

# The Insight Report

An Experian report - Quarter 1, 2009

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# Introduction

## Could perception be helping to drive down the economy?

Charlotte Hogg

Managing Director, Experian UK and Ireland



Welcome to the first Experian® Insight Report, which uses our unique consumer and business information to identify new trends emerging in the UK economy. In the last year, a series of seismic events have left an indelible mark on business life as we know it. The rules of the game have changed, but what of the effects on consumers and businesses in the UK?

Based on our analysis, a consistent theme is emerging. Perception is at least as influential as reality in driving the economy. Belief may be outweighing facts.

Perception and beliefs are becoming far more important to the real activity of the economy than they have ever been before, especially in today's 'always on' society when news and information can be disseminated across the globe in a nanosecond. While many of us still receive our news from traditional media sources, online searches for 'interest rates', 'petrol prices' and the 'credit crunch' have rocketed. The majority of consumers (82%) feel very or fairly well informed – but being informed doesn't mean feeling better. Instant access to information in all its guises appears to lead to heightened concerns about the state of the world and local and global economies.

Ironically, some of those consumers who appear to be most concerned are actually those least at risk of the global downturn. Unfortunately, this is translating into lower spending, which could well have a disproportionate effect on the economy. For those consumers still spending, the focus is on value first and foremost. The rules of engagement, as far as today's consumers are concerned, are all about using offline and online information channels to locate the best deals possible and vouchers are flavour of the month. This explains the peak in online activity on Boxing Day. They find what they want online and get the best value when they hit the high street.

Turning to the business environment, a similar picture emerges.

Clearly, in raw volume terms, the number of business failures is increasing. Also, the underlying health of businesses appears to be worsening, as evidenced by our credit scores. Certain sectors are feeling the pressure more than others and, unsurprisingly, retailers are in the spotlight. As with consumers, businesses are changing their behaviour to adapt to today's climate. In particular, they are hoarding cash as payment rates decline, and anecdotally, taking down their credit lines. They are also not starting up. While there is considerable concern about the level of bank lending to businesses, it could also be true that concern from would-be entrepreneurs is contributing to the drop in start-ups. As with consumers, we may be witnessing perception playing a central role in driving reality.

This view is supported by our insights into the rate of business failures (number of failures over total businesses). This rate is not yet out of line with decade long historical trends, as this picture holds across sectors, geographies and business sizes. Contrary to the views of some commentators that businesses are facing Armageddon, our insight suggests that companies have not fallen off the cliff yet, but the hill is getting steeper.

What can be argued from these trends? For consumers, perception is important and changing the psychology of this recession is as important as traditional policy tools. Equally, organisations need a clear picture of the state of their business and to tie into changing consumer behaviours. Value and the integration of online and offline channels are key. For policy, hard data is critical so they can distinguish between reality and belief, and can differentiate the tools they use to support businesses and consumers through the next quarter and beyond.

These are clearly tougher economic times, and businesses and consumers will be under considerable pressure. We need the facts to manage through it.

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# 1. The consumer landscape

## Consumers' hopes and fears

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

Expectations of what is yet to come are still driving changes in consumer behaviour faster than current circumstances necessitate. Consumers have minimised household spend and the focus has shifted to fears around the reduction of funds coming into the home in view of job losses, wage reductions and lower returns on savings and investments.

### Q4 CY08: Major trends

Today's consumers are facing the current economic downturn against a radically different backdrop to that of the recession in the early Nineties.

The fact that this is the first recession of the globalised and networked age makes a huge impact on how we think, feel, act and react to the impact on our own lives, those of our friends, peers and colleagues and the world at large. The majority of us now live in a world where widespread broadband Internet usage gives us faster access to news and views from personal, professional and all manner of social networks twenty-four seven; a world where we use Twitter and blog endlessly about absolutely everything, both good and bad; where non-stop, real-time news and conjecture is pumped into our lives both at home and on-the-go and 'round the clock'; where increased levels of wealth, freely available credit and competitive pricing have shifted erstwhile luxuries, such as multiple foreign holidays, the latest car and the most up-to-the-minute gadgets, into mainstream lifestyles; and where Green issues have risen up the national agenda to complicate every consumption and brand choice we make on a daily basis.

