



THE IMPACT OF THE RECESSION ON VALUE AND PREMIUM GOODS

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BACKGROUND

Recessions, like any other part of the economic cycle, bring with them challenges as well as opportunities for businesses. Consumer confidence across Europe is currently at a particularly low ebb, as macro-economic factors force shoppers to reappraise their consumption habits. Issues such as rising fuel costs, food and commodity price rises, the tightening of credit and decreasing property values have all encouraged a more cautious approach to spending.

On the CPG side inflation is hurting turnover, as price rises in raw materials force firms to push up in-store prices. In some cases, the price rises, when combined with other factors, are forcing customers to trade down to cheaper brands or private label products, while other goods which are seen as unnecessary to their needs may even be sidelined altogether. However, at the other end of the scale, certain premium products are appearing more resilient to the recession, as consumers sacrifice items in order to satisfy their need – whether societal, psychological or emotional – for these goods.

So what can retailers and manufacturers do to stay ahead of the competition and encourage greater consumption? How do they pick the right marketing and promotional strategies in such challenging business conditions?

IRI has used its powerful Infoscane point-of-sale data gathering technology to compile a wide-ranging study into shopping habits over a range of categories, during the past two years. The body of evidence provided in this paper is a result of this data gathering and analysis tool.

The vast data warehouses of retailers across the UK, France, Germany, Spain and Italy have been trawled to provide us with a comprehensive picture of shopping habits in these regions. Categories are broken down into three tiers – value, regular and premium – products assigned a tier according to their average price per volume. A picture then begins to emerge of where the opportunities lie, and where the challenges are.

IRI has also polled consumers themselves in these five regions about their preferences and perceptions of value to gain a vital snapshot into their ever-volatile shopping behaviour. In conclusion, IRI makes recommendations so that both CPG retailers and manufacturers can approach the coming months and quarters with the confidence that they will make the right decisions to not only survive but thrive during this downturn.

“What can retailers and manufacturers do to stay ahead of the competition and encourage greater consumption?”

Nigel Howlett, IRI



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KEY FINDINGS

For Manufacturers:

Insight: Inflation in the price of raw materials leads to higher prices at the till and forces shoppers to both curb consumption and buy cheaper goods

Action: Increase targeted promotions to mitigate the loss of market share to private label and value brands

- Invest in marketing campaigns to re-emphasise key branding messages, convincing consumers they can't live without your brand
- Investigate other ways to make your brands more attractive to consumers, such as greener packaging

Insight: Excessive promotional activity makes consumers regard promotional discounts as the norm

Action: Do fewer, better communicated promotions and make any price cuts less deep

Insight: Consumers stay at home more often in an attempt to reduce spending in bars, restaurants, hair salons etc, and therefore buy the associated premium products to consume at home

Action: Focus marketing and packaging innovations on premium products to tap this market

Insight: Consumers increasingly buy value goods in commodity categories like water, in order to rein in spending

Action: Track which categories are following this trend and produce more products in the value tier for the associated items

For Retailers:

Insight: Tight margins mean little room for manoeuvre with price reductions, despite the pressure of falling consumption

Action: Resist the urge to make deep cut prices. Innovate with alternative strategies such as marketing to advertise your stores more effectively, or expanding the range of private label goods on offer

Insight: Consumers are thinking more carefully about which products to buy, and trading down in some categories due to recessionary pressures

Action: Invest in more emotionally relevant marketing campaigns

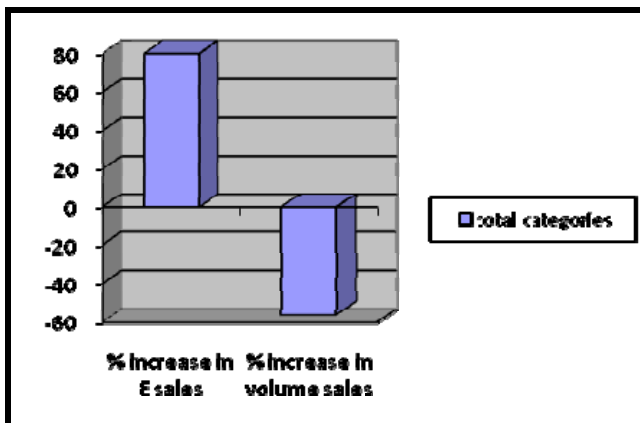
- Improve packaging and quality of own-brand goods to encourage consumers to view them as a viable alternative to national brands
- Continually monitor consumer shopping behaviour and adapt store layout to maximise on current buying habits
- Look for opportunities to increase selection of private label goods in stores in order to maximise sales and meet demand



