

# FMCG And The Recession

Contributed by Euromonitor International

## How Are Consumers Of Food, Drink And Tobacco Products Responding?

In this article picking up on client interest in the impact of the downturn on consumers, we offer a snapshot of the impact of the credit crunch on consumer purchasing attitudes and behaviours with regard to food, drink and tobacco, drawing upon the expertise of Euromonitor International's in-house experts to highlight current and future scenarios in these industries.

### Consumer Food Service

#### What's happening now?

#### Cutting back, ordering takeaways and trading down

Elizabeth Higgins, Euromonitor International's expert on consumer food service says:

“Consumers are cutting back on eating out and this is particularly hurting full service restaurants and cafe/bars. We are seeing some trading down but in some cases lower income consumers are choosing not to eat out all together and in many countries this was the group that was really boosting value for foodservice.”

One of the key advantages during a downturn for any lower-priced operator is the trading-down effect - many consumers remain unable/unwilling to cook many meals at home, yet increasingly look for ways to cut back on spending, often by eating at lower-priced fast food and takeaway locations.

While trading down is quite apparent in some markets, in others this is not always the case:

- In Italy, consumers are expected to eat out less often in times of a crisis, treating themselves occasionally to a mid-priced meal rather than trading down to a lower quality fast food meal;
- In other countries we're seeing consumers return to cheaper and familiar foods, in some countries this might be turning to street stalls and kiosks. In Brazil this has benefited the Kilo restaurants where consumers can find affordable meals including many national specialities for a low price;
- Other sectors that have benefited to date, include the 100% home delivery/takeaway sector in the UK, where Domino's Pizza has seen strong growth attributed to the downturn, sighting that during a six week period in January/February like for like sales increased by 15% as consumers traded down from restaurants to delivery.

Operators across all sectors have responded by emphasising their value positioning:

- Starbucks has introduced their own value offering, advertised as “something good to eat for less than \$4” in a response to others, namely McDonalds, who have taken shots previously at their average priced beverage being priced around US\$4 during their recent marketing of McCafe, which offers espresso based beverages starting at US\$2.25;
- Full service restaurants are also offering a range of promotions, including a ½ price bottle of wine, free entrees and even some independents in the UK asking consumers to name their own price for a meal. In Mexico, full-service restaurants such as VIPS, operated by Wal-Mart are offering meal combinations for less than the price of a Big Mac Meal at McDonalds;
- In the Philippines, fast food operator Jollibee launched a new lower priced concept, called Manong Pepe which offers home cooked meals similar to those offered by street stalls /kiosks. Meanwhile, Jollibee has steadily expanded its core Jollibee brand, adding to its breakfast and snack selections and steadily rolling out 24-hour operations at outlets targeting traffic among consumer groups such as students and call-centre operators looking for a late-night meal.

#### Outlook

Slow revival of consumer eating out habits with faster demand for discounted, on the go options

Overall, the foodservice industry is not expected to pick up again until 2010 with a stronger recovery projected for 2011 and 2012 although a lot still depends on each country's recovery and the effectiveness of the various stimulus plans that have been passed.

It's likely that consumers will be slow to return to previous eating out habits. Fast casual chains could also receive a sales boost from lower-income families who may choose to forego the occasional luxury of a full-service restaurant for a less expensive fast casual meal.

One potential bright side for operators is consumers' continuing demand for on the go options—while consumers are cutting back, without question, consumer foodservice remains a virtual necessity for working urban residents, who remain quite willing to spend money at chains perceived as offering good value.

Thus, many fast food chains have been able to keep traffic growing with a selection of deeply-discounted items, coupled with longer hours and broader menus, designed to capture sales at all times of day and all meal occasions, from light snacks and indulgences to full meals.

However, there are still many emerging markets with low levels of foodservice spending overall and as a result opportunities still do exist for growth.

In more developed markets operators that can provide a convenient meal solution or those that can provide a unique experience will be the true winners as consumers become increasingly more sensitive when it comes to spending money on non-necessities.

## Packaged Food and Impulse Food Items

What's happening now?

Sustained consumer interest in packaged food, particularly value options and impulse food buys

Despite the continued deterioration of the global economy, Euromonitor International believes the packaged food industry is well positioned to weather the storm.

Everyone has to eat, and with global food commodity prices for cereals, meat, and dairy products now stabilising since the volatility experienced between mid 2007 and mid 2008, the spectre of potentially catastrophic food inflation has been dispelled.

