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The Consumer of the Future Part I: Impact of today's turbulence

US and Western Europe

Executive Summary: The Consumer View

- Lower income shoppers are more impacted by cash flow pressures, while higher-income shoppers are more worried about their overall balance sheet
 - All consumers are trading down, but also “fleeing to value”
 - Discounters and private labels are growing share, but consumers still value name-brand innovation within categories
- Long-term trends such as demographic and population shifts are largely unchanged by the economy
- Convenience, “green,” and wellness trends are still relevant, even while consumer willingness to pay high price premiums changes with the economy
- Trends such as nesting, spend polarization, and small personal indulgences are actually accelerated by a downturn

Executive Summary: How Brands Respond

- Ensure you have the best value proposition for your core customers
 - Continue innovation and meaningful premiumization of experience
 - Retailers and producers need to collaborate to keep conversations with consumers positive (**transform Below The Line consumer dialogue, focus on the in-store experience**)
- Don't squander years' worth of brand equity for a few quarters of sales
 - Offer real value for money
 - Create offers for recession psychology
- Relearn the lessons of winners in previous downturns
 - Dust off the 80's playbook
 - Drive simplicity-speed through repeatable models
 - Increase focus on margin by aggressive cost and cash flow management

The current global crisis poses four questions to consumer goods producers

- How are consumers feeling and changing their behaviors?
- What is the impact on global consumer trends?
- What should companies do to react?

The recession is already hitting consumer cash flows



Consumer cash flow

- + Income
- + Available credit for spending
- Savings
- Spend on essentials



**Classic recessionary impact:
hurts business through cycle**



Consumer "balance sheet"

- + Home equity
- + Shares and retirement plans
- + Other assets
- Debt



**Longer term impact:
Harder to predict as it damages
consumer confidence**

Consumers with low incomes will be hardest hit by cash flow pressures

DEVELOPED COUNTRIES

Lower incomes



Middle class



Higher incomes



Exposure:

- **Heavily exposed** to unemployment pressure (e.g. manufacturing)
- Low savings cushion
- **Moderately exposed** to unemployment risk (cuts to middle management)
- Low savings rate
- High income and high levels of savings provides **cushion** from cash flow problems

% households* ~40%

~40%

~20%

% income* ~10%

~40%

~50%

* USA example

Source: Bureau of Labor Statistics

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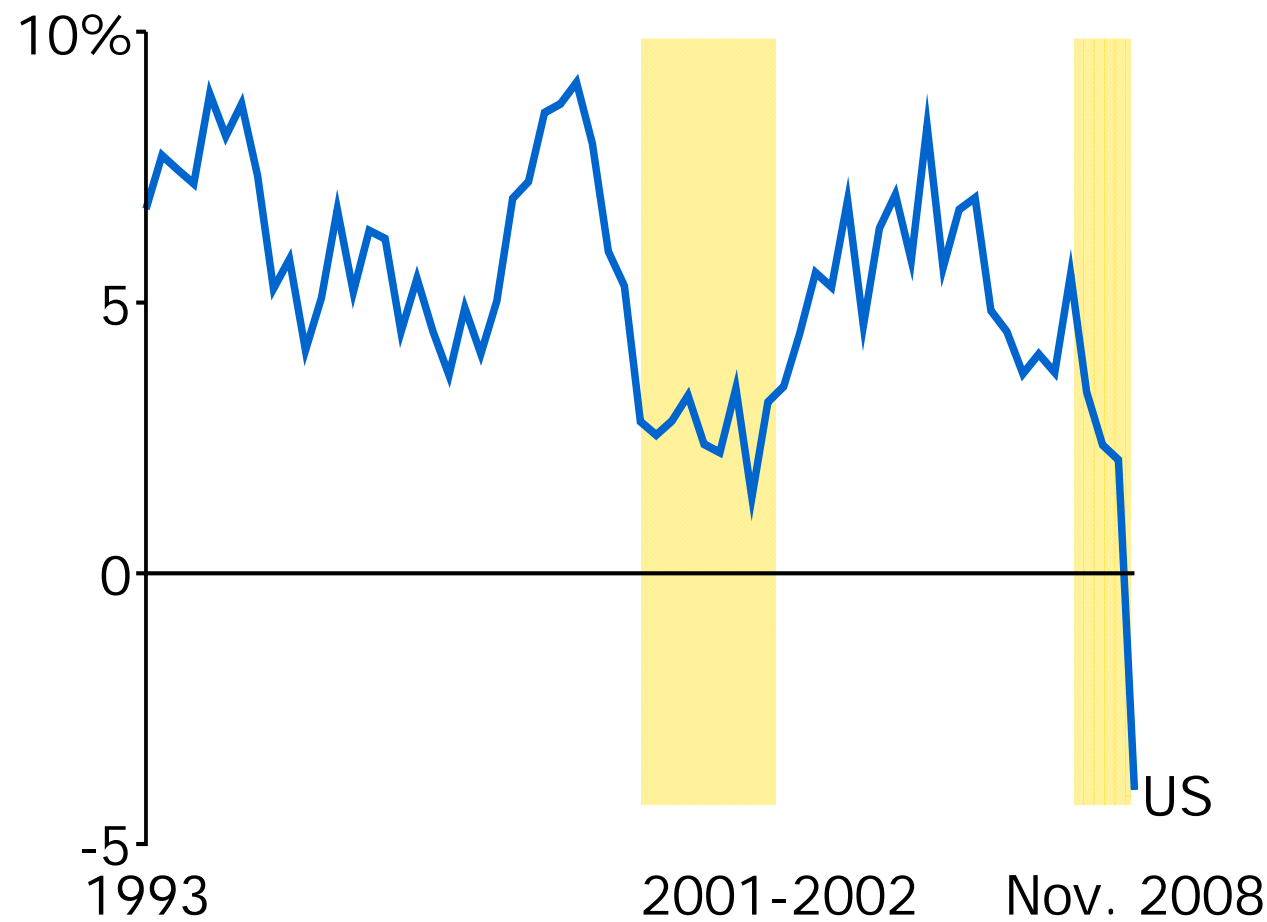
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Cash flow impact is causing consumers to reduce spending: US and UK retail sales in steep decline

