies, market players will need to develop new skills such as dynamic pricing capabilities which match the needs of different consumer segments. Or they will need to adjust brand and product portfolios to include more value brands that appeal to the new thriftier behaviours of their target audiences. (See Exhibit 5.)

Reduced Spending on Non-Essentials

Exhibit 5

Areas of Planned Spending Increases or Decreases



Source: Booz & Company U.K. Consumer Survey, February 2009

As a first step, consumers have already cut spending over the past six months on more discretionary, or non-essential, categories, such as eating out (57 percent of consumers), clothing (55 percent), holidays (48 percent), and beauty and personal care (47 percent). Exhibit 5 details how similar discretionary categories are in line for further cuts over the next six months. In contrast, far fewer people expect to cut back on more essential categories such as transportation, health care, and medicine.

Savings measures in discretionary categories include reducing consumption frequency or even delaying or avoiding new purchases.

Exhibit 6
Saving Measures Already Adopted for Nonessential Purchases

Category	Savings Measure	% already adopted
Food & Drink outside the home	Eat out less often	**56%**
	Go to pubs and bars less often	**50%**
	Order less take-aways	**45%**
	Eat at less expensive restaurants	**44%**
	Pack lunch for work	**43%**
Clothing	Defer purchases of new clothes	**50%**
	Purchase less premium brands	**46%**
	Buy more clothing on sale / out of season	**42%**
	Shop at discount stores	**40%**
	Switch to washing and ironing at home	**33%**
Furniture and Appliances	Delay purchasing new furnishings	**22%**
	Delay purchasing new appliances	**22%**
	Delay purchasing new electronics	**22%**
	Replace old appliances with more energy efficient ones	**15%**
	Take advantage of lower prices to buy desired product	**15%**
Leisure	Reduce number of holidays	**41%**
	Spend more time on the internet (for leisure)	**40%**
	Spend more time watching TV	**39%**
	Entertain friends at home instead of going out	**38%**
	Cut back on concerts, plays and shows	**34%**
Beauty and personal	Reduce haircuts, colouring	**47%**
	Shop at discount stores	**45%**
	Purchase more store-brand personal care products	**41%**
	Where possible, buy items in bulk	**35%**
	Reduce personal care	**33%**

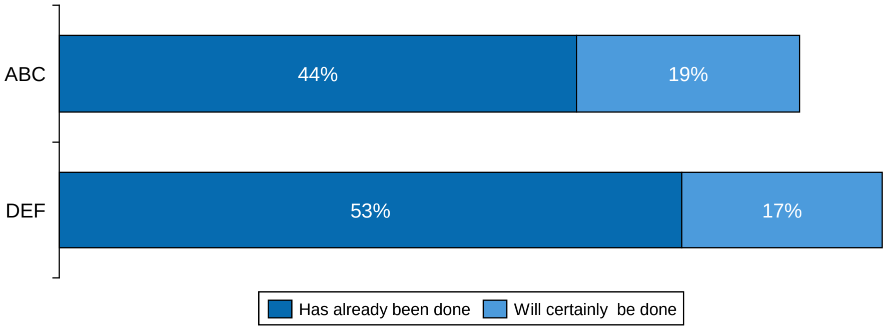
Cut-out | Trade down | Economise

Source: Booz & Company U.K. Consumer Survey, February 2009 (Top five measures identified by subsets of 1,800 respondents who identified the category as one of the top three categories of concern.)

When it comes to eating out, consumers are reducing the number of restaurant visits, trading down to fast food eateries, and reducing the frequency of takeaways. (See Exhibit 7.) Instead, they shift to "eating out at home" and attempt to re-create the restaurant experience and quality of food. M&S is addressing this new trend by their "Dine in for £10" campaign. In a sign of the intense price competition, Tesco has recently reacted to this with its own £9 meal deal. There is continued growth at chains like Kentucky Fried Chicken, which recently announced plans for 9,000 more jobs and 300 more stores, and Domino's, the purveyor of restaurant-quality pizzas, which experienced 15 percent like-for-like sales growth during the first six weeks of 2009.

