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What's in store?

Business insight for the retail and consumer sector

Welcome



Welcome to the first issue of *What's in store?*, which we hope will become a regular feature in the future. *What's in store?* is dedicated to the retail and consumer sector, you'll find articles here that focus on some of our latest research, explore new and emerging trends, and share some of the insights we've gained through working with leading companies in the industry.

If you have any comments, suggestions or queries please contact Jillian O'Grady on jillian.ograd@uk.pwc.com

We're certainly launching the magazine at a challenging time. The UK High Street is heading into the most difficult Christmas it's seen in at least 20 years. House prices are falling, unemployment is rising, and recession is now a reality, in fact, consumer confidence is probably as low as it's ever been. It's no surprise to find that people are cutting back on discretionary spending, and trading down. Companies are planning for lower sales, and if past experience is anything to go by, this may well become a self-fulfilling prophecy. Most market commentators are now predicting that 2009 will probably be at least as bad as 2008.

The economic cycle has shifted from the threat of recession to the reality. Facing up to the new economic challenges requires a different mindset and approach which may be alien to many people whose careers began after 1993. Research from previous recessions suggests that the winners are likely to be those retail and consumer businesses with strong or differentiated brands who continue to focus on their customers and adapt their business models to new levels of sales. The thriving value sector has emerged from the last recession, who knows what new business models will be sparked by this one?

In this edition of *What's in store?* there are several articles that will help you to win in these tough times. We look at what happened in the early '90s for insights, we examine how you can protect your top line by getting more out of trade investments, and we offer some timely advice on managing for cash in a credit crunch. There are also articles on retail in Russia, the key security issues for the sector as well as looking into the impact the downturn has on the people agenda.

We hope you enjoy this first edition. We value your input and comments. Please contact us with feedback, or suggestions for subjects you'd like to see us cover in future. In the meantime, don't forget that we have hundreds of consumer and retail experts in the UK, who can support you on every aspect of your business. As times get tougher, we're here to help.

Happy trading

Mark Hudson
Head of Retail and Consumer

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PwC's wide range of retail and consumer experts are on hand to answer your queries



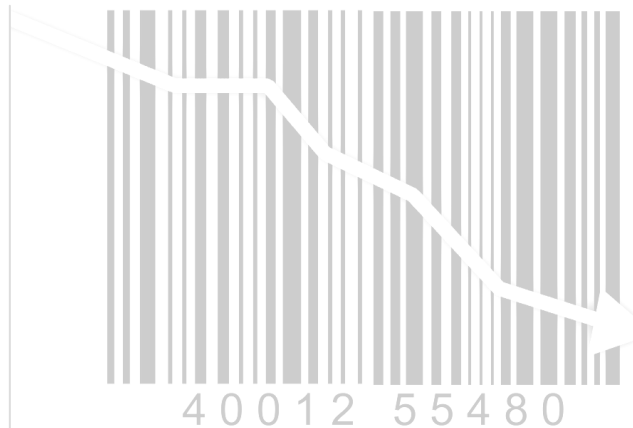
As recession looms, we look at how the UK High Street is...

Dealing with the downturn

According to the old saying, the only certainties in life are death and taxes, but many economists must be tempted to put 'periodic downturns' on the same list. Just when we thought boom and bust might be gone for good, the consumer-led growth of the last 15 years is now falling victim to the global credit crunch. The PwC Strategy team has just finished a major study using original consumer research, to see if there's anything previous recessions can tell us about what might happen this time, and how we might identify the businesses and segments that are fittest to survive – and thrive – as times get tougher.

The team began by looking at the three recessions the UK has gone through in the last 40 years. The downturns in the mid '70s and early '80s were largely the result of political and industrial factors, but the recession of the early 1990s stemmed from a sharp slowdown in consumer spending, and falls in the housing market, making it the most useful benchmark for what's happening now. So were there lessons to be learned which might still hold true now, and what might be the impact on the current downturn of the quite radical structural changes in the UK retail and consumer sector we've seen since then?

The early '90s are a dim and distant memory for most of us now and there's a whole new generation of retail managers who've grown up since then. The sectors that were hardest hit at that time were either big ticket items like cars, furniture and large household appliances, where purchases could easily be delayed, or very discretionary spending, such as holidays, and leisure, where consumers could either cut back entirely or switch to cheaper alternatives. It was the discretionary spending that rebounded most strongly after the recession, while the big-ticket items recovered more slowly. The categories that proved the most resilient included predictably enough food, clothing, and personal care. So what's happened in all these sectors since then? Should we expect a similar pattern this time, or has the High Street altered so much that the outcome will be quite different?



The new retail landscape

In fact, the shape of the UK retail market has changed out of almost all recognition in the last 20 years. As **Olivia Gillan**, the partner who led the project, says, "there are at least six major trends that have completely transformed the sector since the early '90s, and some of them will have a direct impact on how well certain categories cope with the downturn this time."

One of the most obvious is the emergence of a new and dynamic value sector, which offers more competition, and more choice. Another is the extraordinary growth of internet shopping, and the evolution of specialist online 'e-tailers', as well as substantial online operations by the more conventional operators.