United States

United Kingdom

Retail sales growth (% , QoQ growth)



*"For the first time in three years, total **retail UK sales** fell into **negative territory.**"*

British Retail Consortium

 *Global Downturn*

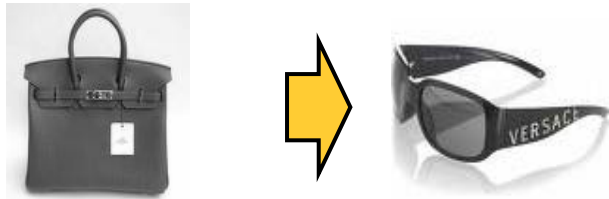
Source: US Census Bureau (until Nov. 2008)

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Consumer spending is reduced in a few key ways

Trading down



Looking for value



Cutting back



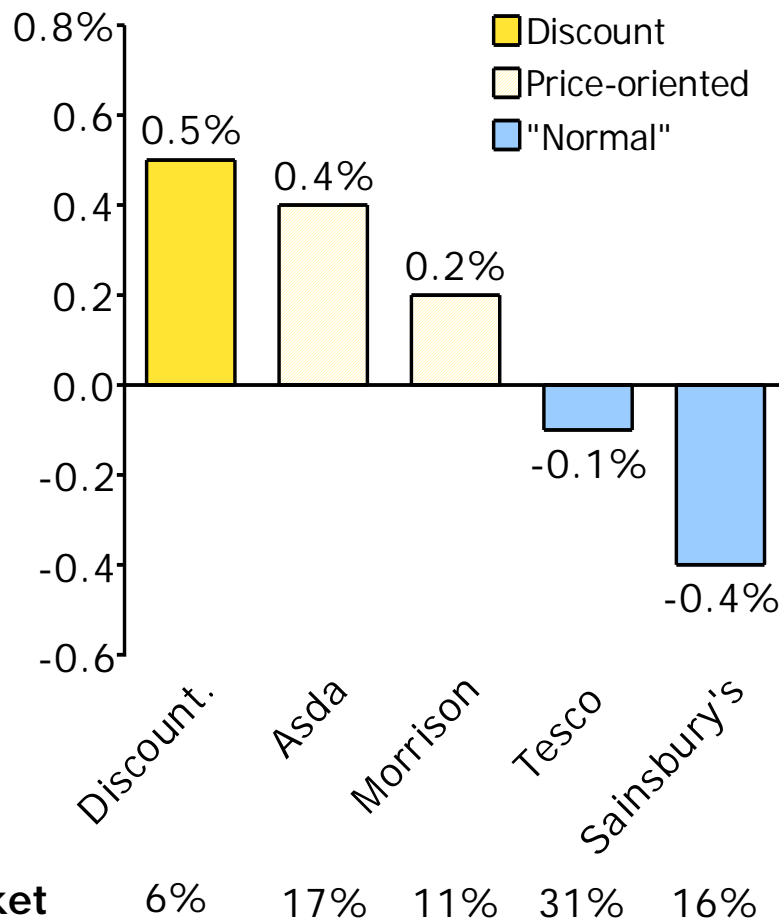
Delaying purchases



Discounters are gaining share in Europe

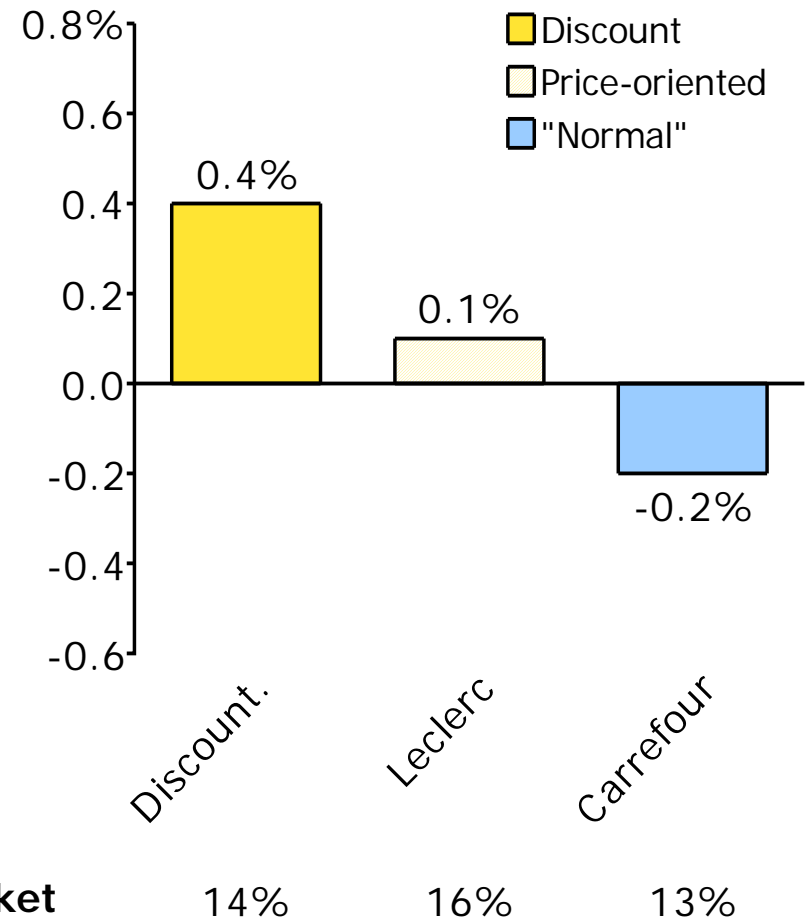
UK Grocery Retail

YoY market share evolution for grocery in UK (as of Nov. 08)



France Grocery Retail

HoH market share evolution for grocery in France (as of H1 2008)