Of course, regional and income differences are also factors. Lower-income groups or regions have already seen significant decrease in eating out, while mid-income groups and wealthier regions will only follow suit as the recession bites more deeply.

Exhibit 7
Cutting Back by Eating Out Less Often

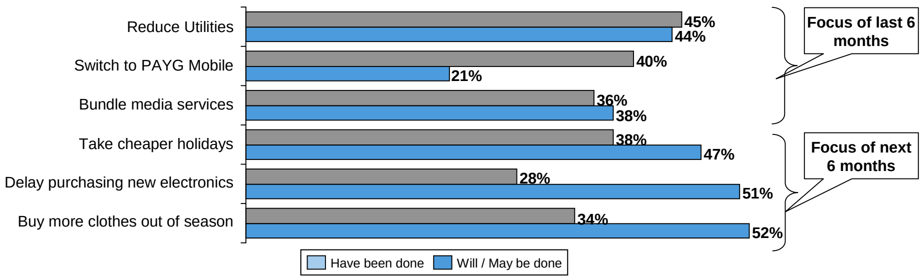


Source: Booz & Company U.K. Consumer Survey, February 2009

Consumers have also been cutting back on clothing and leisure purchases, and the impact is evident at retailers across the price spectrum. Some weaker players have gone into administration (e.g. Woolworths, Barratts Shoes, Principles) while others cut back their operations (e.g. Burberry). Rapid sterling devaluation contributes to the problem: Foreign holidays and brands are becoming less and less affordable. Instead, consumers will be looking for more local attractions, an opportunity for leisure and entertainment companies.

As we now move deeper into the recession, consumers are expecting further cuts in spending and are preparing to make more dramatic changes. Next to go will be larger areas of discretionary spending, where we will see more delayed or cancelled purchases or cheaper substitutes. (See Exhibit 8.)

Exhibit 8
Top Five Possible Savings Measures



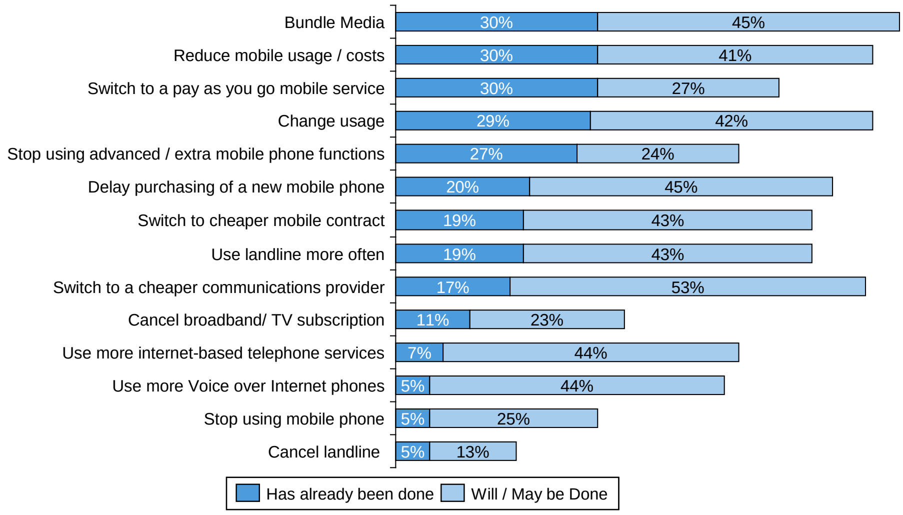
Source: Booz & Company U.K. Consumer Survey, February 2009

Cutting Communication Costs

For most consumers, mobile phones, broadband Internet, and subscription television services have become essential parts of their daily lives. However, many have also acted on available money-saving opportunities, most aimed at reducing costs without incurring significant switching costs or service charges. Consumers have turned to bundling media with the same provider, moving to pay-as-you-go tariffs, and reducing their mobile usage.

