

# The Insight Report

An Experian report - Quarter 2, 2009

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# Introduction

## Getting the bounce back into the economy

Charlotte Hogg

Managing Director, Experian UK and Ireland



In our last quarterly report, we emphasised the psychology of the recession, and the importance of changing our outlook towards the economy. At that point it was consumers' beliefs that were of greatest concern as they scaled back spending; the commercial sector still looked robust.

Over the past quarter, the mood has changed, and we seem to be intoxicated by the heady scent of recovery. But the truth is that very little has changed yet, either for the better or for the worse. The priority now has to be to think through where consumers and businesses will be in 12 to 18 months time. The big hope for the economy has to be that consumer spending will prove to be resilient, and that businesses are still able to grow off the back of that resilience.

In this quarter, we try and paint a picture of consumers and businesses in the future to answer that question, and the further question of how businesses can succeed in this new world. We find the following.

Firstly, the place to focus may not be the epicentre of this recession: London and the South East. Unsurprisingly, employees in financial services have seen a sizeable drop in disposable income, and in the equity in their homes. However, as the aftershocks have been felt in manufacturing (which with construction is the sector now facing the greatest number of business bankruptcies), the impact on the North and traditional manufacturing centres has been severe. And our data would suggest that the ability of these areas to bounce back is less than in the South. So, policies and investment needs to focus on these traditional heartlands.

In particular, we have concerns about mid-size employers; those who employ between 10 and 100. These businesses have been going to the wall at an increasing rate. The loss of these, from where we would expect to see new growth and innovation in the future can only be of concern.

Secondly, consumers are changing and businesses will need to adapt with that change. Across all segments, the recession is forcing a rethink of spending patterns. Interestingly, it isn't all about cheap. It is about value. And value means more than ever it did before. It means green, it means great service, it means trusted by other consumers. And trusted by consumers doesn't mean the company tells you that, it means other consumers do – and they do it directly. Potentially a seismic shift in consumer needs, there is a huge opportunity for market share gain.

So what can we see out there? Risks, to businesses, risks to key economic heartlands of the country – but a prize that nimble, adaptive companies can go after. Supporting those businesses, and winning that prize offers the potential to maintain consumer spending, the potential to bounce back.

# 1. The consumer landscape

## Sunshine after the storm? Bracing ourselves for the bounce-back in consumer markets

Joe Staton, Planning Director,  
The Future Foundation®, an Experian company

The recession has seen a seismic shift in consumer behaviour, with the result that market share could be up for grabs when the bounce-back comes. The winners will be those brands obsessive about delivering the right price, properly rewarding loyalty and providing great customer service every day.

This recession has fundamentally challenged consumers in every income-group to rethink everything they do, buy and desire.

A recession does not just mean lots of fretting; it also means lots of reflecting too. Just why do I always buy this brand, go to this supermarket every Friday, eat this kind of meal, bank with this bank, and enjoy this type of holiday?

Amidst all this, it is clear that the recession has been an invitation to us all to revisit *price*. But this is not an invitation to us just to go downmarket and drop our expectations of quality, variety, range, ethics... It's not the pursuit of quality that decelerates. It's the scrutiny of price that has really intensified.

Contrary to a lot of under-powered and under-researched thinking, it is not just the cheapest items that are luring customers in the recession. We know that they are thinking twice about buying the cheapest item they can find ("Buy cheap, buy twice!"). As a result, this is great news for brands that can, such as the stock of goodwill they have accumulated in the good times, legitimately yank the trust/loyalty lever.

It is surely now apparent that not every offer suffers in a downturn. It is not empty commercial evangelism to claim that a recession is an acronym for redistributed opportunity.

In these circumstances, the goal of the researcher-analyst-forecaster is to uncover all that is fixed and all that is (perhaps temporarily) variable in consumer behaviour. We do this in the knowledge that recessions must end and economies must, sooner or later, bounce.

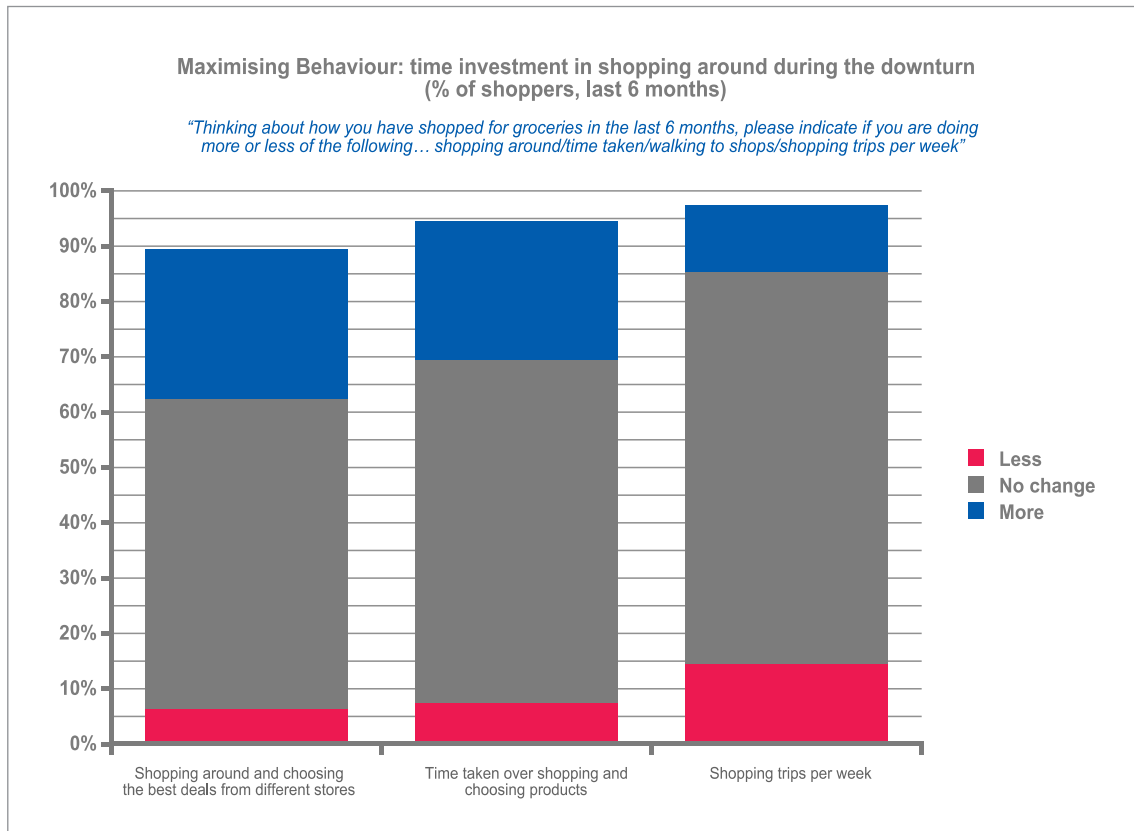
So what should the big preparatory and planning emphases be for businesses? What is really shifting under the pressure of contracted growth? What are the agents of innovation in consumer habit and aspiration?

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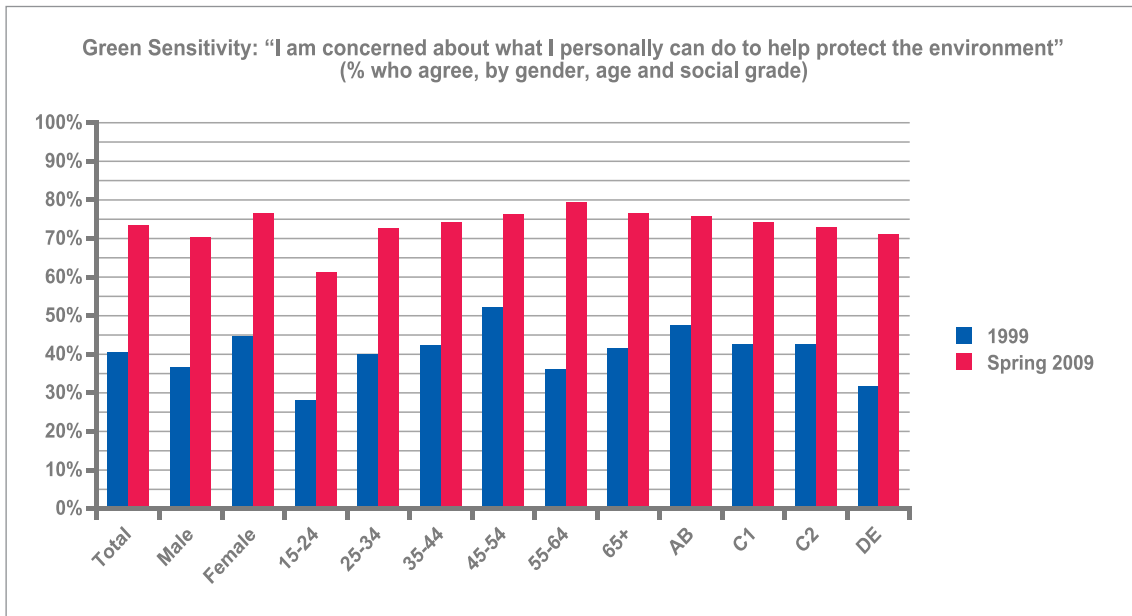
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## A return to Maximising Behaviour



Driven by rampant product and service innovation, the proliferation of consumer choice has become the defining feature of our society. Every brand and every service aims to provide us with the maximum number of options, offers and permutations for everything from mobile phones and computers to cars, credit cards, washing powder and shampoo. In the face of sometimes overwhelming choice amid cost-control pressure, we are seeing the re-emergence of what we call *maximising* behaviour. This means that more consumers are more determined than before to apply an exacting and demanding set of selection criteria in order to, from market to market, make the best and most rational choice. Using appropriate techniques, the number of *maximisers* in a given product category can be assessed. And the thing is that even for well-off consumers, perhaps not damaged by recession in any direct way, maximising activity becomes the right approach. For, as is well appreciated, the psychological effects of downturn – those that can create an atmosphere in which value-for-money is more intensively scrutinised by all – are as important as any other kind.