Sources: TNS WorldPanel UK and France

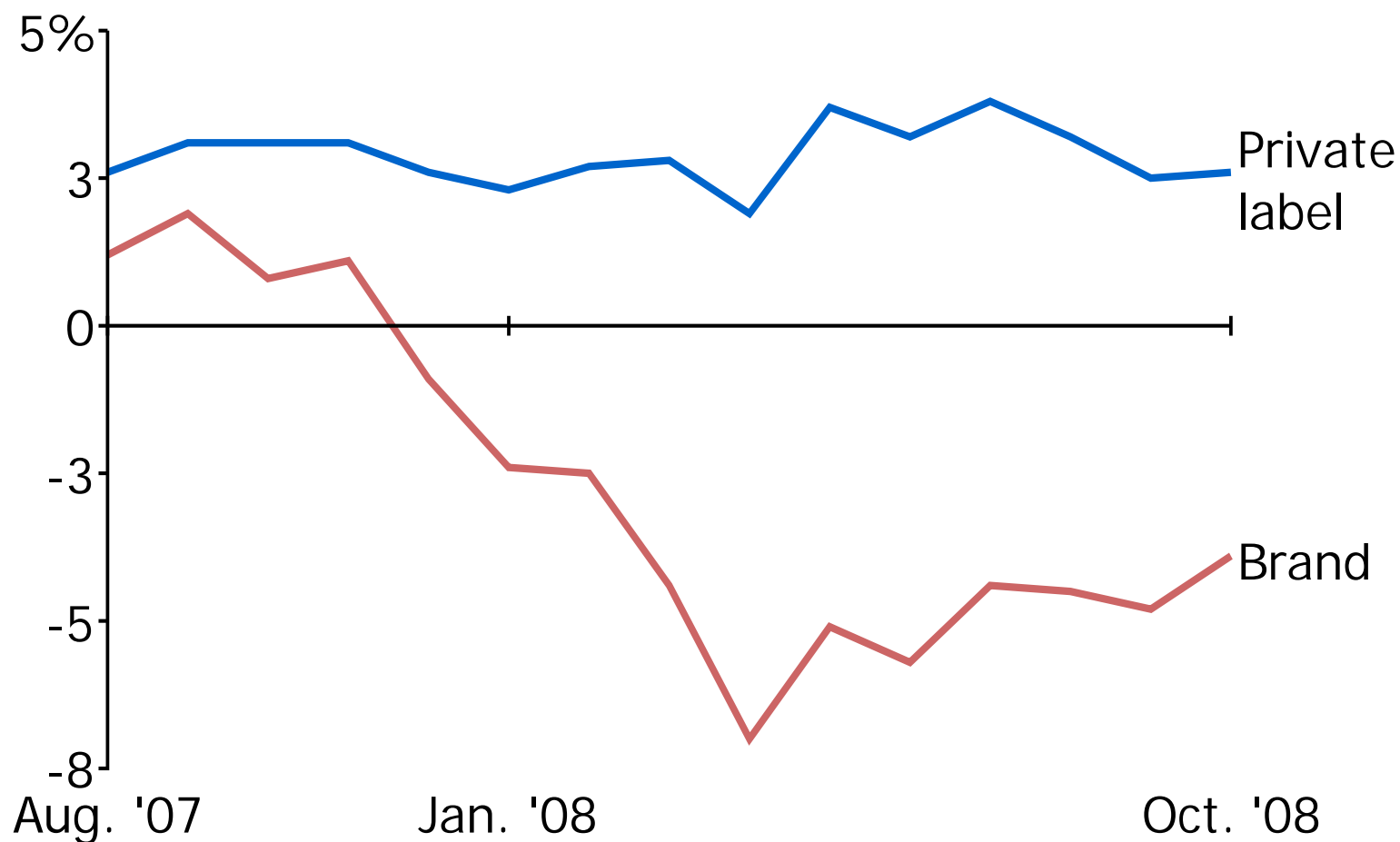
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Private Label products are growing faster than Brands