During the next six months, consumers expect to do more. They indicate an increased interest in switching providers in search of cheaper contracts, and a return to using mobile phone alternatives like landline and Voice over Internet Protocol (VoIP) options. It is unclear whether these expectations will translate into reality, but already, 20 percent of consumers have delayed purchases of new mobile phones, making handset sales dip in late 2008. Over the next six months, 45 percent more respondents plan to delay such purchases. (See Exhibit 9.)

Exhibit 9
Cost-cutting Measures in Communications



Source: Booz & Company U.K. Consumer Survey, February 2009 (based on a sample size of 158 respondents out of 1,800 who identified Telecommunications and Media as one of their top three categories of concern.)

Value is King in Essential Categories

Pressure on income and recent experiences with price inflation mean consumers will continue to focus on daily and weekly shopping savings opportunities with 28 percent of respondents expecting to decrease overall spending. They feel they need to exercise more control and look for better value just to stay within the same budgets. Interestingly, 25 percent believe they will need to increase spending on groceries, most likely driven by expectations of price inflation and the move away from eating out.

In the grocery category, consumers initially tried to stick to their normal routines and shopping channels where possible. Within those channels, they focused on economising measures such as paying more attention to price promotions, deals, and offers. They are also taking other savings measures which involve more significant behavioural changes, but with greater reluctance (See Exhibit 10.)

Exhibit 10
Saving Measures Already Adopted for Nonessential Purchases

Category	Savings Measure	% already adopted
Groceries	Buy more promotional / on offer items	**59%**
	Buy fewer treats and luxuries	**55%**
	Buy more store / value branded groceries	**55%**
	Use coupons more frequently	**51%**
	Increase amount spent at hard discount stores	**33%**
Private Transport	Drive less	**36%**
	Shop at stores closer to home	**36%**
	Take fewer shopping trips	**32%**
	Walk or cycle more	**27%**
	Defer purchase of new vehicle	**14%**

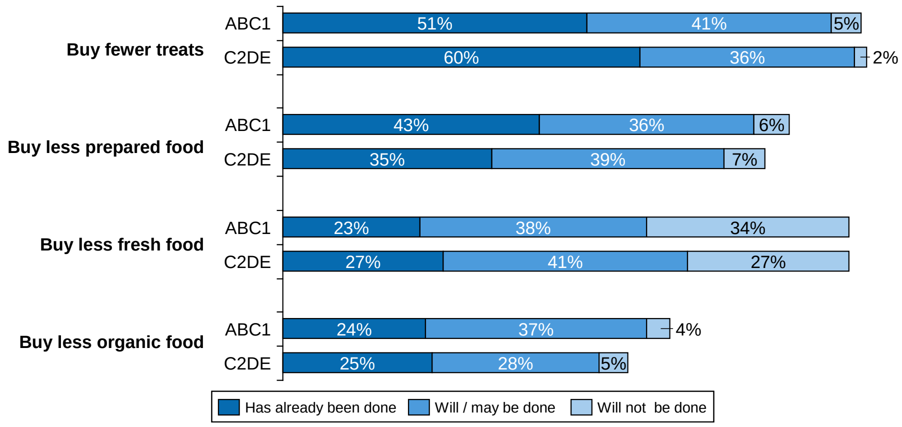
Cut-out Trade down Economise

Source: Booz & Company U.K. Consumer Survey, February 2009 (Top five measures identified by subsets of 1,800 respondents who identified the category as one of the top three categories of concern.)

While consumers are planning a broad range of grocery savings options, they are not prepared to significantly sacrifice quality. Buying less fresh food is not among the top savings measures, and 31 percent of consumers say they will not switch from fresh to tinned or frozen foods. On the other hand, 39 percent are already buying less prepared food, and another 38 percent plan to do it in the next six months. Consumers are willing to put more effort into preparing food from scratch, rather than sacrifice the quality of the final product.

Although there is more food economising further down the socio-economic hierarchy, Exhibit 11 shows upper-income groups have stopped buying prepared food to a greater extent than lower-income groups. The upper-income groups are also very reluctant to stop buying fresh food, emphasising the switch to cooking at home.