## The resilience of Green Sensitivity



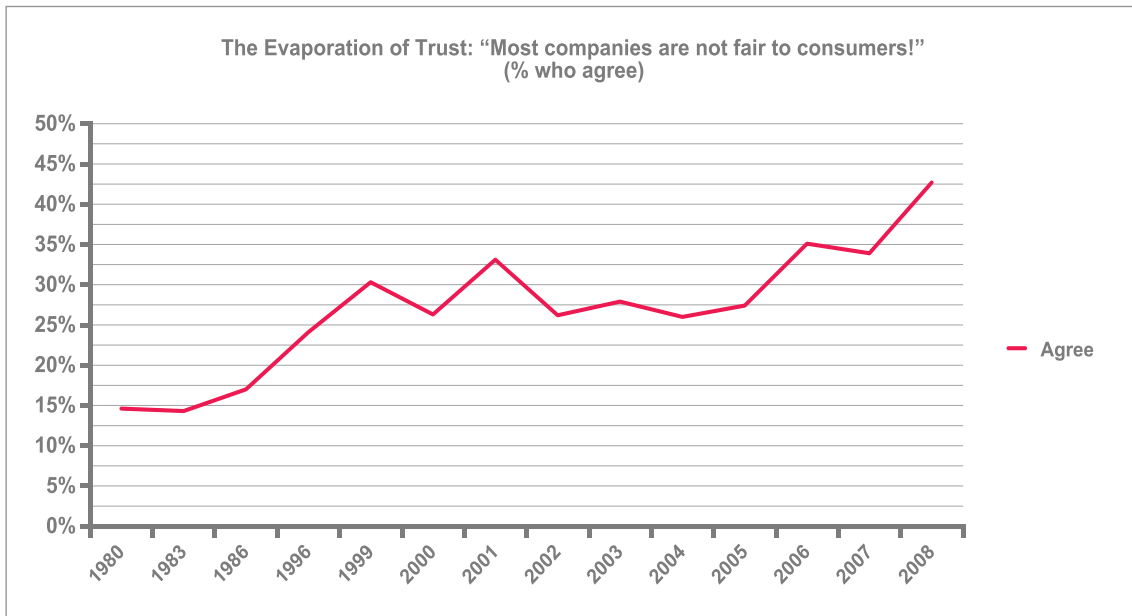
In 1999, Future Foundation research found that 40% of Britons were "concerned about what they could personally do to help the environment". By the time the recession started, this figure had risen to over 70% and we are finding no evidence that this depth of sensitivity is slackening in our much-changed macro-economic prospects. Green considerations are all still present and correct inside the value-for-money equation. Of course, consumers will investigate green claims all the more thoroughly in this environment and not everyone will be able to afford the premium that any 'ultra-green' product may want to attract. But no brand, we strongly suspect, will prosper by shaving away any of its eco-credentials or by disestablishing environmental programmes from within its CSR portfolio. The threat posed by global warming still dominates, creating enough headlines, features and reports each day. The British shopper is no more running away from conscious green consumerism than they are running all the way to discount grocery stores to the exclusion of all other, previously preferred options.

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## The Evaporation of Trust

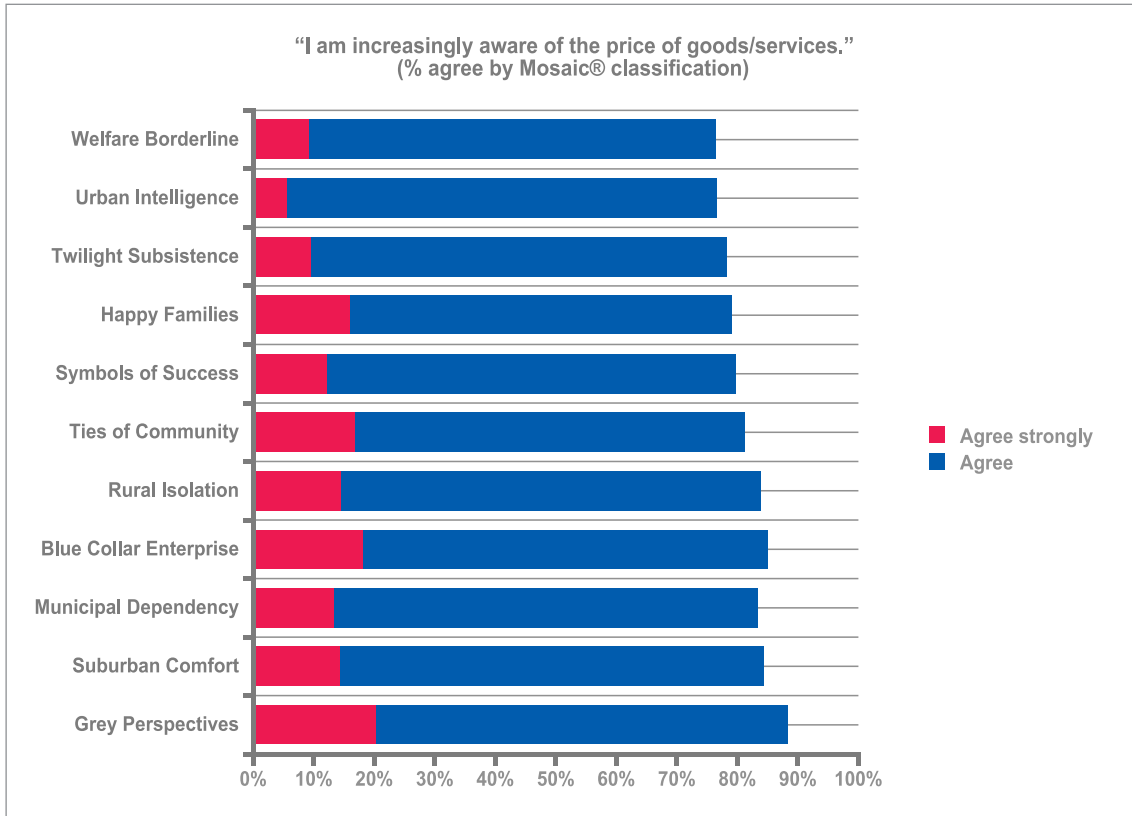


Future Foundation figures show that the numbers of people who agree with the general proposition that companies are not fair to consumers has virtually doubled in the last decade. Consumer markets are these days filled with millions of very opinionated Brits who have long since grown suspicious of banks, utility companies and big business in the round. Loyalty – in the form of repeat purchasing of the same brand – is something that has to be won each morning. It is as if the marketing and communications community are living in their own version of Groundhog Day; what you achieved yesterday may not carry you through the next 24 hours (unless, of course, you remorselessly and continuously reappraise the price and quality of what you are bringing to market). Now, in a recession, it is natural for suppliers to compress margins and reduce ticket prices and thus contribute to a further destabilisation of established patterns of consumer loyalty. In the midst of this though, there is surely the opportunity to reconfigure brand identity to suit the feelings and motives of an often rather frightened consuming electorate. For instance, the performance of the major supermarkets in re-positioning themselves as the suppliers of quality-packaged-at-interesting-price-points shows just how the grip on consumer affections can actually be creatively re-tightened even in grim economic conditions.

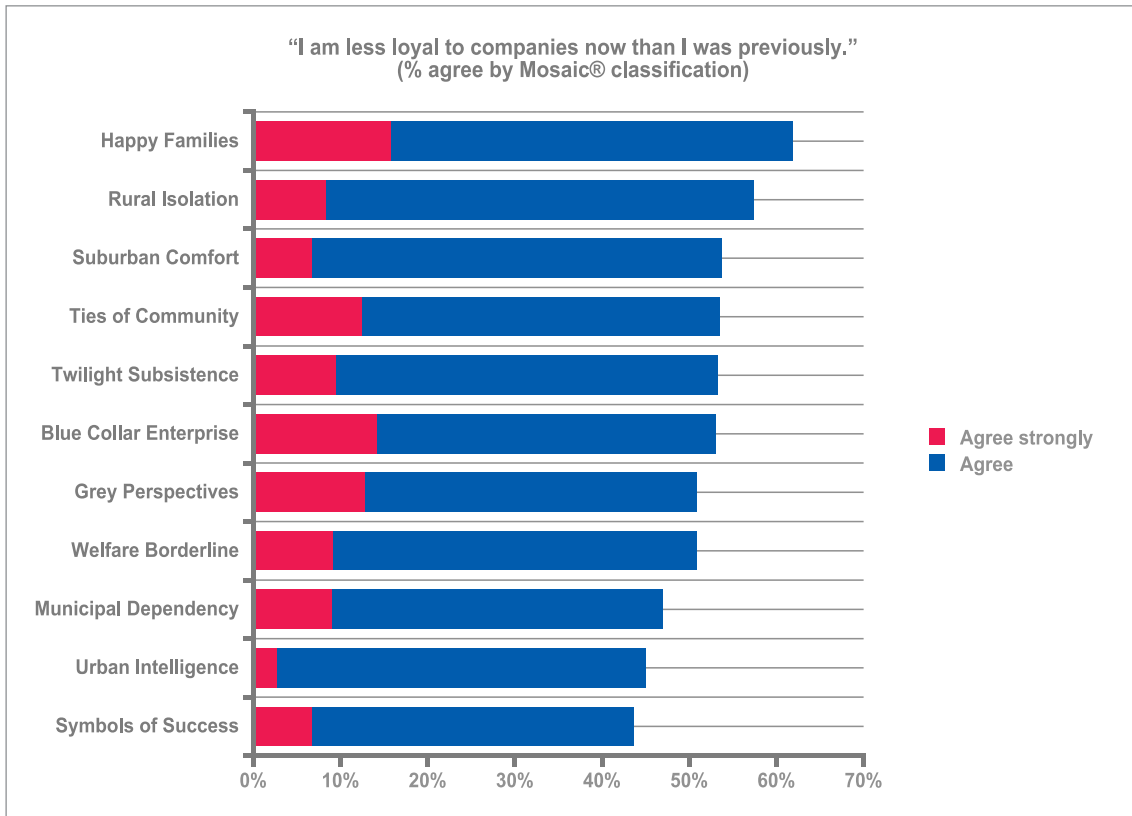
Recession, we argue, is a redistribution of opportunities as it invites month-to-month scrutiny of prevailing assumptions about how consumers are actually responding to the not-necessarily-negative stimulus that downturn brings in its wake.