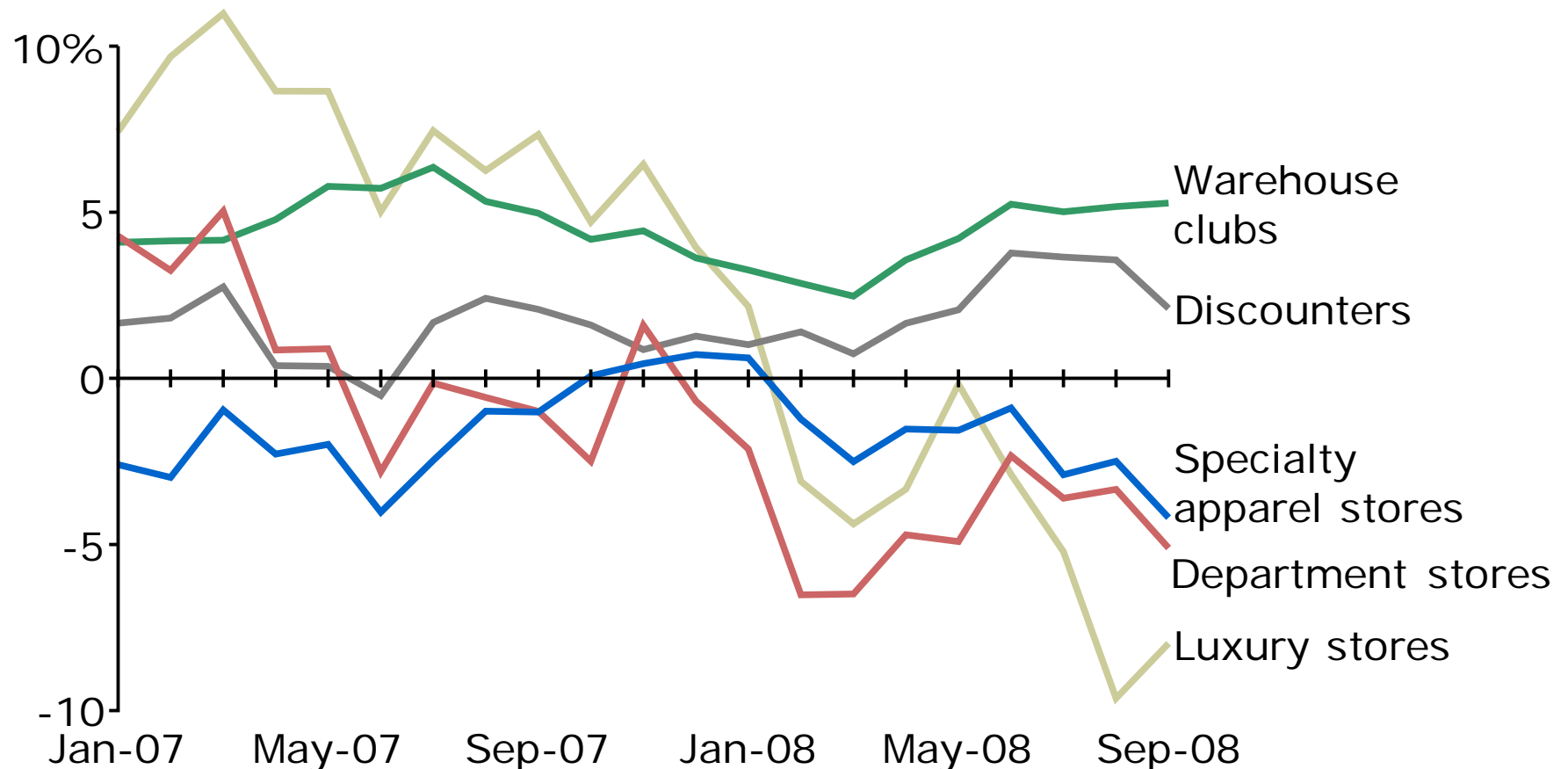
FRANCE EXAMPLE

YoY sales growth,
all grocery categories ('07-'08)



US value-oriented channels are gaining share

Same-store retail sales, 3-month rolling average - US



Note: The 3-month rolling average is based on a subset of retailers within each category and calculated from monthly same-store sales data weighted by quarterly revenues; the data for warehouse clubs exclude the impact of fuel prices for BJ's from January 2007 onward, for Sam's Club from February 2007 onward and for Costco from October 2007 onward

Source: Financo; ICSC; CapitalIQ; MarketWatch; company press releases

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Consumers are looking for value and waiting for sales on branded goods

- Consumers still buying brands, but look for trusted brands with **“proof of value”**
 - Apple iPhone is at a high price point, but perceived as “worth it” (6.9M iPhones sold in quarter to Sep 08*)
- Consumers waiting for sales on name-brand products
 - Top two savings tactics reported by US shoppers (Unilever research):
 - **“Only buy when it’s on sale”**
 - **“Use coupons”** whenever I buy this product”
 - Customers increasingly buying **luxury items at large discounts**
 - Vente-privee.com offers 30-70% discounts to 6 millions French clients



*Combined sales in previous 5 quarters were 6.1M units

Source: Literature searches; Bernstein Research; “Winning in Turbulent Times” (Unilever), Quest France, Nov 08, Bain Study January 2009v2 12

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Consumers are cutting back on non-essential spending

- Consumers are cutting out **non-essential purchases**, particularly in **luxury categories**

- Global luxury goods market to decrease by **3 to 7%** in 2009 (Bain study)



- Strong impact on **food/drink habits at work** (Vault Study, US, Oct. 08)
 - 61% are bringing sandwich from home
 - 28% are cutting back on coffees

"I'm ordering less expensive items from my favourite lunch places."

US consumer

- **Ostentatious wealth is becoming less fashionable**

"In grim times, it becomes distasteful or simply unfashionable to spend money on bling."

Rory Sutherland, Ogilvy

*"It's **now chic to cut back**. People say about their holiday: 'No, we're just spending a very quiet holiday with family' — instead of 'We're going to Anguilla for Thanksgiving.'"*

President of a wealth management firm



Consumers are delaying some large purchases

- Customers are **delaying large purchases, postponing replacements**

"Orders for durable goods, a crucial measure of spending by businesses, declined 6.2 percent in October."

NY Times

- **Car** sales down 32% in the US and 15% in Europe in October 2008



- **Home furnishings** stores down 15% in October 2008 in the US



- **Households appliances** are also impacted



"Some consumers are delaying replacement purchases for appliances."