Exhibit 11
Planned Cost-Cutting Measures in Food Shopping



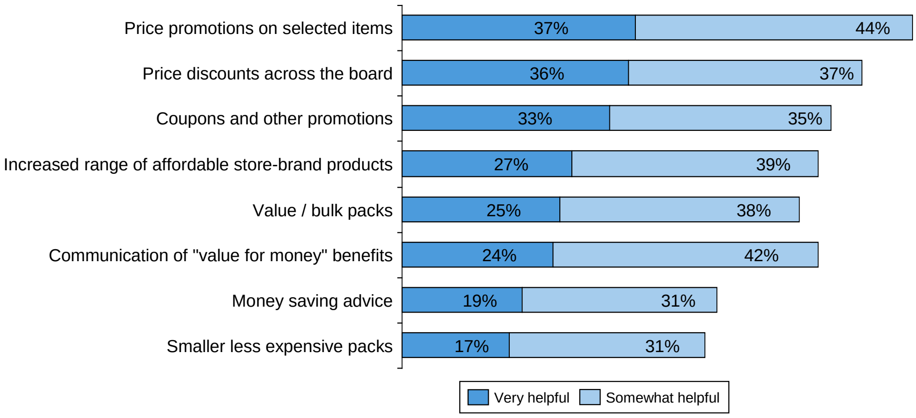
Source: Booz & Company U.K. Consumer Survey, February 2009

Environmental concerns and social responsibility may have been demoted from the headlines, but they continue to be important considerations for existing and emerging consumers. Fair trade products have seen record sales in 2008, although organic food has proven less durable and sales have declined. A relatively small percentage of respondents sees buying less organic food as a top savings measure. For marketers, the robustness of environmental and social concerns provides an opportunity to connect with consumers in ways that help people feel better about their cheaper choices.

Visible Pricing Impact is Critical

We can already measure consumer response to the crisis actions taken by retailers and manufacturers. Most consumers notice and appreciate price discounts on selected items, as well as across-the-board price cuts (81 percent and 73 percent, respectively). Other less tangible actions, such as introduction of smaller, cheaper packs and money-saving advice, are much less appreciated by shoppers. (See Exhibit 12.)

Exhibit 12
Respondent Views on Retailer and Manufacturer Actions



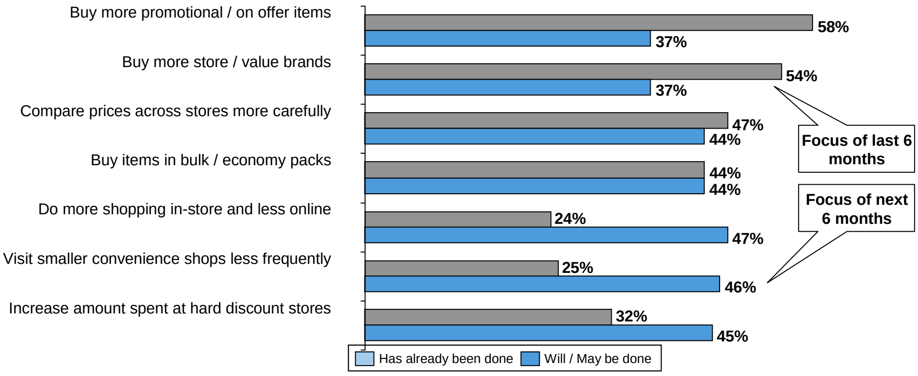
Source: Booz & Company UK Consumer Survey, February 2009

An increasingly critical capability for retailers and manufacturers is dynamic pricing. Consumers are becoming more price-sensitive and making greater efforts to search for value. Exchange rates will aggravate downward price and margin pressures in many categories, including electronics and clothing. More than ever, retailers and manufacturers must respond and collaborate to build more sophisticated pricing capabilities. Consumers in the survey say they appreciate price promotions on selected items even more than across-the-board low pricing. Therefore, at the moment, a Hi-Lo pricing strategy will be more effective than everyday low pricing (EDLP) in standing out and capturing consumers' attention.