There have also been economic and market factors at work including prolonged price deflation in sectors like electricals and changes in the supply structure for categories like DIY as well as more intangible shifts in lifestyles that have seen some discretionary spending becoming more 'essential', and vice versa. In the rest of this article we look in more depth at three sectors where the combined effect of these changes has had a significant impact: clothing, groceries, and restaurants.

Off the peg

In clothing the single most important change in the last 15 year period has been the rise and increasing dominance of the value and supermarket sector, which now holds five places in the top ten womenswear retailers. Their remarkable growth is not just down to price, but the fact that it's become not only acceptable but downright smart to shop there. No-one minds being seen in Primark, and even celebrities are mixing designer labels with cheap High Street chic, as previously more mass market names like TopShop have recruited the likes of Kate Moss to bolster their brands.

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'Fast fashion' is another facet of the same phenomenon. With more clothes being made in low cost markets like China, it's become possible for retailers to break the old pattern of two collections a year and offer new lines fresh from the catwalk on almost a monthly basis something that's made even easier by online shopping sites, and the clever use of internet marketing. It's not quite 'throwaway' fashion but it's been so cheap that consumers have got used to having something new on a regular basis, without feeling guilty about the expense.

All this makes the consequences of the downturn even more fascinating. Some might argue that fast fashion is nothing if not expendable, and will prove a very easy candidate for consumer cut-backs. Likewise, costs are rising in China, which will put pressure on retailers on the supply side, just as demand is dropping back. This, coupled with adverse exchange rate movements could result in a tougher and lengthier downturn for clothing this time round. "On the other hand", says Olivia Gillan, "we also found that some of the bigger winners in the early '90s recession were names like Matalan and New Look, because they really understood their customers and targeted them effectively. It proves how important it is to keep focused and flexible."

A good example of both might prove to be Zara, the doyen of fast fashion, whose unique business model is based on the exceptionally rapid turnover of small runs of their own designs. Sell-outs are commonplace, but quite deliberate, since they drive up demand and create buzz about the brand. Likewise their internal information systems are so efficient that they can test out particular lines, and produce more of those that sell well.



Food for thought

Grocery has traditionally been more immune than most to the worst effects of a downturn, but many of the trends we've observed in clothing are also operating here. In the early '90s food retailers were cushioned to some extent by the fact that there was still plenty of scope to buy growth by opening new stores, and significant savings to be had from operating more efficiently.

In 2008 food retailing is a very different place. Not only are the major players seeing most of their growth coming from non-food items like clothing, but it's a highly consolidated industry, with a small number of very big players who run extremely tight ships in terms of cost and waste. In 1991 the biggest five supermarkets taken together held 43% of the market; by 2007 that figure had grown to 79%, and Tesco had over 30% on its own.

Likewise there's now very little opportunity to build large new stores. Food retailers across the board have had to contend with rising inflation, while the mainstream operators are also being squeezed by the growth of discount operators like Lidl and Aldi, which now hold a 6% share of the UK market.

Another trend to watch is the impact of different price ranges within the same store. Back in the '90s the price stratification of the market was much more clear-cut, with Waitrose and M&S at the top, Sainsbury's in the middle, and Tesco and others like Asda and KwikSave at the bottom. Now there's considerable and deliberate overlap between these tiers. These days there are quite dramatic differences in both price and quality between ranges like Tesco's 'Finest', Somerfield's 'Best Ever', and Sainsbury's 'Taste the Difference', and the rock-bottom own-label lines marketed by the same supermarkets.

This may make turnover (if not margins) more resilient, as consumers can trade down to cheaper products in their usual shop, rather than making the more radical psychological decision to take their business elsewhere. Indeed Sainsbury's Basics range is growing at an extraordinary 20%, and the store will be re-launching its own label range this autumn, while Tesco is running banner ads on the internet that push the savings to be made by buying their own-label alternatives, rather than household names. However, switching to cheaper ranges may depress like-for-like sales growth rates.

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On the menu

The restaurant sector was one of the biggest losers in the early '90s, with real consumer spending down over 10% between 1991 and 1994. But like clothing and grocery, there have been enormous structural changes in the last 15 years, which make it difficult to make accurate predictions this time, compared with previous downturns. In the early '90s eating out was still an expensive treat, confined to the well-off or special occasions, and as a result there were few operators in the middle ground between fast food on the one hand, and gourmet on the other. It's this middle ground that has grown exponentially since then, with a huge choice of different brands aimed at the casual dining market. Names like Nando's, Prezzo, Carluccio's, ASK and Wagamama have developed successful formats and menus, and can rapidly roll them out.

As a result a restaurant meal has become an everyday indulgence, accessible to almost everyone. In fact the number of people eating out at least once a month has grown from 22% in 1989, to 66% in 2006. This could be an important factor in the downturn this time round. Our study showed that restaurant spending is still one of the most vulnerable to cuts in discretionary spending, with 43% of consumers citing it as the first or second thing they would trim.