Whirlpool, Oct. 08

Impacts on balance sheets will last even after the economy recovers



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**Longer term impact:
Harder to predict as it damages
consumer confidence**

Balance sheet impacts will affect consumers with higher asset exposure the most

DEVELOPED COUNTRIES

Retirees



Exposure:

- Retirement income **heavily exposed** to equity markets
- Vulnerable to declines in value of home equity

% population ~20%

% wealth ~35%

Families with mortgages



- **Exposed** to declines in housing prices
- **Depend** on available **credit** (home equity lines and cards) for spending

~40%

~60%

Generation Y



- **Lower exposure** to stock market or to housing equity
- Loss of confidence during downturn, but temporary

~40%

~5%

Note: Based on US wealth distribution by age (Generation Y: under 30, Families: 30-60, Retirees: 60+)

Source: US Census Bureau, Bain analysis

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Some long term changes in lifestyle and workplace participation may emerge

Deferred retirement

- **Older people stay in the workforce longer** to compensate for lost retirement savings



Higher workforce participation

- The number of **dual-income families** may increase, particularly in emerging markets
- A higher percentage of **workers may take second jobs**



Families helping out

- **Retirees may move in with their children** due to reduced savings
- **Children may stay at home longer** due to lack of available credit



The current global crisis poses four questions to consumer goods producers

- How are consumers feeling and changing their behaviors?

- What is the impact on global consumer trends?

- What should companies do to react?

It is still early to predict, but we believe the crisis will primarily impact existing trends, not initiate new ones



- In general, periods of upheaval tend to accelerate or alter existing trends rather than creating new ones
- Long term trends – being long term trends – **shouldn't normally be changed drastically**
 - Some major long term trends in the consumer landscape will be accelerated by this downturn
 - Other trends will continue to be important, but will become more value-oriented

Bandwidth and online information explosion will be accelerated as people spend more time at home

Macro shifts

Ageing population



- Little impact from economic cycles

Increased ethnicity



- Little impact from economic cycles

Rise of the East



- Spending power will continue to shift eastwards, but main GDP growth contributors will slow down

Discretionary spend increase



- Consumer spending power will be hit short term by the recession, but will recover

Global mobility (goods/people)



- Global trade will decrease in the short term, but will recover with the economy

Market freedom/deregulation



- The recession is likely to cause a long term shift towards greater government regulation

Resource depletion/Earth's habitability



- Little impact from economic cycles

Moore's law/
Bandwidth explosion



- Bandwidth and online information explosion will be accelerated as people spend more time at home

Impact of downturn on trend



Decelerated (long term)



Accelerated (long term)



Trend changed in nature



Decelerated (short term)



Accelerated (short term)



Unchanged

These macro shifts are conditioning consumer behavioral and attitudinal trends

Macro shifts

Ageing population



Increased ethnicity



Rise of the East



Discretionary spend increase



Global mobility (goods/people)



Market freedom/deregulation



Resource depletion/Earth's habitability



Moore's law/bandwidth explosion



Core trends

Health and wellness



Consumer experience



Convenience



Consumer conscience



Technology dependence



Emerging trends

Spend polarization



Tribalism



Hiving/Nesting



Individualism



Sensory/indulgence



Post-materialism



Premiumisation



Brand fatigue



Feminization



Consumption caps



Which trends will affect your company's strategy in the short and longer term?

Macro shifts

Ageing population



Increased ethnicity



Rise of the East



Discretionary spend increase



Global mobility (goods/people)



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Core trends

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Impact of downturn on trend



Decelerated (long term)



Accelerated (long term)



Trend changed in nature



Decelerated (short term)



Accelerated (short term)



Unchanged

Health and wellness continue to matter, but at a reasonable price

Pre-recession

- Obsession with well-being
- Switch to "healthy options" (organic, low fat, etc)



Post-recession

- Concern with health and wellbeing, but unwillingness to spend more for healthy products
- "Back to basics" trend:
 - Walk or bike to the office instead of going to the gym
 - Cook 'superfoods' instead of buying expensive healthy pre-prepared meals



Consumer experience will become even more important coming out of the recession

Consumers will try more new brands and products, prompted by the downturn

Brands will have to provide a full experience, preferably at a reasonable price

"Store and brand loyalty are a thing of the past as the size and mode of buying alters shape to suit the times"

The Age

*"The crisis is causing the **consumer to rethink what had become a habit.**"*

Greg Tipsord, Henkel's U.S.