Against this backdrop, we are witnessing a marked perception : reality gap in consumer behaviour. Just as the 'feel good factor' fuelled by rising house prices encouraged high consumer borrowing, so the 'feel bad factor' is out of kilter with reality for many who are changing their behaviour in response to the perceived rather than the real. Many consumers are ahead of the recession curve.

In *Consumer confidence in the current economy* (see page 12) we note that consumer confidence has fallen sharply and remains low, though it is beginning to show signs of stabilising.

Our Consumer Priorities Consortium<sup>1</sup> found that more than three-quarters of adults felt that the UK economy would worsen over the coming six months, a sentiment felt particularly strongly by 'Symbols of Success' and 'Rural Isolation' groups in our Mosaic® consumer classification system. Investment income accounts for 12-13% of total gross earnings for 'Symbols of Success' and 'Rural Isolation' – the latter increasingly includes members of the former, who have been heading to the country in recent years. The fact these segments are cutting back on spending has already been reflected in the higher ends of markets, especially property, luxury goods and cars.

By contrast, less than half of adults in the UK felt that their own personal finances would worsen over the same time period, with the 'Urban Intelligence' Mosaic group showing the greatest optimism.

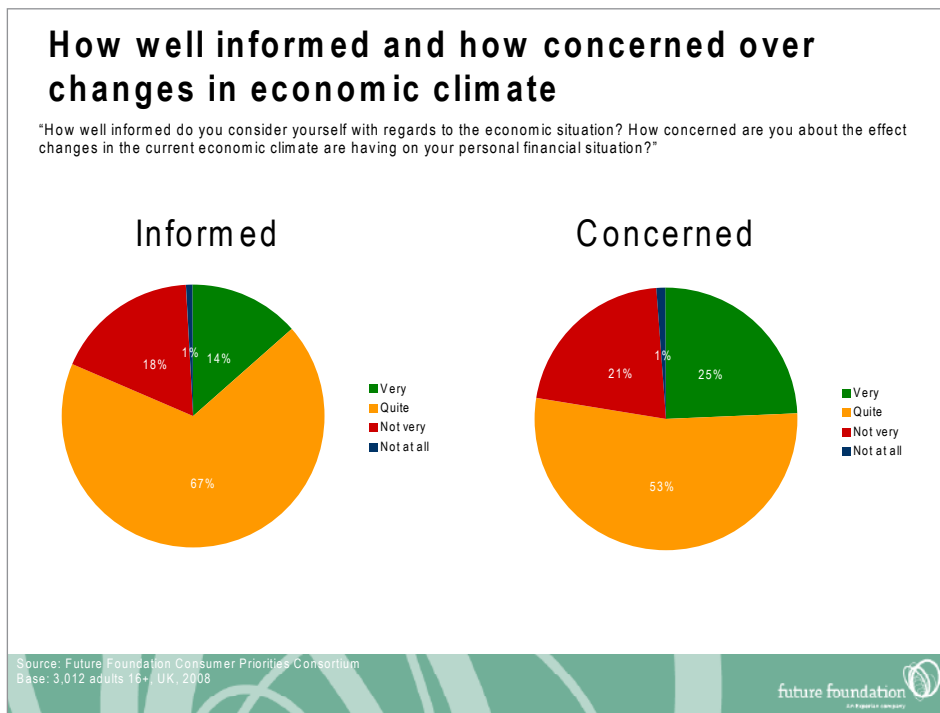
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<sup>1</sup>Future Foundation Consumer Priorities Consortium – Wave 1 end Oct 2008, Wave 2 Dec 2008

Recent indications are that consumers believe the worst has already happened for the economy in general, and most feel that credit/mortgage availability is about as tight as it is going to get, but the knock-on effects for their own personal finances are yet to be fully played out. Past optimists are now declaring a more pessimistic outlook. A key driver for this is fear of falling income (e.g. reduced overtime) or redundancy, with 'Blue Collar Enterprise' feeling this threat more acutely than any other group.