### Winning the fight for the bounce-back consumer

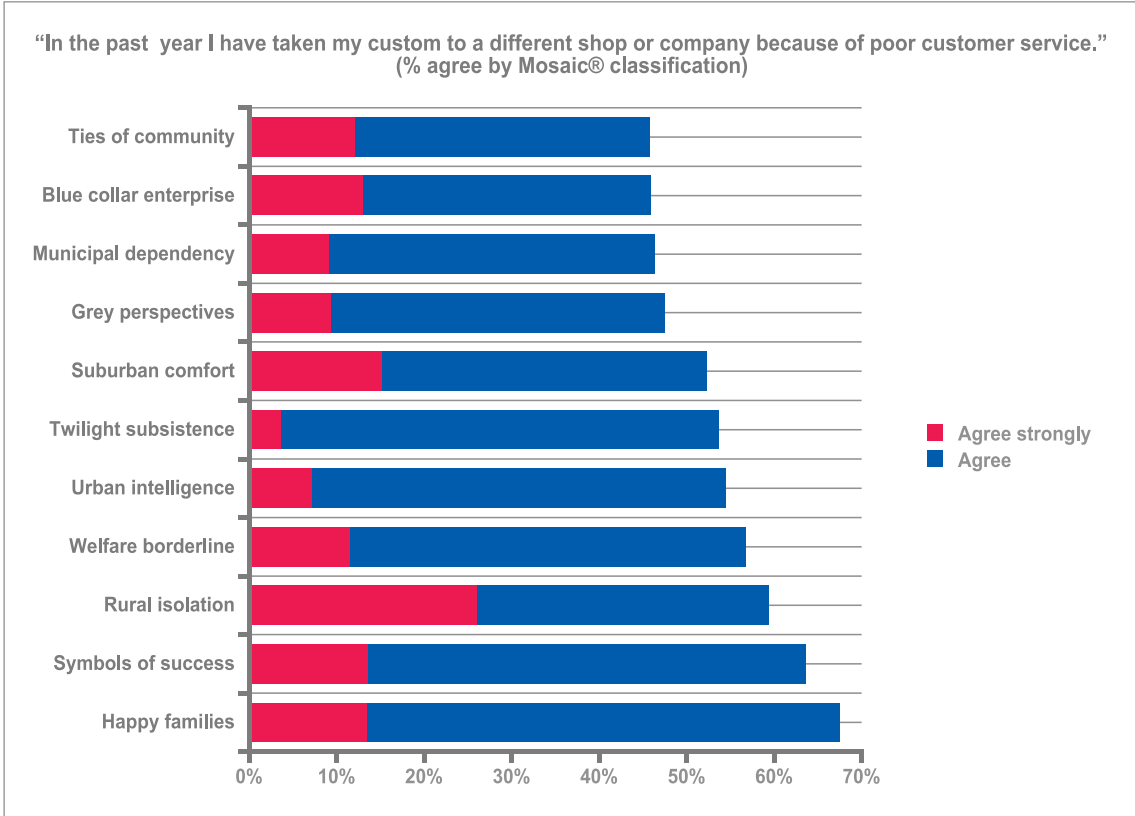
This downturn has forced previously loyal customers from a culture of consumption into a culture of thrift, the momentum of which many economists believe will last beyond the inevitable recovery. The key tenets for marketing in a world that has shifted gears from conspicuous to conscious, concerned and considered consumption, will be price, loyalty and (most importantly) service.



Firstly, price. From Urban Intelligence to Suburban Comfort Mosaic types, consumers will emerge from this downturn more aware, knowledgeable, and more tuned-into an understanding of the price/value equation than ever before. Many will have become used to seeking out low prices by shopping at a wider range of on and offline stores, behaviours that might not have occurred to them previously. This ratchet effect – where short-term changes tend to persist into the long-term – will manifest itself in our ongoing examination of all prices in the future. Thrift will not be un-learned suddenly in the face of this intensification of price scrutiny and volatility, it will be even more vital to remind consumers of the multiple value benefits of your brand; to be transparent about all costs and to hide nothing; look at payment plans and terms to build-in flexibility/'easy-pay' when and where feasible; and re-examine the all-inclusive/package-deal offer to lock consumers in at a great price.



Secondly, loyalty. Even amongst historically brand-loyal groups (like Happy Families and Ties of Community) we are witnessing the growth of increasingly volatile and promiscuous behaviour when it comes to sticking with established brand repertoires. From choice moment to choice moment, we are becoming conditioned to explore whether the very best deal might in fact lie elsewhere and this new mode of behaviour is making us all question our previously unwavering loyalty to many existing brands and services. Although there has to be a presumption that brands which 'cared' for us during the recession will be the ones deserving of our ongoing loyalty once the crunch is behind us (the major supermarkets, for example), what are the bounce-back behaviours that drive loyalty? Alongside the ubiquity of all manner of reward points schemes, great price and great customer service (see page 10), ongoing tailored and targeted one-on-one communications are key. Relationship building through bespoke promotional activity – either in the form of discounts or personalised recommendations – show that you are putting your customer at the heart of everything you do. In this new world, relationships are more important than ever and building stronger ones is a solid strategy for achieving success.



Thirdly, service. In the past year, well over half of all consumers have taken their custom to a different shop or company because of poor or indifferent service (rising to nearly 70% of the well-established and well-heeled Symbols of Success and Happy Families classifications). Bounce-back behaviour will be characterised by our willingness and ability to look elsewhere for a better customer service experience as we vote with our feet or click our way to your competitor if we are unsatisfied on any level. Beyond convenience and a brilliantly built brand, best-in-category interaction and being proactive with your customer will ensure continued financial health with established customers coming back for more and happy to recommend you to their friends and family. To outperform the competition, even in the toughest of markets, excellent and sustained customer service will become the hallmark of the successful brand in the post-recession landscape.

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## How will companies take advantage of user-generated content in a post-recession world?

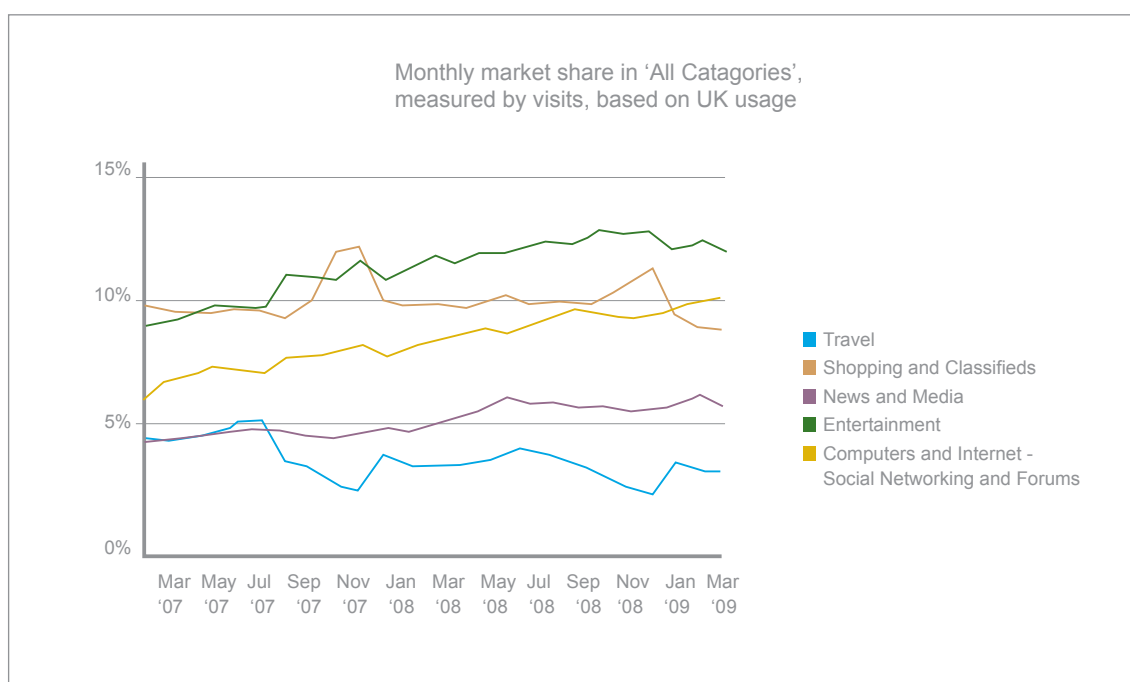
Robin Goad, Research Director, Hitwise®, an Experian company

The recession has seen user-generated content (UGC) come into its own, embraced by consumers and forward looking online segments alike. With sites offering social networking and UGC now amongst the fastest growing on the web, the challenge is on for more traditional online segments to embrace UGC ready for the upturn.

Consumer behaviour has changed as a result of the recession, and many of these changes have been reflected online. From the growth of money saving websites to an increase in searches for home comforts, UK online behaviour has mirrored what is happening in the 'real' world. But Internet usage has also evolved to meet the challenges that the recession has posed for the more traditional online segments.