Convenience remains a goal, when delivered at a reasonable price

Pre-recession

- Demand for 'time-saving', well-portioned, portable products, e.g.
 - Ready meals
 - Single-serve
 - 'On the go'
 - Multi-purpose
- Switch to convenient shopping
 - Convenient stores
 - Impulse channels
 - On-line



Post-recession

- Possible **bifurcation**:
 - Unwillingness to spend more for convenient products
 - E.g. buying fruits instead of smoothies
 - Increased demand for time-saving products and shopping channels as people have to work more



Environmental, moral and social values will be important, but consumers may not pay extra for them

Pre-recession

- Environmental, ethical, moral and social values important to consumers



Post-recession

- Consumer conscience remains vivid, but consumers less willing to **spend more** for it
- Popular environmental trends are those that **save money**
 - e.g. saving power and water
- New mantras for 'save the planet' activists:
 - From '**pro-green**' to '**anti-greed**'



Technology will become even more important to consumers, driven by a “homeward bound” trend



- Growth in time and money spent on the **internet**
 - Computer equipment
 - Broadband subscriptions
 - E-commerce
 - Voice over IP
- Growth in **in-home entertainment**
 - DVD, VoD, internet TV
 - Home cinema, Blue Ray players
 - Video games and consoles

The trend to “hive” or stay at home will accelerate mainly during the recession period

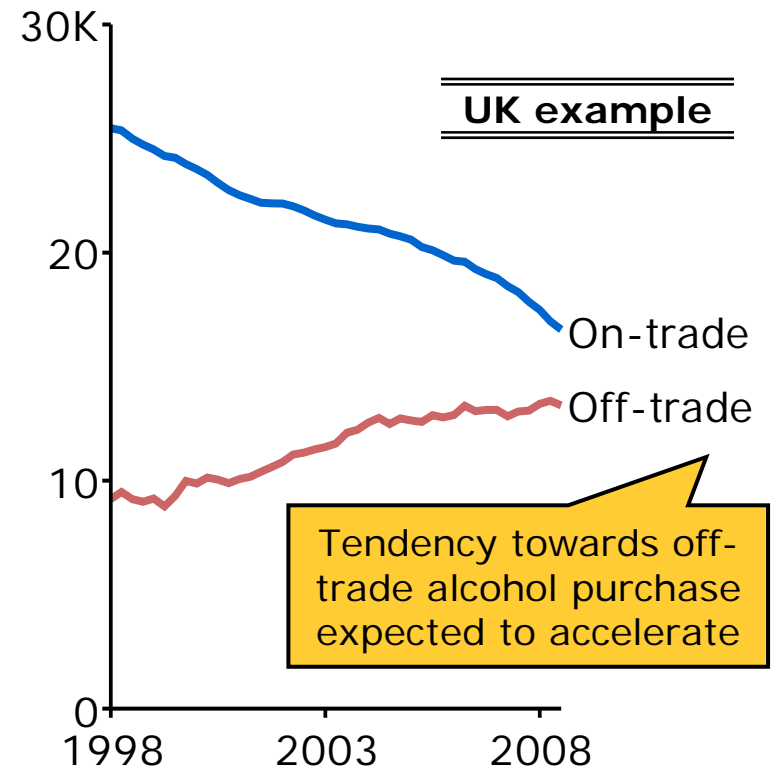
Pressures on cash flow are causing families to stay home more often:

- 73% of US consumers cut back on spending on entertainment, recreation, and eating out (Gallop Poll)
- For 28% of UK consumers, eating out will be the first items to be cut

*“People fear the future, and now with the banking crisis, they are even more afraid... **they buy a bottle at the supermarket and they drink it at home.**”*

Owner, Le Festi'Val bar and cafe

Annual UK beer sales
(rolling average, thousands of barrels)



However as cash flow and confidence recovers, consumers will start going out again

The same consumers will increasingly "polarize", spending on both value and premium at the same time

The trend to
"polarization"
will
accelerate...
with a bias to
more
Discount this
time

- More consumers patronize **Discount** products & channels during downturn
- **Premium** products and concepts remain **attractive** in the long run
 - **Selective indulgence** during tough times
 - **Renewed lifestyle** when economy picks up again