Even though commodity prices are slated to increase slightly during 2009 as consumer demand for eating at home increases, final retail prices should remain relatively stable.

Indeed, manufacturers are doing whatever they can to cut costs and pass those savings on to increasingly cash-strapped consumers. Retailers are also doing their part, by continuing to launch a variety of price promotions around the world.

Private label offerings are also meeting consumer demand for value-minded packaged food offerings, with UK retailers like Tesco, Sainsbury's, Asda, and even middle-class Waitrose all expanding the range and shelf-space of their budget own-label lines.

Moreover, the global economic crisis is prompting more people to prepare their own food rather than eating out. With more and more consumers opting to eat in rather than out, 2008 packaged food sales saw strong retail value growth in key markets like the US and UK.

In particular frozen processed food sales are performing well in both countries, as consumers see them as a more affordable alternative to chilled processed food that also has a significantly longer shelf-life.

This trend is also good news for makers of "lunchbox friendly" food, provided they cater to increasingly sophisticated consumers by offering greater product variety and flavours.

Impulse foods items, particularly confectionery, are also faring well as consumers around the world look for affordable indulgences to offset their economic woes.

While the current climate has led consumers to cut back on holidays, consumer electronics and other expensive household goods, and eating out, life's little luxuries like chocolate confectionery are remaining somewhat recession-proof, at least for the time being.

Indeed, mass-market confectionery manufacturers like Cadbury, Nestlé, and Hershey performed especially well in 2008:

- Cadbury exceeded its growth target of 4-6% and increased sales by 8% in 2008;
- Nestlé also achieved 8% organic growth in 2008 despite the global economic downturn;
- Hershey reported 2008 sales growth of nearly 4%, a significant improvement on a virtually flat performance in 2007.

However, the economic recession is also constraining the higher end of the market, with premium chocolatier Lindt and Sprüngli expecting its sales and profits to take a hit in 2009.

## Outlook

Current trends for eating in and self-treating should keep consumers keen on packaged food

Looking ahead, many of the same trends insulating the global packaged food market should continue to protect it from the full brunt of a prolonged economic downturn:

- Retail prices should remain relatively stable as commodity speculation continues to wane and companies explore further ways to cut costs for cash-strapped consumers to maintain their margins;

- Consumers should also continue to eat more at home rather than eating out, which should be a boon for both the industry at large and specific product categories like frozen processed food, canned/preserved food, pasta, noodles, rice, soup, ready meals, and sauces/dressings/condiments.

- Given the steady deterioration of consumers' culinary prowess in recent years &ndash; particularly in developed markets &ndash; meal solution products offering consumers ease of preparation and convenience should do particularly well;

- Consumers are expected to continue to seek out more premium minded &ldquo;restaurant quality&rdquo; meal solutions, if only for an occasional indulgence. Though more expensive than many competing offerings, such meal solutions are still significantly cheaper than eating out. In the UK, PizzaExpress chilled pizzas have proved one of the fastest growing chilled pizza brands on the market in recent years while the same is true of California Pizza Kitchen frozen pizzas in the USA. Both are linked to popular full-service pizza restaurants and allow consumers to replicate the restaurant experience at home at a more affordable price than eating out. The California Pizza Kitchen frozen pizza website even offers US consumers ideas on suitable hors d'oeuvres and wines to serve with their product. With consumers increasingly opting to stay in and &ldquo;nest&rdquo;, significant opportunities remain for packaged food companies offering a bit of luxury in otherwise austere times.

Lee Linthicum, Packaged Food Industry Manager at Euromonitor International, points out that:

&ldquo;Euromonitor research indicates that many health and wellness trends should remain viable despite the current downturn as the world becomes older and fatter. At present, leading ingredients companies like DSM and Danisco &ndash; which provide a growing range of functional ingredients to packaged food companies &ndash; remain very optimistic about their future growth prospects. They are continuing to develop new ingredients targeting weight management, brain/mental health, heart health, cholesterol/blood pressure reduction, digestive health and immune system support among others. While organic food will likely remain flat, if not decline slightly, in the immediate future as consumers cut back on what they feel is superfluous expenditure (with the exception of baby food, likely to be more recession-proof as parents strive to offer their children the best), fortified/functional food should remain robust as an ounce of prevention is worth a pound of cure.&rdquo;

Meanwhile, it may be fashionable right now to blame the economic climate for lukewarm consumer interest in novel products, but the simple truth is that there is never a good time for follies like probiotic chocolate and omega-3 ice cream, and beauty foods, which are quite a novel concept in many geographies, may have to wait until the economic climate improves.