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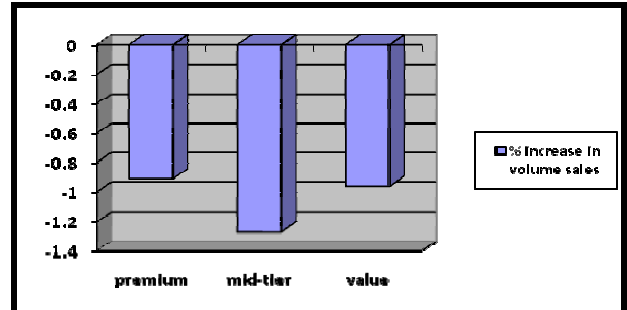
FRANCE

Like most other European markets, Consumer Packaged Goods in France have been hit hard by the recession. In addition, rising inflation on raw materials reaching nearly 5 per cent in 2008 only served to increase the challenges facing manufacturers and retailers, as they were forced to pass on price increases to consumers. As you can see in the table below, 80 per cent of the categories are growing in value when, as price increases took hold, 56 per cent are decreasing in volume. That's an average of 1.9 and -1.3 per cent respectively.



T1: (Percentage increase in volume and € sales, 2008-9)

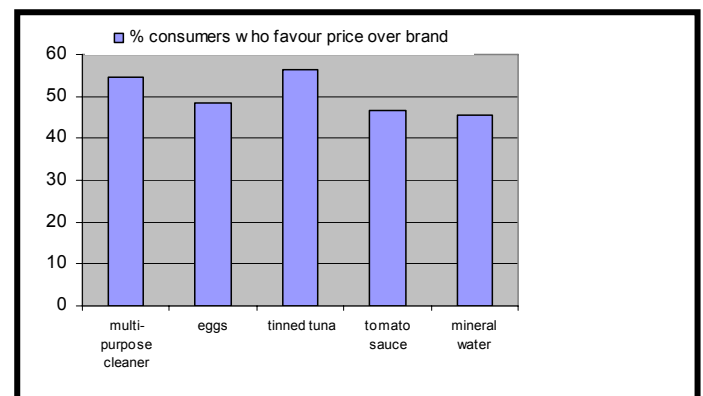
French households are reacting to the crisis and the rising price of goods by trying to spend less – buying cheaper and fewer products. As you can see from T2, all tiers – value, medium and premium – appear to be suffering in the recession.



T2: Average percentage increase in volume sales, all tiers 08-09

It is likely that private label goods are the big winners from this trend, as French shoppers seek lower priced goods in the categories where they once bought national brands.

The table below shows the top five categories where consumers favour cheaper goods over a preferred brand. Unsurprisingly most of these are commodity items like water and vegetables, but it nevertheless shows the increasing importance of price for French consumers.



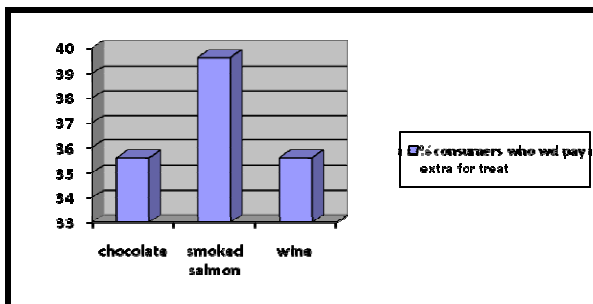
T3 – top five categories where price trumps brand (consumer survey)



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FRANCE (cont)

Premium products seem to be the most resistant to the economic downturn, by a slight margin. This is partly because they are often not in competition with private label or value goods. The reason is that despite and in some cases because of, the economic climate, French consumers may see their premium goods as a necessary luxury or treat. This is why we see categories at the luxury end of the scale, like wine and smoked salmon comprising the top three categories.