On the other hand, if restaurant spending is becoming less and less discretionary and more integral to contemporary lifestyles, these new eating habits may have become so ingrained that they'll prove hard to break. At the very least they may kick back in again quite quickly when the economy starts to turn round in contrast to the prolonged downturn they suffered in the early '90's. In the short term, one aspect to watch in particular is the impact on margins from the use of promotional vouchers. Such activity is widespread at present.

Looking ahead

So what conclusions have the PwC team drawn overall? Are we any clearer about what this downturn might hold, and when it might end? Up until recently, there were some good signs, with consumer spending still growing (albeit more slowly), employment holding up, and interest rates low. However, according to most economists, we are now in a recession. The housing market is showing hefty and very public declines, consumer confidence is falling, credit is tight and getting tighter, household debt levels are high and unemployment is rising.

There's no question that the current environment is tough and volatile. What's more crucial is how long this will last, and how quickly the sector might recover: in the early '90s it took three years for consumer spending to get back to its previous levels. It's hard to say whether this will be a good model for what we're seeing now, but it seems unlikely that we'll see a significant recovery in the immediate future, and most retailers are planning for a downturn that extends as far as 2010.

No-one can predict exactly what will happen this time, but there are still some useful lessons we can learn from the early '90s. As Olivia Gillan says, "One factor that's just as important now as it was then is the idea of value for money. People will only pay extra for something if they think they're getting a good deal, and today's consumers are even more discerning, and shopping around is much easier, especially online. Different consumers will also react in different ways. Some will buy fewer items, or make the most of sales and promotions; others will trade down to cheaper alternatives or other retailers.

That's why working out where you are in the 'food chain' is really important: you need to be clear which customers you might lose because they're trading down away from you, and who you could gain because they're trading down towards you. Understanding and targeting your customers is more vital than ever." Examples of companies that seem to be doing this well so far are those like Selfridges, who have an acute insight into their all-important tourist shoppers, or Asos, who've carved out a profitable niche in the 16-24 year-old clothing market, which is increasingly dominated by online sales.

And to close, one final thought from Olivia Gillan: "In recessionary times it's crucial to keep investing in your stores and your brand. If you need to restructure your retail estate or dispose of unprofitable stores, now's when you should be looking at doing that. It may sound counter-intuitive, but a downturn is always a good time to take brave decisions."

Sticking to the knitting: four key factors that could help you ride out a recession

- **Understand your customer** and give them what they want
- **Make sure that what you're offering is value for money**, whether that's through competitive pricing or by justifying a premium
- **Be ultra-efficient**, both in how you manage your store portfolio, and control your supply chain
- **Avoid the undifferentiated mass market.**

It's not just the banks that are finding that...

Money's too tight to mention

With the wholesale money markets all but closed for business, and three-month libor rate is still trading above the Bank of England base rate, the retail and consumer sector is facing a tough time getting and affording debt finance. We talked to **Richard Boys-Stones** and **Chris Tilbrook** from the PwC Business Recovery Services team, about the new shape of the debt market, and what you can do to make your business fitter for finance.

We've all read the new stories, but what changes are you seeing in the debt markets at the moment?

Most of the press coverage has been pretty accurate so far - raising new finance is difficult for everyone, and even rolling over existing facilities is proving problematic for some companies. Most of us have never seen markets like this before on either side of the fence and no-one is quite sure how things will pan out in the medium term.

Clearly there will come a point when the banks are willing to lend again, but that could be some time away, and the key for many smaller businesses will be how they can survive through the interim period.

And even if the Government's cash injection is successful and market conditions do ease, most people are expecting new rules to apply. It's likely we'll see a 'back to basics' approach to lending from the major banks, not least because so many of them are now effectively nationalised, and will have the Government to answer to for future losses.

Businesses should probably anticipate a return to more traditional and conservative lending criteria with the highly leveraged structures common in the boom becoming a thing of the past.

What's been the impact so far for retail and consumer businesses?

It won't surprise you to hear that this is one of the sectors that's been hardest hit. A lot of lenders are looking for ways to shrink their lending book, and cut back their exposure to specific industries, and retail is certainly high on their list. In some other sectors this would mean crystallising their losses, which the banks are understandably reluctant to do, but in the retail sector there's a natural low point in the cycle where they can reduce their exposure simply by deciding not to extend any further credit. In the UK as in many other similar markets the highest demand for working capital is in the two or three month run-up to Christmas, and this then drops dramatically in December and January as the cash comes in, and the banks can be repaid. This means that for most retailers and especially the weaker ones the danger point will actually be early next year in the quiet trading months when their banks may be reluctant to support them with new cash for another cycle.

There are also other knock-on effects from the current state of the market, all of which will impact on retail and consumer businesses. For example, at one end of the scale, the private equity firms have far less appetite for the sector than they did even a year ago and this has been compounded by the impact of the Icelandic financial crisis on a number of private equity investors in UK retail, while at the other, suppliers are sticking strictly to their trading terms.



What about the asset-backed lenders?