Confidence is tied up with awareness of what is going on, levels of concern and tangible personal impacts. Consumers have historically paid little attention to the likes of inter-bank lending rates, and even stock market fluctuations, more readily focusing on prices of day-to-day items such as food, fuel, electricity and gas – where price increases impact their budgets most severely. The development of a sticky housing market and reports of job losses, accompanied by falling prices, have kept the media coverage bubbling.

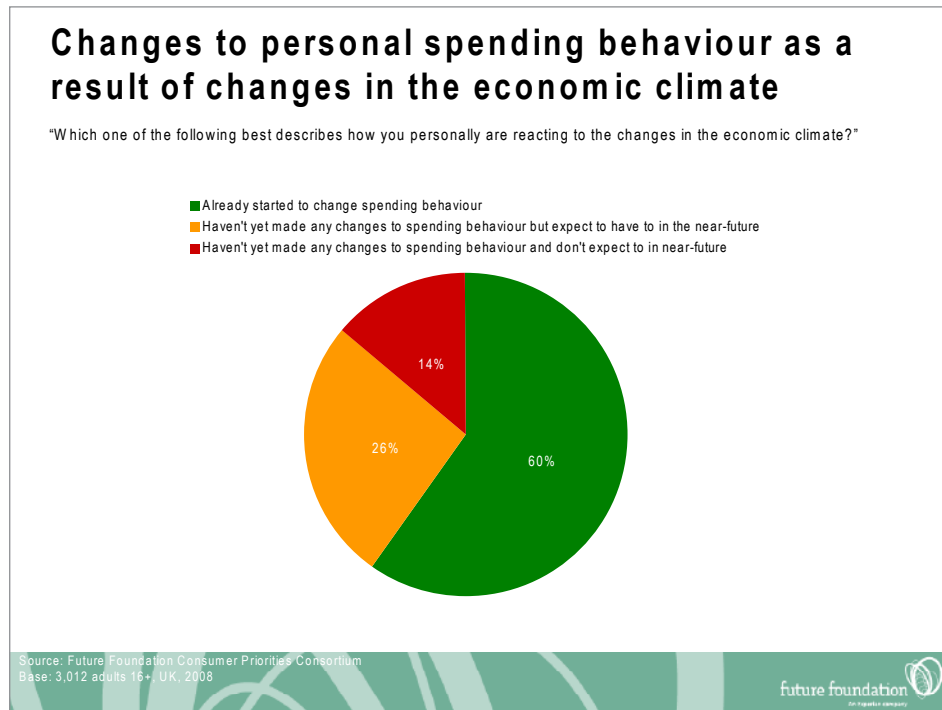
More than four in five (82%) feel either very or fairly well informed regarding the economic situation – but there are significant knowledge gaps felt by those in 'Municipal Dependency' (28% feel not very/not at all informed) in particular.



For many, greater knowledge equates to higher, rather than lower, levels of concern (79% are very/fairly concerned), and concern is felt most strongly by 'Blue Collar Enterprise'. This group are also the most likely to expect to be worse off in six months' time (along with 'Rural Isolation' and 'Symbols of Success') – and this fear is impacting on their current spending behaviour.

## Q1 CY09: Predicted market opportunities and red flags

The zeitgeist finds the majority of consumers having changed their behaviour in response to the downturn, but still a minority are not consciously adapting (just 14% have neither made any changes nor expect to – a state most prevalent amongst 'Suburban Comfort' and 'Grey Perspectives').