More Channel Migration to Come

In the future, more consumers are prepared to alter their behaviour in increasingly more significant ways. They will begin to switch channels. They expect to visit convenience stores less often (46 percent) and increase the amount spent at hard discounters (45 percent). We also see that online shopping in categories such as groceries will come under increased pressure to demonstrate value as consumers look for savings opportunities and more opportunistic "deals" in-store. (See Exhibit 13.)

Exhibit 13
Respondent Plans for Daily and Weekly Food Shopping



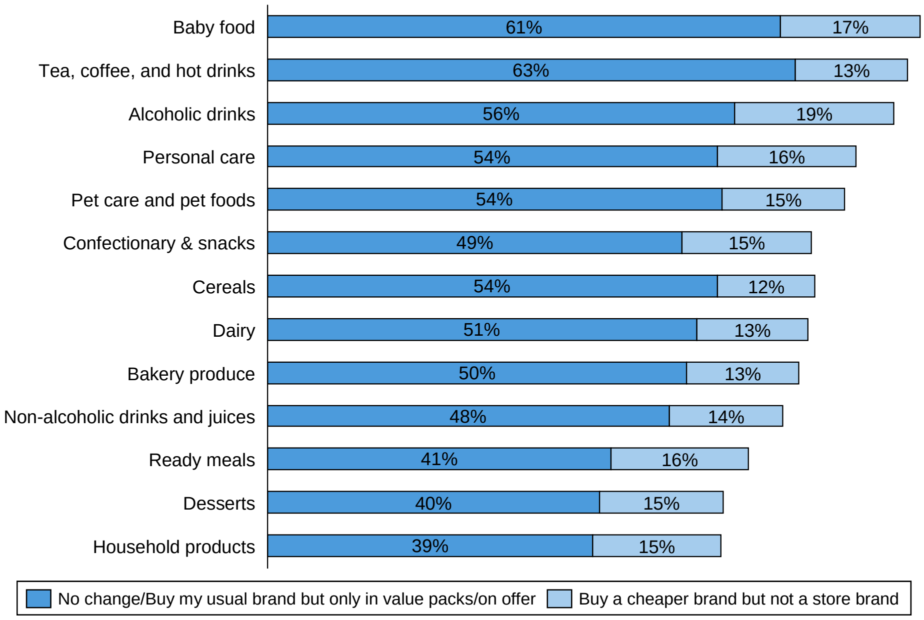
Source: Booz & Company U.K. Consumer Survey, February 2009

There are also regional differences in consumers' channel behaviour. In the past, consumers in London and South East have paid less attention to hard discounters. While historical development patterns and footprint constraints offer some explanation, the differences still affect the regional competitive landscape. ASDA competes with other supermarkets in London, while in the North West its main competition are hard discounters. However, this trend may be changing, with London and the South East showing some of the largest changes in intent to increase spending at hard discounters (48 percent and 47 percent, respectively). Exploiting these differences will help retailers adjust their pricing, assortment, and communication strategies and support the development of their store networks.

Brand Loyalty Needs a Value Argument

Despite their savings measures, many consumers still expect to continue buying their usual brands, while some will switch to other branded products within the category. (See Exhibit 14.) Brand loyalty is notably higher for tea and coffee, alcohol, and baby food. Brands in these categories either have built stronger emotional connections (e.g., alcohol, hot drinks), or still convey superior product quality and safety (e.g., baby food). In contrast, consumers are ready to trade down to less costly alternatives in confectionary, juices, desserts, ready meals, and household products categories where the product's functional characteristics are the main decision-driver, and where retailers have proven they can match the quality and performance of branded products.