## Non-Alcoholic drinks

### What's happening now?

#### Crunch biting into bottled water purchases

Simon Maddrell, Euromonitor's industry manager of hot and soft drinks stresses that bottled water is a key talking point for the industry at present; a recent soft drinks comment article was entitled: &ldquo;Bottled water leaks volume as credit crunch bites.&rdquo;

According to Simon, the credit crunch is squeezing the still bottled water category in two ways, firstly, by encouraging a shift into tap water and, secondly, by inducing stronger demand for sweeter 'comfort' beverages.

If this were not bad enough for the industry, bottled water has also fallen victim to environmental campaigners, resulting in highly damaging media exposure over much of 2008.

It seems clear, therefore, that the category's honeymoon renaissance of the past five years is over.

Western European consumption of black tea is forecast to decline in 2009, reflecting downward pressure from the global economic crisis.

One of the defining issues in the UK is that black tea has a broad socio-economic consumption base, with high demand coming from lower-income households. As unemployment climbs and recessionary fears escalate, there is little doubt that poorer households will look at ways to trim their weekly supermarket expenditure.

Black tea is vulnerable because cash-strapped consumers can save money by using, for example, two tea bags per pot instead of three or one bag to brew two cups. That type of consumption manipulation can have significant implications on volume sales at a national level.

The demographics also work against the black tea industry in Western Europe.

This is because an ageing population means, in reality, a shrinking consumer base. This is compounded by a growing rejection of black tea among younger consumers, who might aptly be described as the "Starbucks Generation";

This consumption shift is less to do with macro-economic conditions and much more to do with fashion.

In short, the coffee sector has been far more innovative and dynamic in its on-trade development over the past decade, symbolised most visibly by the growth of coffee houses as day time social meeting places.

Ironically, Starbucks might even be the one to rescue leaf tea, with its roll out of a new range of black tea choices this year.

## Outlook

Ethical consumption the route to boosting consumer appeal

As the credit crunch tightens in 2009, consumption of still bottled water is forecast to contract in North America for the first time in over a decade, while volume growth in Western Europe is projected to fall below 2%, according to the latest available data from Euromonitor International.

Meanwhile, what seems clear is that leading leaf tea producers across Western Europe need to ring the changes and entice consumers back into the category.

One possible answer is to increase penetration of sustainable tea products, such as Fair Trade and Rainforest Alliance, a strategy that has worked effectively for the coffee sector.

This could, quite literally, be a lifeline for the hot tea industry because it would enable many vulnerable growers to stay afloat, thus strengthening the supply chain. But it would also benefit the tea consumption culture going forward, encouraging greater knowledge about the different variants of leaf tea as well as countries of production.

## Alcoholic Drinks

What's happening now?

Beer buoyant as consumers buy alcohol to drink at home and are trading down

Consumer drinking in bars, pubs and restaurants etc. is experiencing a decline as cash-strapped consumers are going out less, drinking in their home cocoons. Premium spirits will suffer most.

Consumers in advanced economies like the USA, UK and Spain are forecasted to continue cutting back on drinking the most as the economy worsens, while those in emerging economies like China and India will be better placed to weather the economic storm.

Beer will remain the fastest growing category in volume terms.

Domestic lager is expected to perform better than imported beer. Economy lager brands will attract consumers in off-trade. Global alcoholic drinks volume growth is slowing down due to the global economic downturn but significant contraction is not expected in the short to medium term.

Global alcoholic drinks' value growth throughout the crisis years will be affected more dramatically than volume in the short to medium term as most consumers are switching to cheaper alternatives, with spirits and wine prices suffering the most.

## Outlook

Belt tightening will trim sales but consumers should start buying more at the end of 2010 to compensate

The quantity of alcohol consumers drink has proved to be broadly resistant to past economic crises, however as this recession is unprecedented, its effects on the alcoholic drinks market are already markedly distinct from previous crises.

For example, it quickly became apparent that the current global downturn required a revisit of forecast consumption

patterns for beer. Meanwhile, a slowdown in the consumption of wine is mostly expected in Australasia, Eastern Europe and North America, while the majority of spirits volume corrections are expected in Australasia and North America.