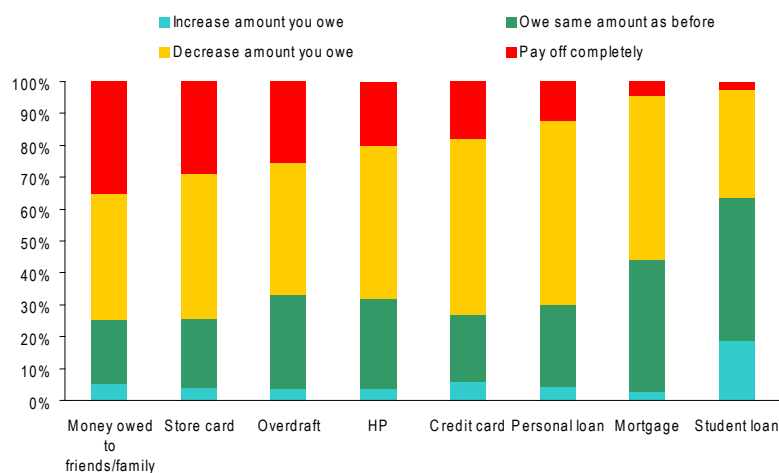
We can look at three broad consumer categories in terms of their response to the downturn:

- Firstly, those who have always had to be cost-conscious and careful to make ends meet. We may expect to see their ranks swell with those forced into this circumstance by reduced incomes or unemployment. Those in 'Blue Collar Enterprise' and 'Welfare Borderline' are the most likely to have changed their behaviour already and perhaps the most likely to form this group.
- Secondly, a group whose habits haven't been significantly impacted - yet. One in four consumers does not expect to see any difference in how well off they are over the next six months. This belief is most prevalent amongst the 'Suburban Comfort' and 'Grey Perspectives'. They are generally older and wealthier and concerned about the state of stock market and the strength of their investments rather than fears about the state of the labour market.
- Our third group is the one to watch as they are highly volatile and irrational when it comes to changes in spending priorities; it is becoming increasingly hard to predict where they will trade-down, trade-off or, even still, trade-up. This group of consumers are suffering from 'slowdown psyche' driven by a lack of confidence in their financial future, specifically, when it comes to job security and the value of their home. The new 'fashionable thrift' and 'make-do-and-mend' mindset is rampant amongst these people despite many being better off courtesy of lower mortgage repayments and the ever downward pressure on retail prices. We believe that they can still be tempted to spend if their purchase is seen as canny, savvy and representing great value-for-money, however, many are postponing large discretionary purchases (such as a new car or dishwasher) just in case.

- Our Consumer Priorities Consortium data shows that out-of-home entertainment was the number one area consumers would cut back on, followed by treats (e.g. snacks, coffee, confectionary). Many of these relatively easy changes have now been made, and we anticipate the previously untouchable areas such as holidays may soon increasingly come under the budgeting microscope, along with other major purchases such as cars, replacement furniture and white goods. Direct debit auditing is likely to result in a streamlining of dusty membership subscriptions. Repayment of debt takes priority over savings and paying back friends and family, store cards and overdrafts top the list.

## What changes do people plan to make to the amount they owe?

"Do you plan to change the amount you owe to each of the following in the next 6 months?"



Source: Future Foundation Consumer Priorities Consortium  
Base: Those who are borrowing, from 3,012 adults 16+, UK, 2008

future foundation  
an Experian company

It is not only purchases of goods and services that get affected – personal life choices are also being mediated by financial concerns. Research from Experian CreditExpert<sup>TM2</sup> reveals that 30% of UK adults are holding off from buying a property, more than a quarter (27%) are cancelling any plans they had to change jobs, and almost a quarter (23%) of 25-34 year olds are delaying having children.

**We believe that (consumers) can still be tempted to spend if their purchase is seen as canny, savvy and representing great value-for-money.**

<sup>2</sup> CreditExpert research

### Q1 CY09: Turning insight into action

Consumers have been given the opportunity to reconsider everything they spend money on – all goods and services are open to fierce scrutiny. The key trend of ‘Volatility and disloyalty’ will be more relevant than ever. Savvy shoppers will hunt for the best bargains without necessarily lowering their expectations for quality and good service. Default behaviours (e.g. “I always shop here”, “I always eat there”) will be exposed to significant disruptions and will be boosted by the enhanced sophistication of online information sharing. Discount vouchers and limited offers will tempt the brand waverers.

Almost a third of adults claim to have no emergency fund to provide for unexpected expenses so those lenders offering small, cheap, short term loans or overdraft extensions may disproportionately boost their customer loyalty. A further third have a ‘small amount’ leaving a significant number eager to find a safe, instantly accessible home for their safety net.