Exhibit 14
Respondent Plans to Choose Less Expensive Brands



Source: Booz & Company U.K. Consumer Survey, February 2009

Across categories, consumers still see value in some brands and are ready to stay loyal. To win and keep that loyalty, brands need to offer stronger value propositions and prices to match consumer wallets, while investing in their emotional or functional advantages. Coca-Cola is a good example of this, defying the recessionary gloom. When the company released its 2008 fourth-quarter results, it announced that it is sticking to its long-term growth targets. Its "Happiness in a bottle" message appears to resonate with consumers during the recession, with a 4 percent global increase in sales volume during the last quarter, helped by strong growth in emerging markets.

In the face of a prolonged recession, companies will need to critically review and rebalance their brand portfolios. Second-tier and lower-priced brands will become increasingly important as retailers continue to strengthen their brands and broaden their portfolios. Retailers such as Tesco and Waitrose have already extended their brand collections at the lower end with options designed to attract customer spending, while pre-emptively addressing competition from discounters such as Aldi and Lidl.

Together with pricing, marketing remains critical to winning consumer loyalty and wallet share. Many consumer savings measures are still only plans, and it is up to retailers and manufacturers to influence consumers' actual future behaviours. Amid falling sales and profits, many businesses are turning their attention to cost reduction, with marketing spend often an early victim. Smart companies instead seize the opportunity to better match their marketing mix to their consumers and benefit from the economics and quantifiable measurement of online, mobile, and other interactive media. By using the recession to increase their marketing effectiveness, companies can further stretch spending and build vital capabilities for the long-term.

Conclusion

Large amounts of household debt and the loss of property values as a wealth driver will most likely lead to a longer recession and a subsequent period of relatively slower economic growth. Consumer spending caution and lack of confidence will continue even as major, yet uncertain economic interventions are implemented. For the foreseeable future, consumers will remain very price-sensitive, exercising caution and acting more frugally, leading to significant structural changes and channel shifts, such as the growth of low-cost retailers.

Companies will also need to fundamentally adjust cost and capacity to succeed across a range of economic sectors. Delivering operational effectiveness and efficiency improvement programs and realizing cost reductions will be crucial, as will having the agility necessary to respond to, and exploit, further changes and swings as this recession progresses.

Successful retailers and manufacturers will combine their market segmentation and pricing capabilities to demonstrate their empathy for consumers, and their willingness to help lead them through this recession. The retailers and manufacturers facing up to these challenges, while developing or exploiting their capabilities to navigate the shifting tides of consumer behaviour, will be ultimate winners.

A NOTE ON METHODOLOGY

- To understand how consumer behaviour is changing in the current economic environment, Booz & Company surveyed 1,800 U.K. consumers (chosen across regions, income groups, and ages to be representative of the U.K. population) from 17 to 24 February 2009.
- Pre-screening was done by market research firm Research Now, and an online survey link was sent to 2,000 U.K. consumers.
- The survey results were validated and respondents who were classed as ”speeders” or “flatliners” were removed from the survey, resulting in a final pool of 1,800 respondents.
- The survey focused on:
  - Sentiment and perceptions regarding the U.K. economy;
  - Changes in spending that consumers have already made over the last six months; and
  - Additional changes they are considering making as the economy continues to falter
- The survey investigated specific actions and lifestyle changes that consumers have taken or are planning to take in major categories, including daily/weekly groceries, appliances and electronics, clothing, housing, and public and private transport.

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Contact Information

London
Richard Rawlinson
Partner, London
+44-20-7393-3415
richard.rawlinson@booz.com

Natasha Kuznetsova
Marketing Expert, London
+44-20-7393-3247
natasha.kuznetsova@booz.com

Zac Peake
Senior Associate, London
+44-20-7393-3562
zac.peake@booz.com

Ian Pate
Associate, London
+44-20-7393-3262
ian.pate@booz.com

About the Authors

Richard Rawlinson, based in London, is a partner in Booz & Company's consumer and retail practice.

Natasha Kuznetsova, based in London, is a marketing expert in Booz & Company's consumer and retail practice.

Zac Peake, based in London, is a senior associate in Booz & Company's consumer and retail practice.

Ian Pate, based in London, is an associate in Booz & Company's consumer and retail practice.