According to Marlous Kuiper, Industry Manager of Alcoholic Drinks at Euromonitor International:  
"On the whole advanced economies will see a more dramatic decline in volumes of alcohol consumption as the economy worsens, and consumers trim their spending, but it is expected that these declines will be short lived and the market will start recovering at the end of 2010. It is possible that 2011 could see steeper growth than originally forecasted, compensating for consumers' belt tightening period."

## Tobacco

### What's happening now?

Trading down and global tobacco bans may bite into the traditional resilience of this industry during recession

The tobacco industry's reputation as a resilient sector in times of recession is based on past performance and unique qualities. But there are some new elements in the equation in 2009 such as the impact on price of tobacco restrictions and bans.

The defensive qualities of tobacco companies have been based on a number of factors.

First, consumers do not tend to smoke less in times of trouble and stress. Second, selling tobacco products is intrinsically profitable and the business is a legendary cash flow generator. Third, the traditional strength of tobacco brands means that prices generally tend to remain robust. Fourth, unlike many other products, cigarettes will not be overtaken by new technology.

On the other hand, unlike previous economic downturns, the current recession comes at a time when tobacco control has the industry in its grip as never before in terms of multiplying public smoking bans and steeply rising prices in many markets as a means of 'de-normalising' the practice of smoking.

The primary fears for the industry in the present economic crisis are not the effect on volumes of falling consumer confidence but the spectre of consumer down-trading.

This is because much of the resilience of the tobacco stocks is based on the industry's ability to continue to raise profits, even in markets where volumes are declining, by premiumisation, i.e. improving the proportion of premium brands in the sales mix.

Another major concern is that the emerging markets which have been shoring up global volumes in recent years will suffer more than developed markets in 2009, as has been the case in previous global recessions.

It has been consumers in emerging markets who have made them the prime contributor to the tobacco industry's income growth. Major financial disruption could affect these markets in ways that it will not affect developed markets.

### Outlook

Smokers expected to be responsive to new products from trusted brands

All indications are that the industry will continue its current premiumisation strategies to woo consumers but with an intensification of new product development which it sees as the best means of keeping prices robust.

Smokers have demonstrated a clear appetite for a succession of new products which are brand extensions of global flagship brands.

These are coming from innovations such as super slim cigarettes for a more elegant look (originally targeting women but now also targeting men), shorter cigarettes for a quicker smoke in public smoking ban markets, charcoal and other innovative filters such as triple and recessed filters plus 1mg tar products with reduced risk appeal, and a range of menthol brand extensions.

In addition there are a range of product re-launches aimed at increasing the prestige of certain brands and extensions in order to persuade smokers to pay more without shifting price bands.

These are all means of keeping prices robust by improving perceived value and following the traditional marketing precepts of generating consumer interest and belief in perceived value.

However the companies will also continue to build pricing safety nets to catch consumers down-trading from premium bands by means of medium price band and price value band offers.

This is a process with attendant dangers, rather like seeking to keep a herd of elephants balancing on a tight-rope &ndash; one slip and where does it stop.

The company wishes to offer an alternative product to a down-trading consumer but does not want to provoke a large scale exodus from premium band to mid-price band, or worse, from premium band to low price band.

This dilemma comes into focus when prices reach a level where consumers will not sustain a premium brand as brand leader.

It happened several years ago in the UK when Lambert & Butler overtook Benson & Hedges and today all the leading brands in the UK are in the mid price sector. Price rises plus recession could bring this pricing dilemma to a head in a number of markets in 2009.

The main forecast conclusion realigned in the light of the downturn, is that due to the recession combined with the increasing effects of tobacco control, global cigarette volume growth will fall by one percentage point from 2009-2011, but by a wider margin in value growth; about 3-4% in this period.

What is the emerging market outlook? The last global financial crisis began in 1998 and was triggered by loss of confidence in Asian economies.

The effect on tobacco markets in a number of major emerging markets was profound in terms of volumes and in terms of the impact on international brands. Inflation caused major local currency price increases and widespread consumer migration away from international brands.

The general view is that the major emerging markets are far stronger economically now than they were in 1999 although tobacco volumes overall will continue their previous declining rate of growth, with legislation having more of an impact than recessionary pressures in the short-term.

In the long-term, as the situation evolves, pricing strategies will become ever more important, particularly amongst mid-price brands, and manufacturers will try to maintain brand loyalty by offering cheaper alternatives to premium and mid-priced brands.

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