This has always been quite a specialised market, and there are really only three or four big players who have the expertise to lend against stock. We're assuming that these lenders will be more cautious going forwards, and they can afford to be choosy as there are now so many other high-quality opportunities in the market, as the traditional banks pull back from sections of lending that are ideally suited to an asset-backed approach.

The other thing to bear in mind is that many of these specialist lenders also rely on the wholesale market for their funds, so they may well be facing the same constraints on capital as the major banks.

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It's not just the banks that are finding that...

Money's too tight to mention

There's also been press coverage about some big high street names losing their trade credit insurance cover – are you seeing evidence of this?

We've certainly heard that some of the bigger trade credit insurers are looking to reduce their exposure to the UK retail sector, which is particularly significant when you bear in mind how reliant many retailers are on this source of funding. The other thing we often remind our clients is that a trade credit insurer can be one of their most important stakeholders, and needs careful management and a lot of senior executive time.

Keeping their confidence is crucial, because if they do change their stance on your company it can have a massive impact on your cash flow in a very short time. After all, their own business model is under new pressure at the moment, and as unsecured creditors it's understandable that they should be looking to manage down their risk in the face of reduced returns.

What should retail and consumer businesses be doing now to make their businesses more recession-proof?

The short answer is be in control of your own destiny. Don't rely on others to deliver your strategy, don't assume the funding will necessarily be there when you need it, and don't expect the market to bale you out.

Manage within what you yourself can control, and manage for cash. That's a phrase that has rather gone out of fashion in the last few years, but we're all facing a radically different environment from what we've lived through for the last 15 years, and market conditions that most managers will never have experienced. It may prove to be a temporary blip, but it's safer for everyone to assume it'll be a lengthy downturn, and plan accordingly.

Money talks: Cash is king in a deep downturn

Focus on getting cash in the door, even if that's at the expense of margin and profit

Understand where the cash is really generated in your business – and where it gets spent

Manage the need for new bank funding down to the absolute minimum

Put a 13-week rolling cash flow forecast in place, and stress-test it regularly

Develop contingency plans for how you'd cope if things don't go as expected – don't leave it to the last minute

Explore other ways to release cash and value from the business

PwC believes that that the businesses that will emerge from the downturn agile and fit for the future will focus on '10 Fundamental Priorities' – visit PwC's dedicated website which provides more information and views on the current economic climate:

www.managinginadownturn.com



You may think you have it covered, but...

Just how smart is your security?

'Lax standards' on data security, Customer data sold on eBay, Firm 'broke rules' over data loss, Review in wake of missing package. We've all seen the headlines, and we've all thought (if we're really honest) that 'there but for the grace of God'. Security issues like this are affecting organisations up and down the UK in both the private and public sector but are there some common themes linking these high-profile but apparently unconnected events? And are there lessons that the retail and consumer sector in particular can learn from them?

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Just how smart is your security?

Steve Wright, Senior Manager in the PwC Security team, has been working in risk and security for over 15 years, and his experience shows that there is indeed a common factor underlying all the recent security lapses, the lack of a joined-up approach.

"It's a cliché, but your security chain really is only as strong as its weakest link. Each time we have one of these scare stories in the papers, firms and organisations rush to check their own procedures in that particular area, but what they often forget to do is review how the whole system fits together. Checking that your contractors' practices are as secure as your own employees' is an obvious example."

The starting point for any review like this is one key question, who takes ultimate responsibility for security in your business?

This may seem a rather obvious point to make, but it goes to the heart of some important trends in risk and security, which lie behind many of the recent and very public lapses. Ten years ago a company's security department concerned itself with protecting physical assets like people and buildings. Risk Management looked after issues like health and safety and brand protection, while I.T. was tasked with safeguarding the systems. Not any more. As the pace of technological change quickens, these three areas are fast converging.

In fact the security risks most businesses face are now so complex and sophisticated that departments as diverse as Governance, Audit, Legal, and HR all have a role to play, and a responsibility to assume. 'Virtual' risks are now staggeringly diverse, ranging from identity theft to cyber-terrorism, but physical risks have also proliferated, and now include counterfeiting, kidnapping, as well as good old-fashioned fraud and industrial espionage.

It's getting harder and harder to have a complete picture of the risks the business really faces, and ensure that nothing is falling through the gaps (whether that's a disk, a memory stick, or something just as important but rather more intangible).

Even companies that have audited their security procedures may find that they're not as well protected as they'd assumed. In fact an audit can sometimes induce a false sense of security, because some auditors will focus only on certain specific aspects of the security chain. As Steve Wright observes, "I've found that Internal Audit tend to home in on detailed procedural things like access controls, while external auditors concentrate on wider issues like governance. Yet again, the risk is that cracks open up between the two."

Open all hours?

As you might expect, some security risks are particularly acute for the retail and consumer sector. Credit card and ID fraud are obvious examples, especially now that 5p in every pound spent in the UK is now paid over the web. There's been a 34% rise in internet shopping since 2001, and the total now stands at more than £19bn per year. Specialist online operators like Amazon are growing their market share, and even mainstream retailers like the major supermarkets expect anything up to 40% of their revenue growth to come from e-commerce over the next 3 years.