Another of our key trends, the growing ‘Cult of the home’, is being boosted as feelings about our homes begin to move away from ‘most important asset and investment’ and back towards ‘your nest and cocoon’ or ‘your fortress’. This yields a plethora of opportunities for those supplying low cost entertainment and home makeover solutions. However, durable replacement cycles are lengthening and the newest technology is again the realm of the early adopter as caution grows amongst the mainstream.

Customers are demanding (and receiving) better service, even as companies want to cut the cost of providing it. Consumers are looking for brands that treat them in an honest and fair way and in today’s landscape, tone of voice is just as important as the message itself.

Millions will travel relatively untroubled through the downturn and so maintain a demand for premium experiences and social and cultural capital accumulation. The desire for quality, luxury and indulgence still remains - especially amongst those groups who remain largely unaffected. And, in tough times, the need and desire for life’s little luxuries grows for all. However, the accumulation of permanently-owned possessions is now clearly not the only route to consumer fulfilment as renting, ‘fractional living’ and trading in secondary markets will chime well with both the ethical and economic mood of the times.

Using highly targeted marketing techniques that play to consumers’ needs and behaviours and clearly demonstrating value for money is going to be critical for those brands looking to engage effectively with their customer base.

#### 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.

## Consumer confidence in the current economy

Matthew Sherwood, Senior Global Economic Adviser and Sunita Bali, Senior UK Economist, Experian Business Strategies

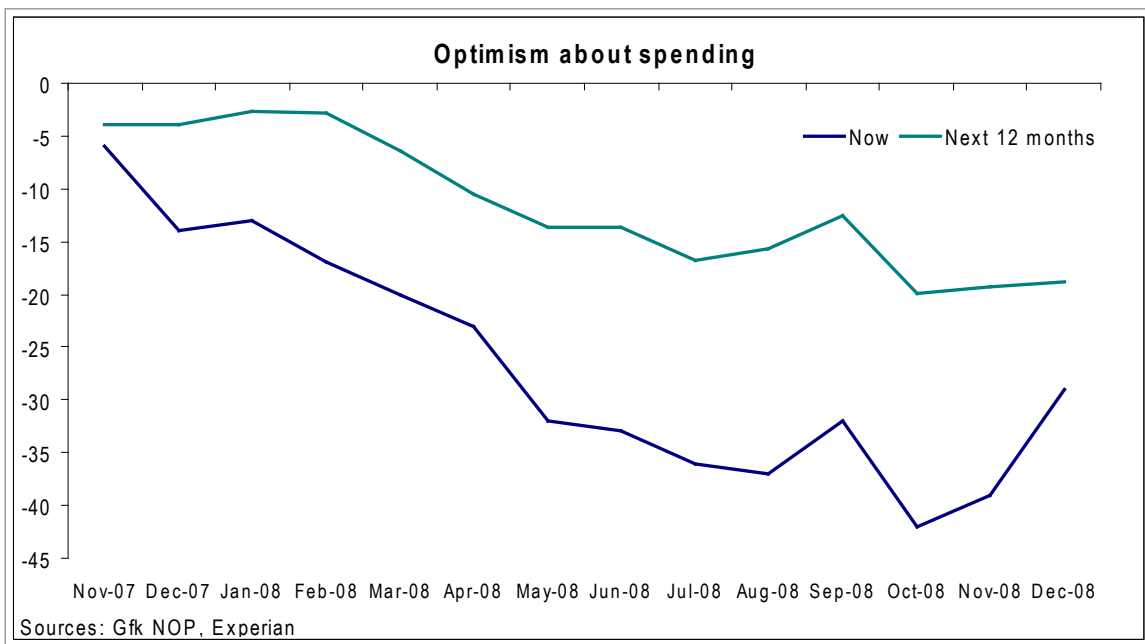
Consumer sentiment increased slightly in the final quarter of 2008. But forecasts of doom and gloom are becoming a self-fulfilling prophecy, with retailers facing another tough year.