With money tight, UK Internet users are spending less of their online time on transactional websites. In March 2007, before the credit crunch started to bite, the main content driven websites (news, media and entertainment sites, plus social networks) received 35% more UK Internet visits than retail and travel websites (which combined account for the majority of UK eCommerce revenues). Over the last two years, that gap has widened significantly; in March 2009, content driven sites picked up 138% more visits than their transactional counterparts.

Of course, websites offering something for free have always thrived online, but they have fared particularly well during the recession. For example, social networks overtook retail websites in the UK for the first time in January 2009, and by March 2009 were already receiving 14% more Internet visits. Sites that take advantage of social media and user-generated content (UGC) have been amongst the fastest growing over the last two years. Facebook saw a 769% growth in traffic between April 2007 and April 2009, while Youtube's traffic increased by 177% and Twitter's by some 17838% over the same period. Social networks now account for one in every ten UK Internet visits and one in every five page views.



For the sites that have picked up a significant amount of UGC, monetisation remains the main challenge. The original plan went something like this: build a compelling site that people wanted to use and will return to frequently, then sell advertising. And not any old advertising; highly targeted personalised ads based on the content, preferences and lists of interests that users had previously shared with the site owners. Unfortunately, the global advertising slump has dented some of these ambitions. True, online has suffered less than other channels, such as print and TV, but it isn't immune to the recession. For example, the proportion of search traffic that an average website received from paid listings fell from 12.1% in March 2008 to 9.4% in March 2009.

The commercial model may not have worked out quite as planned, but consumers have taken to the world of 'Web 2.0' with gusto. And, as a result, there is no turning back. Compare the user experience on a well executed retail website, i.e. one that incorporates rich media content and user recommendations, with a more basic site and there's no contest. Therefore, the sites best positioned to take advantage when the market turns will be the ones meeting these new consumer requirements for interactivity.

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## **Online has suffered less than other channels, such as print and TV, but it isn't immune to the recession.**

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Content driven sites, from Friends Reunited to Twitter, may have been the first to embrace UGC, but more transactional driven companies can benefit just as much. Firstly, there is the benefit of all that (almost) free content driving visitors to your website, especially if they are arriving via search engines. Forward thinking retailers serving sectors as diverse as fashion and DIY are already attracting customers to their websites with everything from catwalk videos to 'how to' forums. This trend will continue, and the companies that stay ahead of the game will be those picking up the most new customers in the free-spending, post-recession world.

Then there is the benefit in terms of conversion rates. Getting customers to your site is only part of the battle; getting them to spend with you when they have a vast number of other choices elsewhere is an even bigger challenge. Good UGC doesn't only help with the customer experience, it also improves conversion rates. More and more sites are adding user reviews, and they are becoming more prominent. An increasing number of retailers sort product search results by customer rating rather than price or company defined 'relevance'. Why do they do this? Because, given the right safeguards, customers trust other customers more than corporations.

This trend will continue, but with even more sophisticated content and feedback mechanisms. And the impact of all this UGC won't only be felt online. Information collected online, from product reviews to sophisticated technical support solutions, will increasingly find its way into offline marketing. Your hotel is rated number one on a popular travel website? Why not take advantage of this in your press and TV advertising! Similarly, if you're using user ratings to choose which products to push on your website, why not do it in store as well? The savviest organisations are using the web to collect data on everything from their customers to their products, and this will prove to be an invaluable tool across all channels and business functions when the good times return.

## Recession creates a new twist on old North/South divide story

Matthew Sherwood, Senior Global Economic Adviser,  
Experian Business Strategies

The epicentre of the recession sparked by the UK financial crisis may have been London and the South East, but the aftershocks for both industry and consumers have hit hardest in the UK's traditional manufacturing heartlands.

The expectation was that the UK recession would be centred in London, the South East and other financial centres across the country. Just last autumn, newspapers were full of headlines proclaiming a 'middle-class recession' as thousands of white-collar workers in those regions and centres faced the axe. While London and the South East have been affected, the global nature of the recession, especially in the wake of Lehman Brothers' collapse, means UK manufacturing has been hit especially hard.

Indeed, job cuts in manufacturing since mid-2008 have matched those in business services, while losses in banking and insurance have paled by comparison. And looking ahead, manufacturing is projected to shed over 350,000 jobs between mid-2008 and mid-2010. Construction and distribution will also take significant hits. While business services is just behind manufacturing in terms of projected job losses, redundancies have so far been mostly limited to non-professional positions, such as admin and back-office support.

This has major implications for northern England and the industrial heartland of the West Midlands. Indeed, consumer confidence in the West Midlands and the North West – the latter encompassing Liverpool and Manchester – is lower than in London and nearly as low as in the South East, the region with the worst sentiment readings in the country. In the East of England, South East and London, employment is actually holding up surprisingly well, considering that the knock-on effects of the meltdown in financial services and property are concentrated in the region.

With this in mind, it should be no surprise that the North is facing a tougher time of it, as revealed by a marrying of our economic forecasting and consumer segmenting capabilities – Mosaic Economics. The Mosaic types worst affected by the recession are those where employment prospects look bleakest, in terms of rising rates of unemployment. These segments comprise mostly low-skilled labour employed in low-paid manufacturing, as well as very small businesses, such as corner shops and the like.

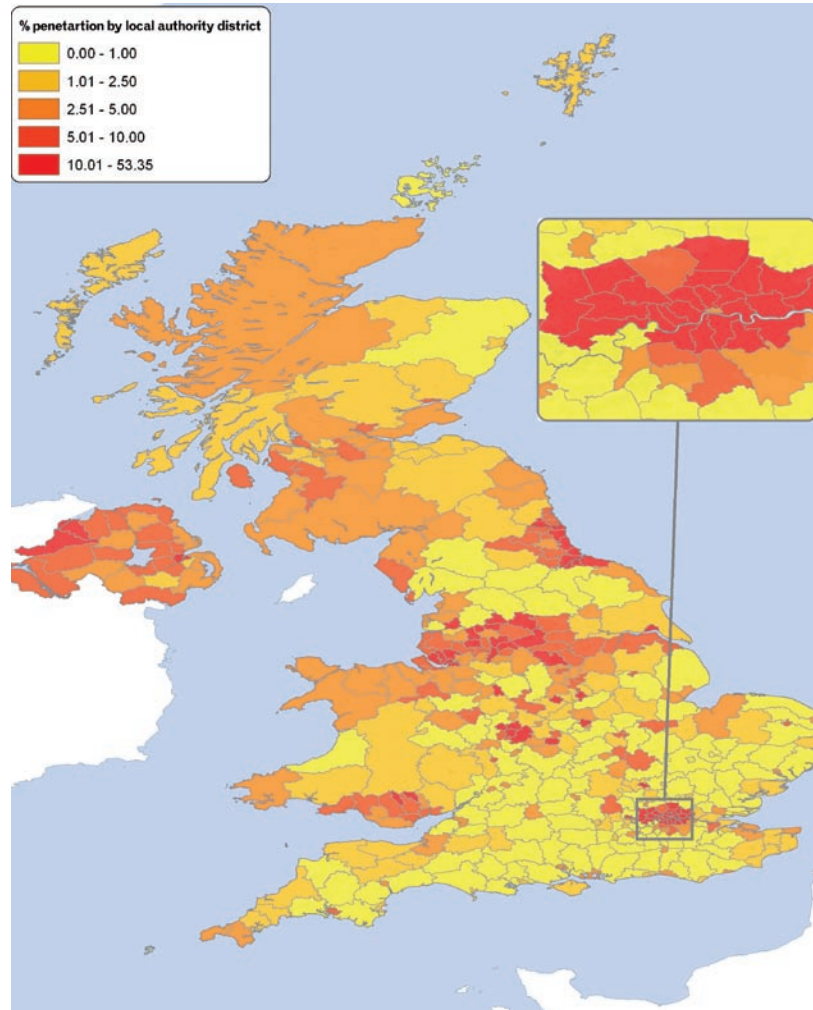
- Small Enterprise - Well-qualified minority groups, many from Asia, living in semi-detached suburban areas
- Low-paid Manufacturing - Larger families, many of South Asian origin, in high-density terraces
- High Density Urban - Tenants of public housing in inner city areas, with a high proportion belonging to minority communities
- Families on Benefits - Disadvantaged families with children on very low incomes, typically living in low rise council estates.
- Low Horizons - Tenants reliant on city councils for housing and transport, where few neighbours have bought their homes

They are largely concentrated in the urban centres, especially north of the River Trent (see map on page 14).

A typical example might be a family living in Felling, Tyne and Wear. They have always had to be cost-conscious and careful about making ends meet. In that sense, their reaction to the recession is "What's new?!" While they are not affected by the falling housing market per se, their low-paid jobs are increasingly at risk. Rising benefits and lower inflation will help, but their behaviour is likely to have already changed, in terms of cutting back on discretionary spending. And with credit hard to come by, purchases of big-ticket items or other status symbols have been postponed indefinitely.