But if the rewards are significant, the risks are too. Big names like Tesco or Sainsbury's have spent many years and many millions developing trusted brands, and place increasing importance on building loyalty with their regular customers, but a significant breach in security could destroy all of that in a matter of minutes.

Consumers assume that the names they know will have foolproof websites that are 100% secure, but they're just as intolerant of clunky online operations that are slow or cumbersome to use, and it's the retailers who have to bridge the gap between security and speediness.

So what can you do? How on earth do you tackle a problem that seems bigger and more complicated the closer you look at it?

Steve Wright's first advice is not to panic. "Panic measures are rarely the right ones, in my experience. And even if the issue looks vast and seems to be constantly changing, remember that what you're protecting remains the same as it ever was, your people, your physical assets, and your I.T.

You need a cross-functional framework that can handle each of these effectively on an individual basis, as well as making the crucial links between them. Start by reviewing the roles and responsibilities of all your risk and security staff, and ask yourself how joined up your overall approach is. Is it really fit for purpose?" As Steve says, one key factor for any effective security framework is the ability to get the right information at the right time, so you can take pre-emptive action quickly if you need to, and spot potential problems before they happen.

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Just how smart is your security?

Likewise, any security operation needs to be comprehensively reviewed on a regular basis, to take account of new threats and avoid the risk of stagnation and complacency. "At the end of the day Security is a service to the rest of the company, which is why clear service level agreements and robust KPIs are such a good discipline.

They're also a very good way of ensuring that security is always aligned to the basic objectives of any business, which are growth, increased revenue, and operational efficiency. That's where the real value is."

The last point to make might appear to be another cliché, but it's surprising how often it's overlooked. At the end of the day, security is an attitude of mind. Everyone in the business not just people like store detectives or those who handle sensitive data needs to think and work in a way that respects and reduces risk.

There's a lot you can do to help that happen, especially when you back it up with incentives, education, and targeted training, but changing culture and behaviour is a slow process, and there are no easy short-cuts. That said, however complex your security risks are, the central message is broadly the same and always has been.

A recent Radio 4 programme asked Jean Valentine, a code-breaker at the top-secret Bletchley Park operation during the war, what she made of the latest wave of security lapses, and her response was refreshingly straightforward: "It's basic. You look after things. If you're put in charge of them, you look after them."

Countering the counterfeiters

Counterfeiting has been a problem for high-value consumer goods companies for at least 20 years, but as technology has got cleverer the fakers have got much better at it. Gone are the days of the wrong shaped bottles or spelling mistakes on the label. Even brand protection specialists now struggle to distinguish the real thing from the copy, which makes tackling the problem that much harder.

And it's made all the more complicated when you add in the cultural and legal factors at play in many of the developing markets where the problem is endemic. In places like China and India counterfeiting doesn't attract the stigma attached to it in Europe or North America, and the legal framework is much less stringent. For example, few developing countries have anything like 'trading standards', and manufacturers have to develop good working relationships with local law enforcement if they're going to make any headway.

Premium drinks brands have always been a magnet for counterfeiters, and the International Federation of Spirits Producers is particularly active in this area, working with individual manufacturers and distributors. Many of the biggest drinks companies have already recognised that what's true for security in general is especially relevant here. You need a coherent and joined up approach that brings together every aspect of your operations, from country managers, to security, to risk management and brand protection.

Top tips for dealing with data

Data protection is always a crucial area for retail and consumer businesses, and one where it's particularly challenging to keep up with the latest developments. Steve Wright recommends doing a comprehensive review of your data management processes, starting with some fundamental questions:

1. Where's your confidential information being held? You need to look at the whole data life-cycle here, and take into account off-shoring, outsourcing and third parties. This is particularly important if you trust a third party to 'dispose of' or 'cleanse' your data equipment, this is where one major bank recently got caught out.
2. How is the data being used? For example, how is your most treasured data being encrypted or protected during transit? And what happens to back-up tapes that are taken off-site?
3. Who's accessing your data, and why? If there's any suggestion that it's being used for anything other than genuine business reasons, have a look at the access log, as this may flag up any unusual activity.
4. What's the best way to prevent your data from being lost? This includes what you should do if data is actually lost. For example, what would your CEO say to a journalist who'd heard a rumour your business had suffered a major security lapse? How you deal with these crucial first minutes is vital to safeguarding customers' confidence. And if you do have a major problem, which of your different security teams need to be involved, and how well tested are your incident response or crisis management plans?

As the going gets tough, the shrewd operators know it's even more important to...

Make the top line the top priority

Even in good times growth is hard to get. Profitable incremental growth is even harder: after all, there's good growth and bad growth. No-one's interested in short-term gains at the expense of long-term profitability, but there's always the temptation to sacrifice margin for market share, especially in the face of an economic downturn. But it doesn't have to be that way. Even in challenging markets like these there's plenty you can do to grow your top line, and protect your profits at the same time.