### Q4 CY08: Major trends

One could be forgiven for thinking that consumer confidence has been knocked out by all the bad economic news in recent months. Buffeted by the credit crunch, skyrocketing food and fuel prices and gathering gloom in the global economy, sentiment as measured by our Consumer Sentiment Index<sup>3</sup> hit an all-time low in October 2008.

However, in November and December of 2008, consumers' views of their current situation actually improved to levels last seen in the Spring of 2008. This largely reflected petrol and food prices coming off their recent highs and the Bank of England slashing interest rates by three percent in the quarter.

All the while, consumers have remained comparatively sanguine about the future. The gap between consumers' views of their current and future financial situation remains wide after hitting the low in October.



Even so, with optimism about spending over the next 12 months remaining at close to all-time lows, it is not surprising consumers' concerns are hitting results on the high street. Official national statistics continue to show some volume gains in the 12 months to November, but surveys are painting a bleaker picture. According to the British Retail Consortium, like-for-like sales were down 2.7% from a year earlier in Q4 CY08.

<sup>3</sup>Experian's consumer sentiment index figure is calculated as a weighted combination of questions 1, 2, 4, 5 and 6 from the monthly GfK/NOP survey results. This includes questions on the economic and financial situation past and present, as well as unemployment expectations and the advantage of making major purchases now.

Household goods have been especially hard-hit, reflecting the ongoing correction in the housing market. Non-specialist stores are also being squeezed by the consumer downturn. Retailers are still moving clothing and footwear, but only as a result of aggressive discounting. Pre-Christmas sales began earlier than ever and many January sales were brought forward to Boxing Day.

If there have been any 'winners' in the current environment it has been the major supermarkets. Supermarkets are increasingly seen as discounters, with consumers turning to them for cheaper electricals and white goods.

#### Q1 CY09: A differentiated impact on consumers...

It seems unlikely that consumer sentiment will show much, if any, improvement in the first three months of 2009. While current expectations may improve further from October's low – owing to retailers' discounting and further falls in energy prices – consumers are likely to become even more pessimistic about the future. The economy is forecast to shed at least 200,000 jobs in Q1 CY09, a pace that is expected to be kept up over the rest of the year.

That said, sentiment indicators vary widely depending on households' socio-economic profiles (see *Consumers' hopes and fears* page 6). While Experian has long provided clients with insights into the behaviours of households, a new element is being added, coupling the Experian economic forecasting capability with its Mosaic® geodemographic profiling capabilities. Here the initial findings are more revealing than treating the UK consumer as one.

In the immediate short term, those segments that see their spending power holding up are those that rely least on the markets. These groups include those that take home a substantial share of their income in the form of benefits. They will also benefit from the sharp deceleration in inflation expected in the coming months.

Risk is concentrated in those groups of the population that are extremely reliant on wages and salaries for income, making them especially susceptible to redundancy. With large amounts of debt (especially mortgages) they are increasingly stretched and are finding only limited relief from lower interest rates, particularly as falling house prices mean that the equity in their homes is too small to qualify for better mortgage rates.