T4 – top three categories where consumers are most likely to pay extra for a treat

There is cautious optimism ahead for France. Any upturn in the French CPG market will depend on the falling price of raw materials and the success of promotions. The first three months of this year show that prices are indeed dropping steadily, this should lead to an increase in consumption this year.

Promotional activities have begun to increase again, after a period of stability. Manufacturers and retailers can be expected to continue using this strategy to maintain their volumes and increase turnover in the coming year.

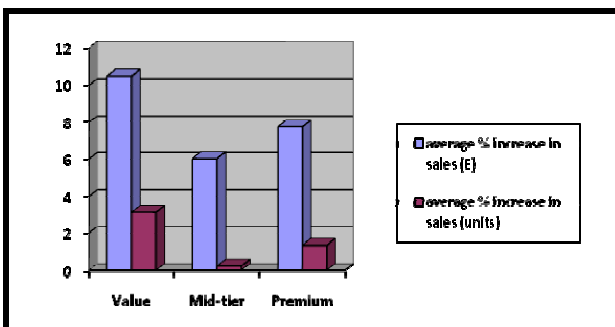


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ITALY

The Italian economy has suffered less damage from the global crisis than many other European countries, but still found all sectors hit by negative growth: the automotive market is one of the worst affected with negative growth of 40 per cent compared to the previous year. As in France, raw material prices rose, forcing CPG firms to increase prices, adding to the higher cost of living for consumers.

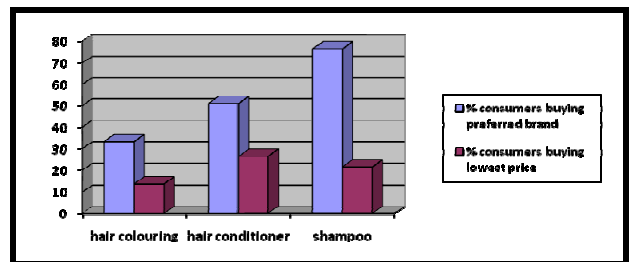
Partly as a result, consumers are increasingly seeking out value goods, especially private label items. In terms of packaging and general quality of the products, the perception is that these goods are improving, offering customers not only a cheaper option – vital in a recession – but also one in which they can be satisfied. The table below clearly shows value goods benefiting most from the recession, over the period 2008-09, outstripping premium goods in average unit sales and € sales, with mid-tier goods being the main losers.



T5 – average % increase in sales (€ and volume) for all tiers, 2008-9

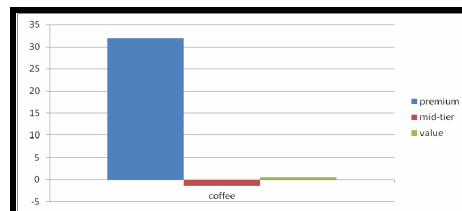
Manufacturers have tried a range of promotional activities over the period in order to keep the prices of their brands at the same level as private label, and to try and prevent a trend of down-trading. However, in certain categories, value goods, and especially private label goods, are still not wholly accepted by the public.

For example in hair colouring, Euro sales of premium products grew by 26.7 per cent but value products registered a -45.73 percent growth in sales. The table below shows that according to IRI's consumer poll, customers favour their preferred brand over a cheaper version in these beauty-care categories.



T6 – percentage of consumers buying preferred and lowest price goods in 3 categories (consumer survey)

Premium goods are undoubtedly being helped by strong brand equity in Italy. Consumers buying these products may represent a niche rather than the majority, but the overall result is that premium is not being significantly affected by the recession. Coffee is a perfect example of the power of brand equity. We can see below the growth in unit sales of premium coffee products from 08-09 far outstripped value and mid-tier equivalents



T7 – percentage growth of unit sales: premium coffee v mid-tier v value, 2008-9)



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It's important to note here that this dynamic also works the other way around. Where value products have a high market share, it will usually indicate that premium brands are unlikely to make an impact on that category. Promotions are often needed in these cases by manufacturers to help them mitigate any losses incurred through down-trading to private label or value goods.