Steve Sinclair is one of the more recent additions to the Revenue Growth team at PwC, having worked in both consulting and industry, most notably as Marketing Director of Boots. His team are working with a number of major companies to help them grow their revenue, and make their sales operations more effective and efficient. As anyone who's ever worked in marketing knows, it's easier and cheaper to keep an existing customer than it is to get a new one, but many companies still seem to put more time and money into marketing than they do into customer management.

Long-term and sustainable revenue growth is about putting the customer at the heart of everything you do, and tracking how effectively you're doing it. With the evolution of new channels and the disintegration of traditional buying patterns, there needs to be an even greater commitment to the customer, shared across the whole organisation, especially in the face of what could be a prolonged downturn.

As Steve Sinclair says, "We specialise in helping companies get and use better market, customer, and competitor insight. This will show them where their real opportunities lie – and how to seize them." Armed with knowledge like this you can focus your limited resources to make maximum returns. You can streamline and redefine your sales operation, and make smarter choices about the channels you use. You can even shift the emphasis from the profitability of your products to the profitability of your customers, so that your investment can be targeted towards the ones worth chasing.

And that doesn't just apply to business-to-business selling. One High Street retailer has not only upped its profits but drastically cut the number of expensive catalogues it mails out, simply by understanding who its most valuable customer groups are, and what they're most likely to buy.

One of the ways that the Revenue Growth team helps clients to surface and then address these issues is through their rapid commercial review. This diagnostic style process scrutinises a businesses sales, marketing and service functions and compares them to the teams in depth understanding of practice in leading organisations, highlighting the areas of weakness for targeted improvement effort.

One such area and a key focus for the team has been trade investment. These can often be the Cinderella of the marketing budget, or worse still a black hole of expenditure that no-one really understands. It's hard to believe but a staggering 18-23% of consumer goods companies' revenue typically gets spent here, most likely in the form of payments made to retailers to display, discount, and promote a company's products, including offers like '3 for 2', or 'Buy one get one free'. The sums involved aren't just a huge cost to the business, but a potentially enormous opportunity, but all too many companies have little or no idea how this money is really being spent, or what they can do to get a better return. And in the teeth of a recession, getting better value for money here is even more vital, and could even make the difference between survival and success.



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As the going gets tough, the shrewd operators know it's even more important to...

Make the top line the top priority

"We support producers and suppliers to work more actively with their retail customers to analyse what they've actually achieved with their money," says Steve Sinclair. "We analyse which investments have worked, why, and with whom. Adding discipline, transparency and accountability to the process allows businesses to focus on what's profitable and cut what's not." The key stages of the process are developing the strategy, designing the right processes, making best use of technology, establishing robust policies and controls, and finally, what Steve Sinclair calls 'test, measure and learn'.

The results can be quite a revelation, especially for businesses that have never undertaken an in-depth analysis of their trade investments before. For example, the answer for one major food company was to sharpen up its control and compliance processes, and as a result it's now getting far more value and measurable value from the £4m it's paying to one of the big five supermarkets. Another was doing different promotions with two or three different retailers, but had no idea which were working, and which weren't.

Proper evaluation helped them sharpen up their approach, and target it more effectively, adapting their activities to the customer base in each outlet. Likewise a food supplier involved in supplying the raw materials for special offers like the M&S 'Dinner for Two for £10' needed to have a very clear idea about how much they were contributing, and how much value they were realising from it.

The lessons here are obvious enough. Trade investments may be an unavoidable fact of life for companies who supply the major High Street retailers, but that doesn't mean they can't be managed more effectively, and make a much bigger contribution to the bottom line.

Case study: Quality, not quantity

The Revenue Growth team worked with one household name who spent over £40m on over 1,000 different promotions in 2007. However, a thorough analysis of a wide sample of promotions showed that the contribution they were making was much less than the company either expected or realised.

In fact, on average those assessed had a negative impact on profits once support costs were factored in.

There were a number of specific factors that were contributing to this. For example, many promotions were not confirmed until a short time before they were due to start, which made both production planning and implementation much more difficult. The company were also out of step with their competitors and the demands of consumers in their reliance on deep discount and 'BOGOF' promotions, and their much lower use of multi-buy offers.

The key recommendations that came out of the PwC work included negotiating better payment terms for some sorts of promotions, reducing the overall number of promotions by applying more rigorous financial criteria, re-balancing the number of BOGOF and half-price deals, developing a longer-term promotions calendar, and improving the company's processes in a number of other key areas, including its reporting systems. The result? Not only a sharper and more effective approach, but annualised savings of over £4m, or 10% of the total spend.

As more and more companies face up to the realities of a recession, now's the time to think about...

Managing your people costs in a downturn

Your people may be your greatest asset, but in a downturn they're also a significant expenditure. This is especially true for retail businesses, which will not only feel the effect of a recession far more quickly than some other sectors, but also tend to have proportionately large numbers of employees. Most UK companies are already starting to look at ways to cut their operating outlay, but there are also some very real benefits that could come from a more rigorous and flexible approach to the whole range of costs managed by HR.