Consumers treat themselves with small indulgences or premium products



- Sales of **chocolate, tobacco** and **liquor** holding in most regions
 - Cadbury sales up 6% in Q3 08
 - BAT sales up 9% in Q3 08 (at constant currency rates)
 - Diageo reported organic net sales growth of 6% in the 3 months to Sep 08
- **Cosmetics** are also seen as an affordable luxury
 - German cosmetic sales increased 6.9% YoY in 2008
- There will still be room for premium products, but they will need to pass the "worth it" test



But Alcohol and Tobacco may begin to decline soon, driven by lower on-trade and Duty Free sales

The downturn is likely to have a limited effect on the remaining trends

Sense of affiliation, tribalism



- Consumers desire to belong to a group or tribe

Affirmation of self, individualism



- Consumers express themselves through what they buy

Brand fatigue



- Consumers develop few emotional relationships with brands

Feminization



- Consumers buy women-only products, or male 'grooming'

Post-materialism



- Consumers derive social benefits through non-materialism

Consumption caps



- In the developed world, basic needs face real 'consumption caps' (e.g. calories or hours per day)

The current global crisis poses four questions to consumer goods producers

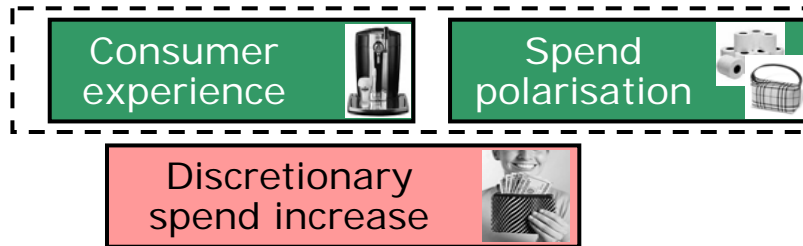
- How are consumers feeling and changing their behaviors?
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Implications of consumer trends for consumer goods producers

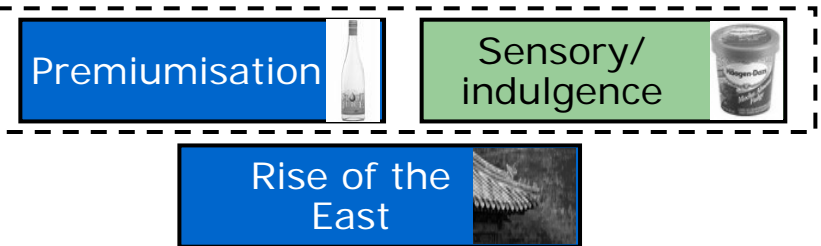
Trends

- Relatively stable:
- Questions on timing/impact:

Right Now



Medium-long term



Implications:

- Continue **innovation** and premiumization of experience
- Continue to work with customers to **transform BTL consumer dialogue**
- Adjust to recession environment:
 - Offer real **value for money**
 - Offers for recession **psychology**
- Once predictable parts of strategy are **now turbulent**:
 - Eastern Europe and Asia no longer the clear 'growth hedge' for the developed world
 - Shift towards greater regulation may impact

Recommended actions:

- 1 Don't lose **focus on innovation** and **in store** activities
- 2 Dust off the "**80s playbook**"
- 3 Ensure you have the **best value proposition**
- 5 Develop **strategy for sustainable growth** that's robust against downside scenarios

Capabilities required:

- 4 Define and rollout **repeatable models** for revenues and costs
- 6 **Build capabilities to win** during real turbulence

The Alphabet Game...

Effort and
resources

A

- Stay the course on innovation and in store transformation
- Start the 80s Play Book
- Drive simplicity-speed through repeatable models

90%

B

- Hedge against deeper recession and declining 'Growth in the East' through greater focus on 'profit hunts'

8%

C

- Continue to ensure that the strategy and business model are robust against alternative future scenarios

2%

Lessons from previous downturns: Winners demonstrated strong fundamentals and adaptability

Winners

- **Strong core business** and deep understanding/appreciation for the sources of that strength
- **Cohesive and aligned** management team with a **clear strategy**
- **Multi-year focus on balance sheet** and asset building
- **Lean and flexible** operating model to maintain investments
- **Embrace turbulence** as an opportunity and demonstrate the **courage to seize it**

Everyone Else

- **Vulnerable core business** and/or insufficient clarity on what really drives success
- **Divisive leadership** and/or **vague sense of strategic intent**
- Consumed by short term effects on **P&L/compensation**
- **High fixed costs** embedded in rigid organization structure
- Allow trauma to **thwart decision-making** and force defensive/reactive moves

FOR MORE INFORMATION

For more information on Bain & Company's 'The Consumer of the Future' research study or media inquiries, contact:

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