### Highest probability of long term unemployment

source: Mosaic Economics



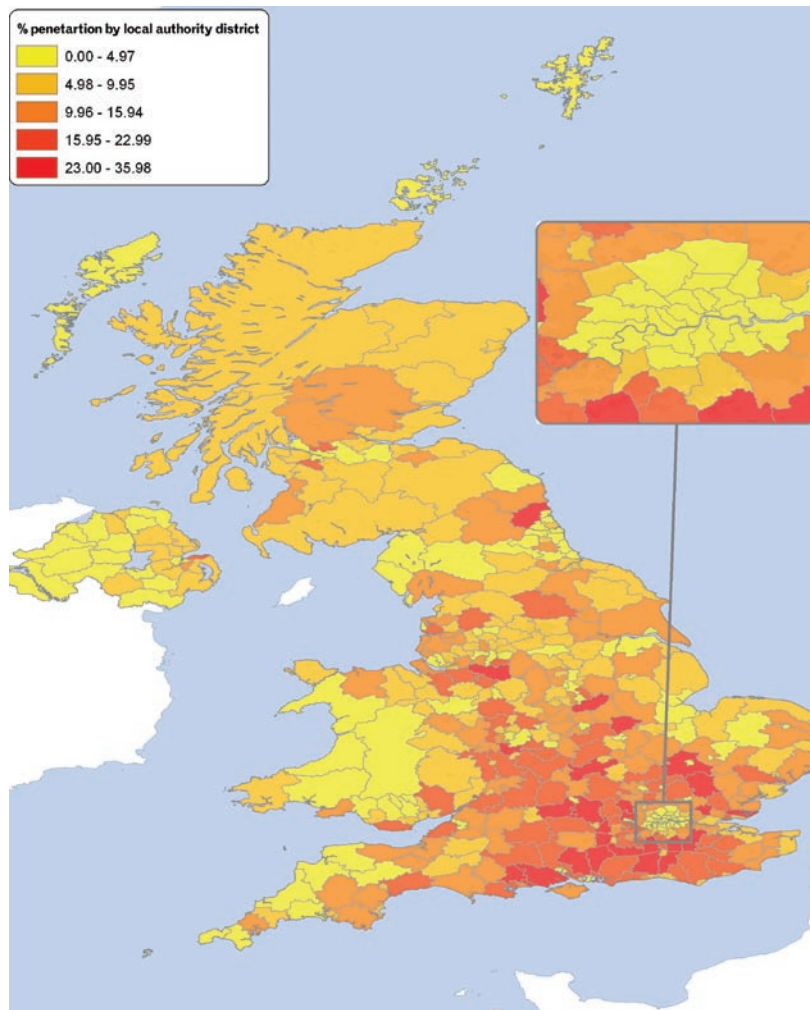
That is not to say that London and the South East will not be hit. The area is home to a significant number of households that derive a sizeable portion of their incomes from financial investments. Markets have declined sharply since late 2007, hitting incomes and wealth. Even with the recent rally in equities, prices are down a third from their 2007 peak. And with interest rates near zero, those living off their savings will face a tougher time of it. While the wealthier are still in a position to weather the storm, it does seem likely that discretionary spending will be toned down in the short term. Like their northern cousins, these Mosaic types have already adjusted their spending behaviour. Those most affected include:

- Golden Empty Nesters - Families in later lifestages, many retired following successful careers, in select neighbourhoods
- Provincial Privilege - Well-educated older professionals living in established suburbs
- Semi-rural Seclusion - Higher income families living on the outskirts of commutable metropolitan areas.
- Close to Retirement - Older couples and families reaping the benefits of their industrious working lives
- High Spending Elders - Well-off early retirees enjoying affluent and active lifestyles in pleasant locations

These segments are largely concentrated in the counties along the southern coastline and in the London commuter belt (see map below).

### Largest falls in disposable income

source: Mosaic Economics



### The post-recession landscape

Consumer spending growth will slow over the next decade as a result of more subdued income and employment growth; a weaker housing market; the heavy servicing burden of existing debt; and the growing need for retirement savings.

It seems likely that London and the South East will once again lead the way in terms of growth. That said, the UK economy's rate of growth will be slower than in the 1990s and early 2000s. A return to the buoyant financial markets of the past seems highly unlikely, with implications for the Mosaic types that rely on savings and investments for a significant share of their incomes.

But it seems that all consumer segments will have to face up to reality, with employment and wages growing at a far slower pace in the future than the norm for most of the 1990s and 2000s. While borrowing rates currently may be low, at least for those with enough equity sunk into their houses, the massive loosening of fiscal and monetary policy will have to be wound up before inflation returns with a vengeance. This will see interest rates rise significantly sooner rather than later. Those households still toiling under a mountain of debt seem most likely to see their behaviours change more significantly in the longer term.

A typical example would be a Happy Family living in a place like Milton Keynes. Let us call them Nick and Claire. Their middle-management jobs seem relatively secure, although their wages are likely to have been frozen, or even cut. This will hit their bottom line, particularly as wages and salaries comprise almost all of their income. Nick and Claire took a sizeable mortgage out a few years ago as they started their family. With the fall in house prices they find themselves in negative equity, limiting their access to better borrowing terms and their mobility. They may also have maxed out their credit cards. So far they have not changed their behaviours substantially, but reality will probably kick in by 2010, with big purchases and holidays abroad on hold. In the post-recession environment, it will be the Nicks and Claires who will have to adjust their expectations accordingly as wages grow slowly and their debt burden remains significant.

## **Mosaic® classifications**

### **Happy Families**

Happy Families contains people whose focus is on career, home and family. They are mostly young couples, married or living with their partner, raising pre-school and school-age children. This group's educational attainment has enabled them to secure positions in large organisations in either the private or the public sector, with the prospect of future career advancement. These neighbourhoods consist of modern, purpose-built family housing, either detached or semi-detached, on estates with other young families. These estates are often some considerable distance from major commercial centres but an easy driving distance from many potential workplaces, such as major new industrial or office 'parks'.

### **Blue Collar Enterprise**

Blue Collar Enterprise people are practical and enterprising, rather than well educated. Many live on council estates where a high proportion of tenants have exercised the right to buy. The lifestyles of this group have improved in recent years. They have become home owners; they may have one or even two cars, putting them in reach of a new range of jobs with higher wages and other incentives; in the more prosperous regions, unemployment has declined, creating a seller's market; their health has improved; the crime rate in these areas has fallen and the environment is generally pleasant.

### **Suburban Comfort**

Suburban Comfort people have established themselves and their families in comfortable homes in mature suburbs. Children are becoming independent, work is less of a challenge and interest payments on homes and other loans are becoming less burdensome. These people live in inter-war suburbs and work mostly in intermediate level, white-collar occupations, where they are beginning to plan for approaching retirement. They are likely to be married and most have children, who may be at secondary school or university, or grown up and starting families of their own.

### **Symbols of Success**

Symbols of Success people are well set in their careers and their incomes have risen far into upper income tax ranges. Some work for large corporations in senior management positions; some hold respected roles in professional practices; others have built successful enterprises with their own commercial acumen. These are people with busy and complex family lives. Their children are now less time consuming, with more independent lifestyles, but with leisure interests that are likely to be more expensive.

### **Rural Isolation**

Rural Isolation people live deep in the countryside in small communities that are little influenced by the influx of urban commuters. Here, people have different levels of income but share an attachment to the local community. Despite the mix of incomes, most people own their homes and there is substantial hidden wealth, much of it inherited, in the form of land, property, investment and small business ownership.

### **Municipal Dependency**

Municipal Dependency families lack the funds to buy their own homes and are reliant on local authority housing, which is typically on large, low-rise estates far from the centre of the city. Living in council accommodation, reliant on buses for mobility and on television for entertainment, these people lead particularly passive lives, with far less choice than the better-off groups.

### **Grey Perspectives**

Grey Perspectives people are retired but still independent, with time on their hands and in reasonably good health. They own and run their own homes and are financially independent. On retirement, they may have swapped their suburban home for a property in a coastal resort or pleasant heritage town or rural village, or in a smart apartment block in the outer London suburbs. This down sizing is likely to have left them with a significant amount of capital.

### **Welfare Borderline**

Welfare Borderline people are struggling to achieve the material and personal rewards that are assumed to be open to all in an affluent society. Few hold down rewarding or well-paid jobs; most rely on the council for their accommodation and on state benefits to fund bare essentials.

### **Urban Intelligence**

Urban Intelligence people are young, well educated and open to new ideas and influences. They are cosmopolitan in their tastes and liberal in their social attitudes. Few have children. Many are in further education while others are moving into full-time employment. Most do not feel ready to make permanent commitments, whether to partners, professions or to specific employers. As higher education has become internationalised, the Urban Intelligence group has acquired many foreign-born residents, which further encourages ethnic and cultural variety.

### **Twilight Subsistence**

Twilight Subsistence people have reached the late stage in previously independent lives and now require the support of housing and social services departments. Most rely entirely on state benefits for their income. They either rent their homes from the public sector, rather than owning, or use local authority rather than private care homes. This reflects their low levels of savings and incomes; most do not hold any equity, either in their homes or in financial investments, and their incomes are likely to be restricted to the basic state pension supplemented by other welfare benefit payments.

### **Ties of the Community**

Ties of Community people live in very established, rather old-fashioned communities. Traditionally, people in this group married young and had manual jobs in industries such as docks and mines. Today, this group has a younger than average population; many are married or cohabiting and bringing up young children. Social support networks are strong, with friends and relations nearby.

# Summary:

## The post-recession consumer landscape

From previous recessions, it has become evident that consumer spending has improved at only a modest rate in the years following. This recession will be no different. Consumers will start spending again, of course, and the hope has to be that businesses will be able to grow off the back of this spending. Retail, the sector which has remained surprisingly resilient during the downturn, will be a lead indicator for signs of recovery. With the north of England and the West Midlands hit by the manufacturing downturn and seeing the lowest levels of consumer confidence, it will be London and the South East that will lead the way in terms of growth post-recession.

But across all regions and across all consumer segments, the rules of the game have changed and in some cases there is no going back. From a culture of consumption we've moved to one of thrift; a make do and mend mindset that has become fashionable in itself. It's a mindset that has galvanized consumers across all geodemographic segments and developed a momentum that is likely to continue even as the upturn comes. This thriftiness and drive for value doesn't always mean looking for the cheapest option. Instead, it's about *maximizing*, using an exacting set of selection criteria to make the best value for money and most rational choice on everything from mobile phones to washing machines to shampoo.

Consumption when it happens will see a shift from conspicuous to conscious consumption. Maximising, showing our green credentials and being particular with our brand loyalties are all part of a new concerned and considered consumption. In this new world, brands will need to focus on price, loyalty and most of all, service.