According to **Stephanie Phizackerley**, a partner in the PwC Human Resource Services team, some of the country's larger companies are already starting to look much more closely at this area: "Most companies see redundancies as a last resort, but if you're forced to take that course, then it's important to manage the process in the right way, not least because the tax consequences can be quite significant if you get it wrong.

But there are lots of other savings companies can look at before things get to that stage, ranging from flexible approaches to benefits and pensions, to new incentive structures that reflect the realities of the environment businesses are now operating in."

A number of companies are introducing or reviewing flexible working policies and extending part time or fixed term working to a wider workforce. You could also open up opportunities for shorter working days, offer unpaid leave, and career breaks which provide greater flexibility without additional costs. Others have extended the flexible working concept further and linked this with formulating more robust controls around dealing with absenteeism.

There are opportunities to restructure the provision of benefits in order to make them tax and NIC efficient. "We're already seeing more companies offering benefits by way of salary sacrifice arrangements for example, in relation to pensions and childcare vouchers. This saves employer's National Insurance costs on the proportion of salary the employee has effectively given up in order to receive the benefit. These savings can also be shared with your employees."



Many employers are also reviewing their company car scheme. This is an area where green concerns and cost imperatives are definitely converging. Encouraging staff to choose and use more environmentally friendly and economical cars at the same time as delivering these in a more cost and tax effective way is a great win-win on both agendas.

Companies are looking at their international postings. Since most ex-pats cost at least twice as much overseas as they would at home, this represents considerable outlay. Businesses are looking specifically at their mobility policies, and their return on investment from such programmes to make sure they are being as creative as possible and getting the most out of this valuable talent pool.

In the long run this may create recruitment challenges in some markets, but at the moment hiring is low down the list of priorities, even for the largest businesses.

For the PwC team, it's the re-examination of incentives that's producing some of the most innovative thinking. As Stephanie Phizackerley says, "Long-term incentive schemes are really taxing in this environment as it is so difficult to establish a sensible three year performance measure in such a volatile environment as we're seeing now. As things stand, it's hard to predict a few months ahead, never mind three years, and we know that both HR departments and executive remuneration committees are concerned to ensure that the incentive plans are both motivational and stretching thus many have reduced the emphasis on long term (three year) plans and are instead focusing much more closely on short-term schemes, and in particular on new ways to incentivise and reward those who can generate cash flow for the business.

For most organisations cashflow is king so now is the time to review all your incentive plans and if they don't obviously focus on cashflow generation then it is probably time to change them. And you may want to take a look at your share option schemes: options that are seriously underwater are very little use to anyone. They don't function as an effective incentive to the employees who receive them, and they're still a cost to your P&L.

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As more and more companies face up to the realities of a recession, now's the time to think about...

Managing your people costs in a downturn

There are plenty of other things you could do which provide an immediate saving in employment related costs. One obvious example would be to review company expenses and travel policies to ensure they meet current business needs and develop controls to protect against excessive and unnecessary claims.

You may also want to think about benchmarking pay and benefits against your competitors. Clearly you don't want to lose your most productive employees, the 'war for top talent' is no less fierce in a downturn.

Finally, it would also be worth reviewing how you use agency staff and contractors which carry a premium price, to establish whether you're getting value from them. You could look to transferring some tasks back in-house.

None of this is rocket science, but it's no less valuable for all that. As Stephanie Phizackerley says, "the point about the retail sector is that while it does indeed have large numbers of staff, and many of those are at the lower end of the pay scale, this does mean that small incremental cost improvements can add up to a significant difference when they're all taken together.

Consumers are starting to get a lot more price-conscious about where and how they shop, and it's time for the retailers to do the same. There's a lot they could gain by being a bit smarter and thriftier about how they manage what they spend on their staff."



Spotlight on...

Russia

It isn't so long ago that the popular image of retail in Russia was people queuing for hours to buy bread; these days we're more likely to think of oligarchs buying Ferraris and football clubs. We interviewed Chris Skirrow, Retail & Consumer Leader PwC Moscow, on how far Russian retail has come in the last few years, and what the outlook for the market is now.



Can you give us a picture of how the Russian retail market has evolved?

The Russian market has gone through a fascinating series of changes in the last hundred years, reflecting the shifts and upheavals of its political history. As recently as the mid 90s this was a country characterised by acute shortages of supply, with huge numbers of intermediaries between manufacture and sale, and a reliance on outdoor markets and small kiosks for day-to-day shopping.

Since the financial crisis of 1998 this picture has changed drastically, and most of the major retailers operate a number of different formats, from discount, to supermarket, to hypermarket. There are customer loyalty schemes, CRM technology, and private label ranges in most of the big domestic players.

In fact, I often say that Russia has leapfrogged 80 years of retail evolution and gone straight into modern retailing in one huge step. Russia never had the sort of high streets we're used to in the UK, but 'down-town' malls combining shopping, eating and entertainment are now commonplace, especially in the big cities. Russian consumers seem to find them particularly appealing perhaps because they're all under cover and warm in the winter!

How does the retail market work in Russia now?