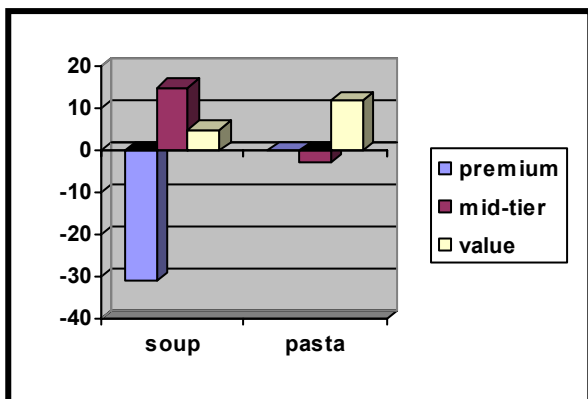


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SPAIN

Spain's economic plight has been one of the most severe in Europe. With the collapse of the housing industry – one of the country's most important markets – and unemployment figures rising from the lowest in Europe to currently the highest, consumers have been forced to pull back on spending. Add to this the increase in price of raw materials felt by most other European countries and the rise of private label has been almost inevitable, as consumers look to buy cheaper products. Private label now stands at around 38 per cent penetration. This makes it the highest percentage share in any European country, with most products coming in food and commodity categories like water.

One of the most obvious trends in Spain is that people have less and less time to eat lunch. As we can see from the table, this means that products such as pasta, and soups – both staples for easy and quickly-prepared lunchtime meals – are showing growth in the value and/or mid-tier range. Shoppers are eschewing the premium brands because of cost-cutting reasons, and possibly because these rushed meals don't give them the opportunity to savour their food. Spanish shoppers are thinking 'why spend more?'

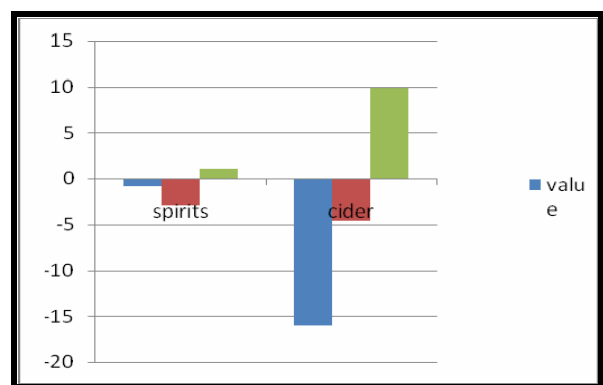


T8 - average percentage increase in volume sales for all tiers in pasta and soup categories (08-09)

IRI's consumer survey found, similarly, that 30 per cent of Spanish consumers bought cheaper pasta because of the recession, while 17 per cent purchased cheaper soups.

On the other hand, there was good news for premium products in Spain. Over the last year consumers have been spending more time at home, to save money they may otherwise spend outside. In areas such as alcoholic beverages, we can see that, far from reducing spending to the minimum by buying value goods, a large number of shoppers are still sticking to their premium brands. The consumer survey backed this up with 53 per cent of consumers saying they would spend either a little or a lot more on a national brand in this category.

The rationale for this is that sticking with a premium brand ensures quality and still means significant money savings on the price of going out to a bar. The following table shows that in both the spirits and cider categories, only premium products recorded an increase in volume sales between 2008-09, while others fell.



T9: Average % increase in volume sales for all tiers; cider and spirits

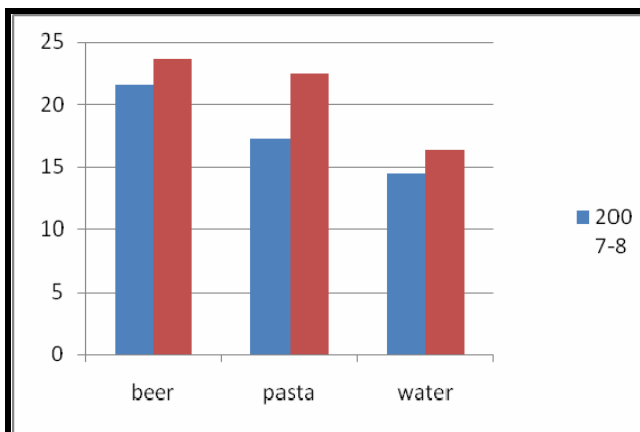


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SPAIN (cont)

Manufacturers may benefit from focusing their marketing efforts on these premium products to maximise their turnover in this area, and ensure that when the recession ends, these brands will be able to bounce back to register previous levels of consumption.