The price/value equation consumers are tuned into will require brands to work harder than ever to offer flexible payment and seek to lock consumers in with all inclusive packages at great prices. Alongside this will be a greater focus on loyalty card schemes and offering customers tangible rewards. Finally, in the post-recession world, exceptional customer service will be the making or breaking of a brand, and personal recommendations driven by successful interaction with your business, will be a key element of any brand's success.

Such drivers will also apply online. In particular, user-generated content (UGC) will increasingly shape the online landscape post-recession.

Free content and UGC chime well with consumers focused on value for money and service. Consumers, especially in the online world, are used to getting something for free. But those online retailers who get their free content right, will be best placed to pick up new customers once the recovery curve comes. What's more, good UGC, in particular customer reviews and recommendations, also drives transactions and, as with the offline world, personal recommendations will be increasingly important and drive ever more sophisticated feedback mechanisms and content.

And when the upturn really comes and marketing spend increases once again, UGC will break out of online to feed into and feature in advertising across all channels.

# 2. The business landscape

## The business distress index: a tale of three economies

Rolf Hickmann, Managing Director, pH, an Experian company

A tale of three economies is emerging as the UK progresses through the recession. But, it may not be the story many expect. A quarter on from our last report, we are still not observing recession-level insolvencies – in fact, all the metrics for April are positive. Digging deeper, analysis shows that while smaller businesses are still holding up despite the recession, the impact is visible on mid-sized and larger organisations, particularly in terms of the insolvency rate.

Each recession has its own anatomy and internal logic. This one is characterised, and was indeed triggered, by the balance sheet and liquidity calamity within the banking sector. A calamity of such epic proportions that it was a front-page news fixture for months, exerting huge psychological impact on the public at large, causing sudden and significant deferral of large purchase decisions (and large deflation of values) on big ticket items and assets such as cars and homes.

The knock-on effect for these industries, typically populated by few employers but each with very significant employment, has been devastating, and they have had to take an axe to their cost structures to adjust to the drop in demand, making staff redundant - further reinforcing, of course, the doom loop and affecting demand. As a result, GDP is sharply down, unemployment is sharply up and the economy is in trouble.

All that is needed to make the picture of gloom complete is to confirm the demise of the 'third estate' in the economy; the broad population of small and medium-sized firms across the remaining industry sectors. Over 90% of all UK companies fall in the SME category and are especially prevalent in the services and retail sectors.

Indeed, the demise of the SME economy, as opposed to that of the banking, automotive and housing sectors, has also been a constant and intoxicating message in the media these past months. This has been helping to drive a second stage of this recession, the psychological engine which has followed the original fallout in the financial sector.

In reality:

- the evidence shown here confirms, against all expectations, that the SME population at large still continues to remain resilient in spite of all this adversity
- even as operating results within the 'real' UK banking sector, i.e. its recurrent, operational P&L results (away from US toxic securitised assets, from misjudged mega-mergers, and from over-reliance on funding from the wholesale markets) prove on the whole to be respectable

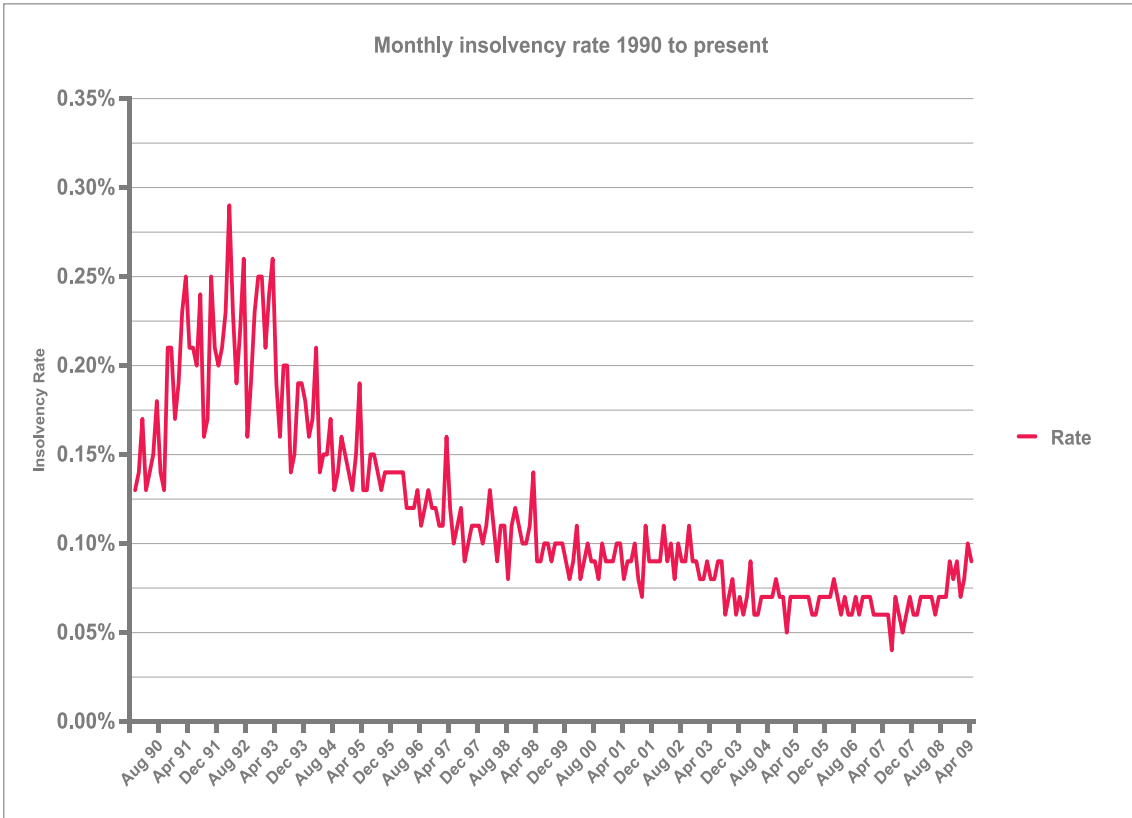
So is there some hope for a short-and-sharp, rather than long-and-deep, recession? And could the psychology be reversed? Or are we heading for a final cycle of calamity?

### What's happening now?: the real evidence on SMEs

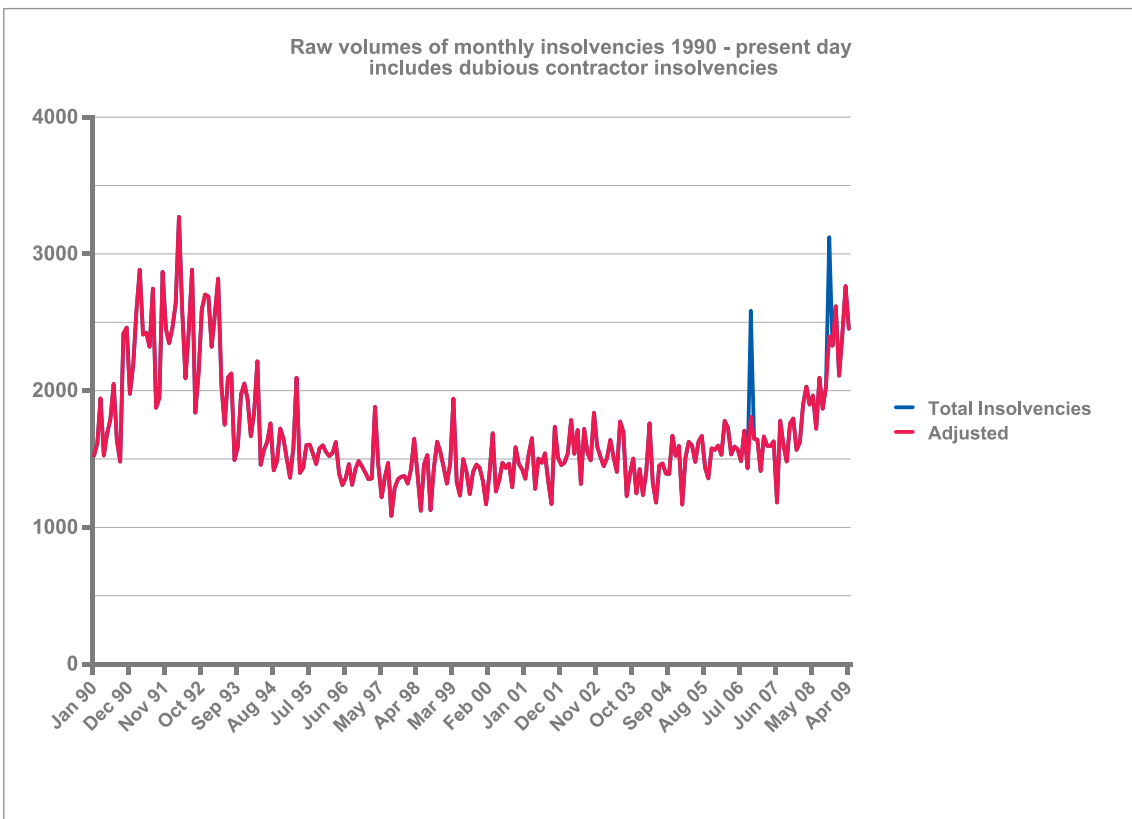
Using data collected via Companies House, pH has been closely tracking insolvencies across the business population, and the progress of the recession since September 2008.

And still, the spike in overall company insolvency rates (business failures as a percentage of the business base), observed in the 1991 recession has not appeared.

In fact, after a measured (but far from catastrophic) rise since the final quarter of 2007, the overall insolvency rate was actually down in January 2009 from its level in December 2008, and after coming back up for two months at the end of March, is actually down again in April. It still lies at only a third of its 1991 level!