You have to remember that this is an absolutely huge country it covers 11 separate time zones, and there are 12 cities with a population of more than a million. Distribution logistics can be a nightmare, and the transport infrastructure unreliable. All this means that the environment in a big city like Moscow or St Petersburg is radically different from what you'll find in smaller towns, or the territories in the east, though this is now starting to change.

The other key point is that the retail market is still very fragmented. There's been some consolidation in the last few years but the top players still account for less than 20% of the market, which is a tiny proportion in comparison with somewhere like the UK where the top players are proportionally higher.

What does the Russian consumer look for?

Value for money, primarily. There's a huge in-built preference for Western brands, and as a result something like 75% of the food brands sold in Moscow are imported. The challenges for domestic food producers are taste, availability and quality, which is why imported brands do so well. Russian agriculture is still suffering from the neglect and bad management of the Soviet years, and as a result many food producers have had to extend right down the value chain to farm-ownership, simply to ensure the quality and quantity of supplies of basic staples like milk.

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Spotlight on...

Russia

What are the biggest challenges you see for Western firms wanting to break into this market?

In 2007 there were only two significant non-Russian players in the top food retailers – Metro and Auchan. We have no Tesco, and no Wal-Mart, though we do have Ikea, and Carrefour have recently announced plans to open a store in the Black Sea area.

Understanding local preferences and adapting to local business practices are absolutely critical for foreign players even Moscow and St Petersburg are different in terms of consumer preferences and market segmentation, never mind the more outlying regions.

Likewise, finding the right sites and dealing with the bureaucracy for acquiring land and leases can be tough, especially for any business that needs a lot of floor space. Until recently the balance of power here has tended to be with the developers, and managing those relationships successfully is another area where local experience is vital.

What about the downturn – how is that playing out in Russia?

Up until very recently all the big players (Russian and foreign) had huge expansion plans for this market. As capital has been squeezed, most of these have had to be reined back, and I doubt we'll see anything like the same level of M&A, IPOs, or new store openings that we've been used to.



However, the process of consolidation will be much faster as companies with weak financing go broke or get sold. Those operators who have strong cash flows and minimal debt problems will undoubtedly be able to take advantage of the opportunity to buy good sites at knock-down prices, or acquire weaker competitors at EBITDA multiples closer to 4 than 20, which was what we'd seen before.

That said, the focus for most Russian operators now will be to improve the performance of existing stores – just like in the UK, it's going to be all about like-for-like.

How do you see the future?

It may well be that over time the downturn plays out slightly differently in the Russian market. In a country with a lot of consumer debt, like the UK, people will usually react to a recession or a financial crisis by restraining their spending.

But there's comparatively little consumer debt in Russia, and a deep-rooted distrust of banks that goes back to the financial crisis in 1998. That means the typical Russian consumer will be more likely to keep their cash under the bed, or spend it. That could buoy the market for a while, though it's also possible that there will be a shift from value for money, to pure value, at least at the lower end.

The luxury market is a completely different animal. BMW and Mercedes still sell more cars here than in the rest of Europe put together, and up until very recently one of the fastest-growing sectors of the market was luxury yachts.

As Nikolai Uskov, the editor-in-chief of the Russian edition of GQ magazine, recently said, "The richest Russians will continue to consume huge amounts and they simply can't stop. If you want to buy new watches and you have the money, you will keep buying them. I think they won't care about another 10,000 or 20,000 euros even during a crisis time."

Events and publications



Precious Plastic

The latest edition of **Precious Plastic** is published this week. This edition explores the **impact of the 'credit crunch'**, the **crisis in the banking sector** and the downturn in the global economy on the **UK consumer finance market** and considers whether similar trends are being witnessed across continental Europe.

This year's publication also presents the findings of the first **PwC Credit Confidence survey**. This provides an important 'street-level' perspective on everyday debt repayment and credit issues and is coupled with the thoughts of financial institutions on the outlook for the consumer credit market in this volatile and challenging lending environment.

For more information, including a podcast recording of the authors discussing their views on these topics in more detail, please visit:

www.pwc.co.uk/preciousplastic

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Post-Christmas trading: Live webcast

Wednesday 28 January 2009 | 11.30 to 12.30

A chance for you to watch Mark Hudson, UK head of Retail and Consumer at PwC and Stuart McKee, partner in Corporate Finance at PwC talk through their outlook for retail companies for 2009 and beyond. Mark and Stuart will also comment on the aftermath of Christmas.

As the webcast is live, you will have an opportunity to ask questions directly to Mark and Stuart.

If you would like to register for the event or require more information, please contact Louise Holland:

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Find out more...

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Stephanie Phizackerley

Stephanie is a partner in the UK Human Resource Services practice. She has been specialising in HR consulting for over 15 years and has extensive knowledge in all aspects of international mobility including tax and policy planning, international pensions and reward, process improvement and cost reduction.

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Chris Skirrow

Chris is the Audit Partner in charge of our Consumer & Industrial Products practice at PwC Russia. He has more than 30 years of experience with PwC in Canada, Europe and international markets such as Turkey, and Russia and has been a partner since 1990.

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Design by PwC OLP (12/08)