CPG firms in Spain have also resorted over the recession to promotional discounts in order to improve and protect market share. We can see from the table below that water, pasta and beer all showed large spikes in amount of volume sales coming from promotions.



(T10: Percentage of total volume sales on promo; beer pasta and water)

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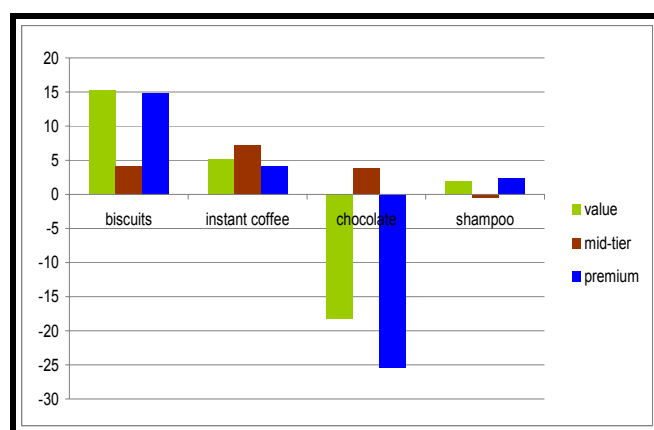
UNITED KINGDOM

The UK has unsurprisingly been one of the worst recession-hit countries, given its heavy reliance on the crumbling financial services sector, with consumer confidence now at an all time low. Consumers have become more prepared to try out discount stores such as Aldi and Lidl in their bid to save money and in certain categories of goods are even looking to buy smaller sized items, in order to save money in the short term. When it comes to groceries, the rising cost of raw materials has forced CPG firms to push up the prices of their products – dry pasta, for example, went up by 40 per cent from 2008-09 – further denting consumer confidence.

The UK is a complex market however. It is not a given that those who normally buy premium goods here will continue to do so despite the recession. Pasta sauce, for example, could be regarded as something of a premium category, and yet volume sales for premium products decreased by nearly three per cent between 2008-09. Volume sales in mid-tier meanwhile grew by a respectable 8.7 per cent. It is likely that because the cost of pasta had also risen, consumers were trading down on the accompanying sauce, to balance their budgets.

However, in some categories, consumers are still sticking firm to their habitually-chosen products. Here we can see that in the biscuits category, £ sales of premium and value products both increased by about 15 per cent. The consumer survey bears this out by finding 42.2 per cent favour cheaper products while a similar amount, 46.6 per cent, selected a

preferred brand in this category. On the other hand, in some categories, like chocolate, there is no trading up or down, but consumers simply decide that these products are not core to requirements. We can see that both premium and value tiers in this category experienced huge declines in sales and volumes, with the mid-tier growing very slightly.



T11 (percentage increase in £sales on all tiers; four categories 08-09)

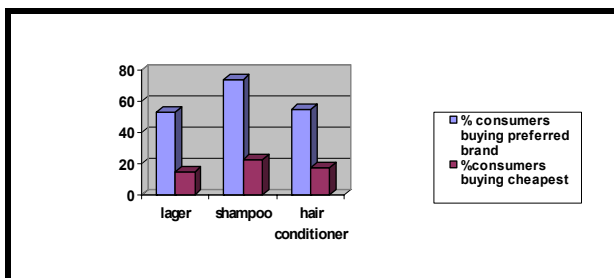
As in Spain, we can also see that consumers are deciding to spend more time at home, driving sales in categories like lager. It would be a mistake to think that by staying in consumers are not spending more. In fact, we can see the average and premium tiers growing in this category as people seek to buy good quality home comforts.



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The same trend can be observed in beauty products, with premium shampoo volume sales actually increasing by a couple of per cent more than value goods. Consumers, for example, are deciding to buy premium brands like Nikki Clarke or Charles Worthington for use at home, rather than to go for a treatment at the hair salon.