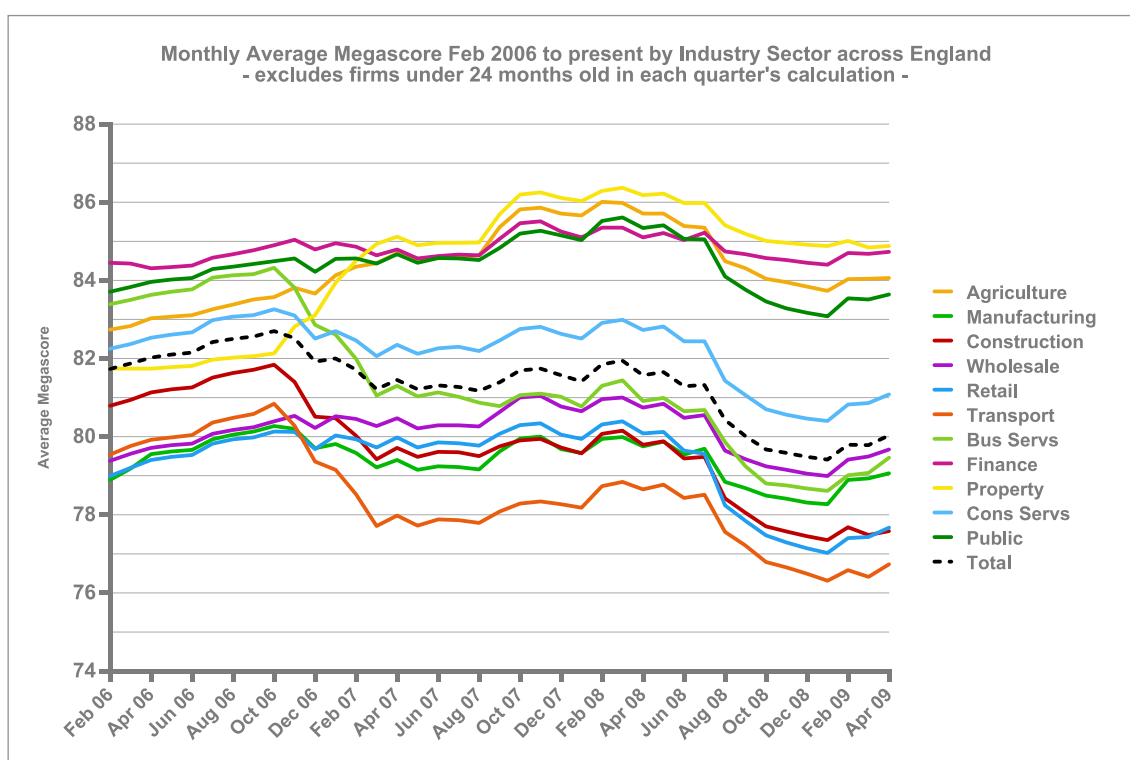


While the sheer numbers of defaults have visibly risen faster since mid-2007, so has the base of live firms, which is largely overlooked. Critically, this oversight invalidates the message that we are at record insolvency levels. In fact, we are still far from the 1991 peak in terms of default rate (the correct measure) and just barely back up to...early 2003 levels! Indeed, April's figure was down (see raw volumes chart below).



Stepping back for a broader perspective and looking at the financial solidity of the UK business population, it is evident that the average balance sheet strength has improved from February and into April 2009. This is the case across all UK regions, which again is coherent with the other analyses. The pH Megascore is a default probability model, which takes balance-sheet and P&L factors into account, such as liquidity and gearing, to generate a score of between one and 100 that measures the financial solidity of the business population. This measure reflects balance sheets filed in many cases before the onset of this recession, however many already do reflect it, and in any case the score has been validated as a very strong predictor of future business failures. What this score also points to is that the average level of financial health prevalent within the business population was quite good before the unexpected onset of the liquidity crisis. It would have been far worse had the tsunami hit at a time when the foundations were weaker.

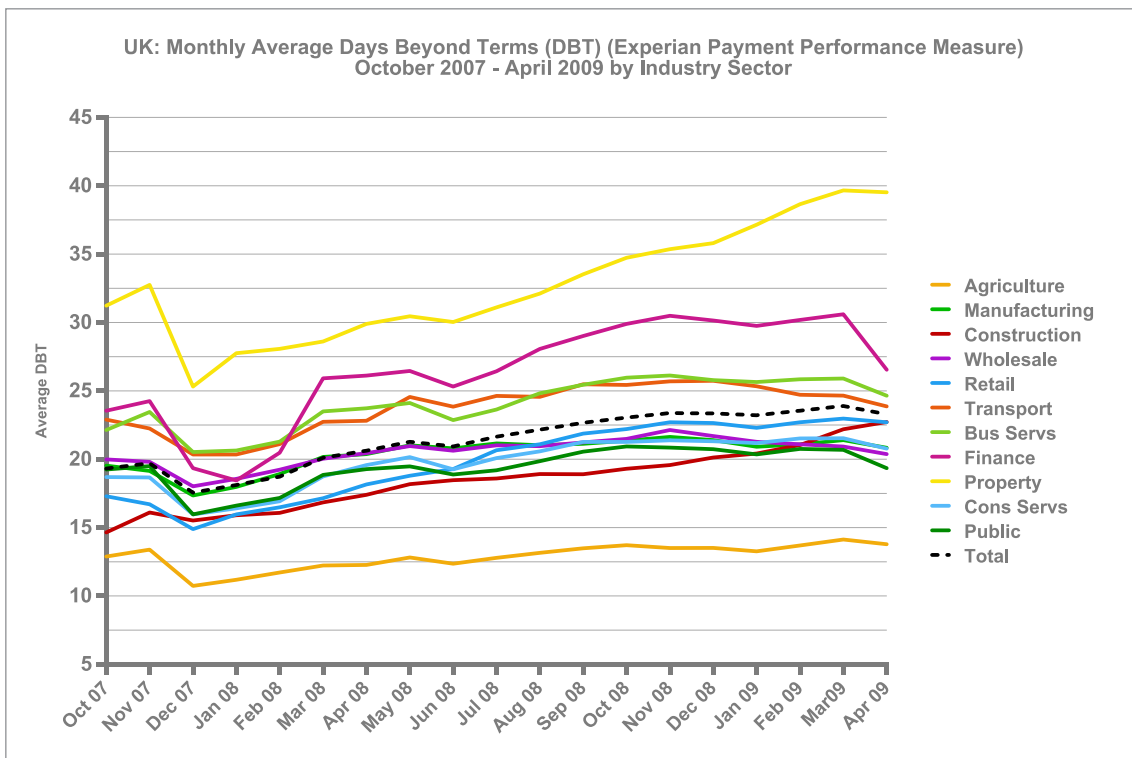
## It is evident that the average balance sheet strength has improved from February and into April 2009.



Drawing on Experian's commercial database of UK payment information, which tracks 20 million transactions worth £15billion each month to indicate good and poor invoice payment trends, provides an invaluable insight into the impact of the recession in terms of liquidity.

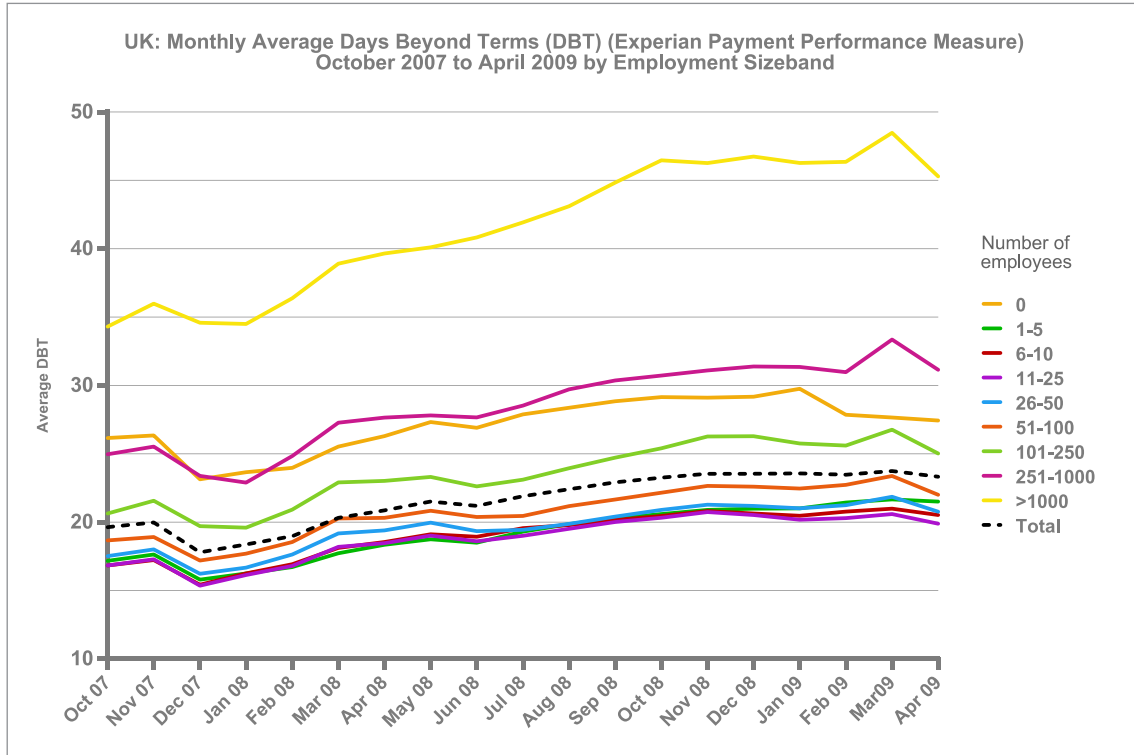
Not only has the average number of days beyond terms (DBT) practised by firms in their payments not exploded since the crisis, it has actually remained quite stable and at a relatively benign level up to March and even started to decline in April 2009, standing at 23 days. This confirms the insolvency rate and Megascore message: no catastrophic transition is yet visible overall. Instead, there has been a broad-based and consistent short term improvement.

There are, of course, marked differences between the key industry sectors. Since the start of 2008, the property sector has seen its DBT increase by almost 12 days, from 28 days to 40 days. Finance and business services are two additional slow paying sectors. The finance sector's DBT has increased from a recent low of 18 days in January 2008 to 27 days at the end of April 2009. Business services, meanwhile, is the third slowest paying sector with a current DBT of 25 days.

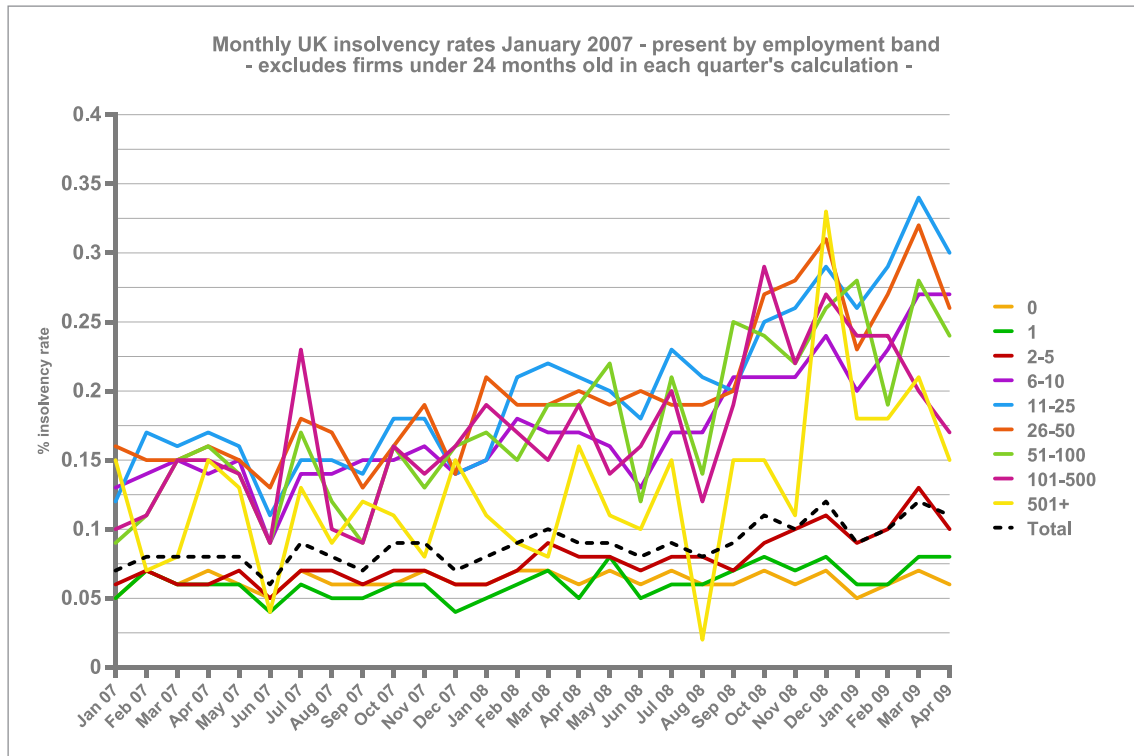


Analysing payment performance by size of business clearly shows that the very largest businesses (1,000 plus employees) are paying their bills considerably more slowly than smaller businesses – 45 days beyond terms at the end of April 2009, compared to the next slowest payer (251-1,000 employees) at 31 days beyond terms.

Businesses with 50 employees or fewer are the promptest payers; organisations with 11 to 25 employees pay bills 20 days beyond terms on average.



In fact, focusing further on company size, a much more striking feature of the trend in company insolvencies is revealed. It is a tale of three economies: the small, the mid-range, and the large – with very differentiated and counter-intuitive insolvency patterns.



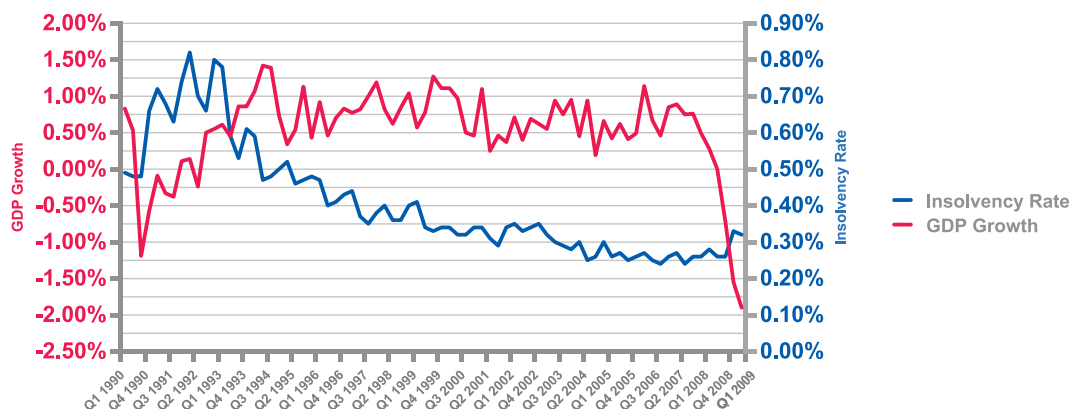
The smallest businesses (0-1, 2-5, and 6-10 employee firms) have actually been experiencing the lowest default rates, and seem least affected by the current crisis. Mid-range businesses (11-25, 26-50 and 51-100 employee firms) have consistently been experiencing the highest default rates, moreover with significant uplift since mid-2008 and in recession since then. Finally, the largest (100-500 and 501+ employees) have evolved from having the lowest default rates at the start of the century, to an intermediary (and crisis-sensitive) position as at the end of March 2009.

This suggests it is the mid and upper mid-market which policy makers should be focusing their efforts on. However, all five bands actually improve – the mid and large size by a considerable amount – in April.

### How will the business landscape look post-recession?

So where will we finally land? And what will the business landscape look like when we do? The challenge is working out exactly where we are now. Coming back to the insolvency rate, there is an apparent lag of a few quarters between a significant drop in GDP and subsequent mass insolvencies, and of course GDP has just suffered a massive drop. So is there still a major leg of this recession to come, with a real jump in SME insolvencies? Or, is this not instead evidence that the SME population, the backbone of the economy, is not yet in a terminal state?

Past history suggests that insolvency rates rise  
1-2 quarters after negative GDP growth is experienced



Imagine the consequences of letting this runaway train run its course: SME default rates would finally lift up, they could even reach their 1991 peaks, meaning that a spate of default rates three times higher than the current ones will be experienced - but on a much larger base of firms than in 1991 – and even if we assume just a few job losses per firm on average, with a 1992-like rate of insolvencies persisting over several quarters, we would be facing a large incremental rise in unemployed from the SME sector alone.

What we will see when we start the upturn is that weaker firms will be fewer on the ground. Notwithstanding the relatively low insolvency rate we are experiencing, the weakest firms will not survive, leaving the business base overall financially stronger by measures such as the Megascor, our probability model that measures the financial strength of a business and its likelihood of failure due to financial distress.

Insolvencies in raw volume terms are likely to flatten again at what has up until 2007 been a baseline of around 1,500 per month, but still against a growing business population. Despite the recession, there were over 91,000 new business registrations in the first three months of 2009, down slightly on the 2008 level, but still outweighing the number of business failures significantly. Once confidence returns, both the number of new business registrations and the business birth rate (the number of new businesses as a percentage of the base) would be expected to increase – although given the slow recovery anticipated, at a somewhat slower rate than after previous recessions. After the recession of the 1990's the number of new businesses registered grew from a little under 116,000 in 1993 to almost 406,000 ten years later, while over the same period the business birth rate increased from 10% to 19%.

What we do know is that the SME economy has shown itself to be remarkably resilient so far and all the evidence shows there is still time to avert the worst.

# Summary:

## The post-recession business landscape

What has surprised many commentators is that the downturn has been fairly broad-based across industry sectors. While initial forecasts had the recession concentrated in financial services and construction, the severe decline in output in the past six months has been far more widespread: the service sector, which has supported growth in recent years, has endured a marked period of contraction, led by distribution and business services. Manufacturing was down sharply and construction output is depressed by a very sharp fall in housing starts and the cancellation or postponement of many projects.

The relatively broad-based nature of the downturn, together with an inherent flexibility and agility, may indeed explain why the smallest firms have proved themselves so resilient, with an insolvency rate below that of their larger counterparts.

Overall, conditions remain weak as the global recession depresses exports, while domestic demand is undermined by low levels of confidence, falling business investment and house prices and a weak labour market. Business investment in particular has been hit hard by the worsening of the global financial crisis in the wake of the Lehman Brothers' collapse. While some commentators talk about green shoots appearing, trading conditions will remain extremely tough in the short term.

Businesses of all sizes will now be looking for the stabilisation in the business economy. Factors driving that recovery will include the renewal of lending to businesses and an increased export demand, buoyed by the weak pound. But this recovery curve will be restrained by weak export markets, particularly within the European Union, rising unemployment and a further rise in the savings rate, as households continue to worry about job security.

As a result, recovery is likely to be slower than during the last recession and without the booms in key sectors witnessed in the past. While start up activity will get a boost as confidence in the economy gradually increases, we will not see the same rapid expansion of the business services sector again.

Market participants in all sectors will have to grow accustomed to slower rates of growth as the boom years of the 1990s and 2000s become a distant memory. Nor will growth be dominated by a few frothy sectors, such as financial services or construction. Instead, growth will be better balanced. Services will continue to lead the way, providing a healthy, if not exciting, rate of return.

On the whole, the business landscape itself is unlikely to look a great deal different. Survival of the fittest means that weaker firms will fall by the wayside, particularly in those sectors with an abundance of suppliers and organisations that aren't able to differentiate themselves on the price, loyalty and service fronts (these marketing tenets will be significant in the business environment too...). The business base as a whole is likely to emerge stronger and more stable. Good news for those businesses ready and prepared to ride the recovery curve.

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