Further reinforcing this view, IRI's consumer survey demonstrates that shampoo, hair conditioner and lager categories are coming out amongst the top categories where UK shoppers favour brand over price.



T12 – percentage of consumers buying preferred brand v cheapest price in shampoo, lager and hair conditioner (consumer survey)

Another side effect of UK consumers being increasingly careful about their money is the large number now taking advantage of trade promotions. The amount of volume sales in the last year which were actually products sold on deal frequently rose above 50 per cent. This is a dangerous game for manufacturers to play – make this the norm and it may become a vicious deflationary circle which becomes difficult for CPG firms to break.

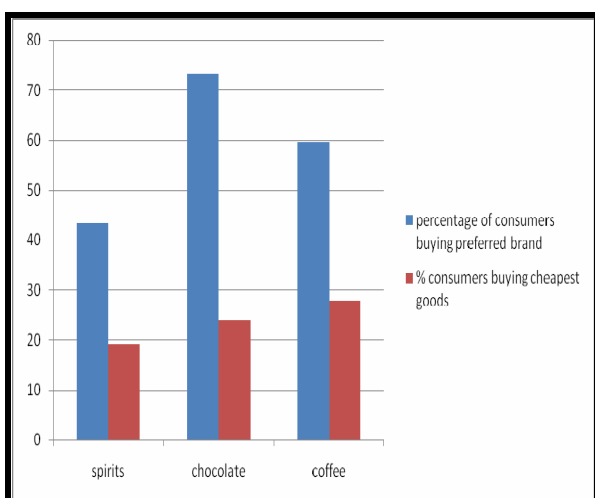
GERMANY



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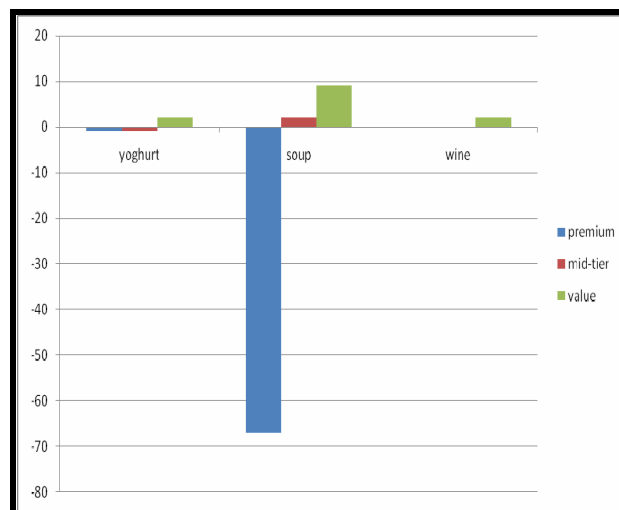
Germany, almost unique in Europe, has yet to feel the full impact of the recession. Although exports are down, unemployment remains pretty low – even if some workers have to shift to part-time to preserve their jobs – and inflation has dropped from highs of around 2.6 per cent a year ago to virtually zero. Consumers therefore still have money in their pockets, and the large-scale price rises seen in countries such as France are yet to hit the CPG industry here.

If the German consumer is convinced a premium product offers something special and different from other lower value goods, they will purchase it. The table below shows three categories in particular where preferred brand trumps price every time. With spirits, consumers are buying preferred brands because they have been sold an image thanks to packaging and marketing, as premium quality. Bacardi rum, for example, makes great play on being able to offer consumers a sense of luxury and escapism.



T13 – percentage of consumers choosing versus price; chocolates, coffee, spirits.

Despite the relative economic prosperity of German consumers today, however, they still have an eye for a bargain, so it's not surprising to see small rises in the value and mid-tier goods of certain categories. The table below shows that in wine, yoghurt and soup categories, consumers are going after cheaper goods, mainly in the value tier.



T14 – percentage increase in volume sales, all tiers, soup, wine and yoghurt categories (08-09)

In the wine category, the rise in demand for value goods can be explained by higher prices that resulted from a poor harvest in 2007. This pattern could be repeated in other categories in the coming year, with consumers increasingly seeking to buy in the value tier in order to rein in their spending as the recession takes hold.

German CPG firms are very much in the calm before the storm at present. By 2010 it



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is expected that jobs will have to go as the recession finally kicks in, and even if exports by this stage have actually risen, CPG consumption is likely to fall, forcing retailers and manufacturers into traditional reactionary measures of greater price cuts and more promotional activity. This is understandable, given how tight retailers' margins are here, but the level of cuts needed to sustain volume sales is unlikely to save some firms from bankruptcy. Retailer and manufacturers instead need to be more creative about how they market private label and value goods.



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SUMMARY

Don't think of the recession as something out of your control, the following actions could go some way to helping CPG manufacturers and retailers protect and grow their market share, and put them in good shape for when the economic recovery finally begins.

For Manufacturers:

While promotions and price cuts may seem to be the obvious way of protecting and growing market share, manufacturers must beware that these can affect the image of a brand, and lead to a vicious

circle of consumers expecting products to be on promotion all the time.

Manufacturers should not think that if consumers stay in more they are spending less

Manufacturers should therefore bear brand equity in mind at all times and seek to do fewer, better communicated promotions, with smaller price cuts. Manufacturers should not think that if consumers stay in more they are spending less; it could actually mean more opportunities for premium brands as consumers look to treat themselves at home. There is an opportunity here for some relevant marketing and product and packaging innovation to press home the point.

As consumers stick to the brands they know and to the core brands they need,

extra effort is required to persuade them that your brand falls into this diminishing group. Marketing can help here to convince consumers of the quality of your goods and remind them why they chose them in the first place. This will raise the chances of consumers staying faithful, or at least considering a return to your brand after the recession. Products which 'float' the recession will bounce back stronger when the upturn eventually comes. Finally, passing on falling commodity prices as soon as possible to consumers will encourage greater consumption, improve turnover and help encourage the long-awaited economic upturn.



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For Retailers:

Continue to invest in improving packaging and the quality of private label goods to encourage consumers to view them as a viable alternative to national brands. Changing consumer habits now could mean that in categories such as commodity goods, these new preferences stick long after the recession is over. Retailers must continually measure, monitor and manage sales and stock to identify the best growth opportunities, as well as areas which need to be scaled back. Looking for categories where premium goods are on the slide, for example, will help you spot opportunities where a greater selection of value goods in stores would increase sales.

Investigate ways other than price reduction to make your private label goods more attractive to consumers, such

Retailers must continually measure, monitor and manage sales and stock to identify the best growth opportunities

as greener packaging. During a recession, people tend to think more seriously about what matters to them, so make marketing campaigns emotionally relevant for consumers,

and continually monitor and adapt store layouts to maximise on consumers' current buying habits. When margins are tight, resist the urge for knee-jerk price cutting and think more about how to innovate in private label goods, maybe by expanding the range of goods on offer into premium quality products. Invest in marketing of these and in promoting your own stores as a way to differentiate.



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RESOURCES USED TO PRODUCE THIS PAPER

INFOSCAN:

InfoScan is a syndicated retail tracking service that enables manufacturers, retailers, brokers and financial analysts to acquire industry insights used to make better business decisions. InfoScan utilises the data IRI collects from grocery, drug, and mass merchandiser retailers to provide the most comprehensive and accurate syndicated data offering in the Fast Moving Consumer Goods (FMCG sector).

SHOPPER INTERVIEWS:

Get inside your shopper's mind to really know what they want and when they need it, and you will have a complete perspective. Today's transforming economy makes it essential to evaluate consumers' needs and preferences. To do this we have a specialised team that will give a complete and accurate view of you shopper. For this particular white paper we have run a multi country survey with online shoppers to understand better their perception of value, mid-tier and premium products.

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About IRI

IRI is the world's leading provider of consumer, shopper, and retail market intelligence and insights supporting 95 percent of the FORTUNE Global 500 consumer packaged goods (CPG), retail and healthcare companies. Only IRI offers the unique combination of integrated market information, automated and predictive analytics, innovative enabling technologies, and domain expertise. With IRI, leading retailers and manufacturers are able to quickly discover breakthrough insights driving smarter decisions and actions across the enterprise for breakthrough results. Companies around the world depend on IRI for improved productivity, stronger brands, and dramatic revenue growth. For more information, visit www.infores.co.uk.