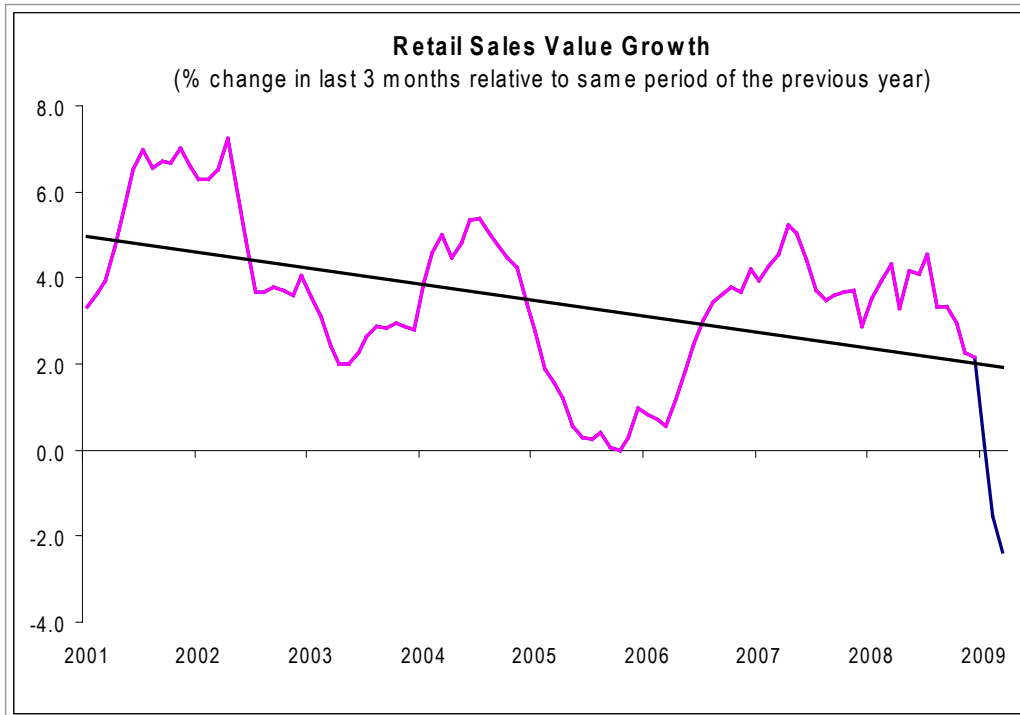
Conversely consumers with a high share of income generating assets will continue to cut back on spending, but with their accumulated wealth they are in most cases well-placed to ride out the recession.

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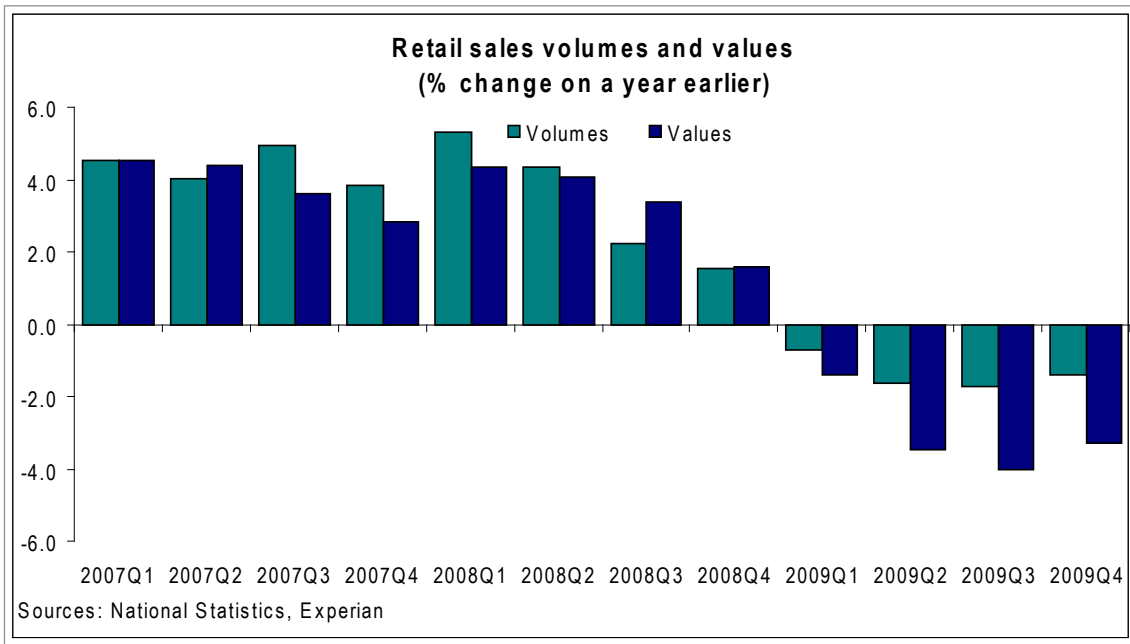
## Q1 CY09: .....and on retailers



In the retail world, Q1 CY09 will continue to see aggressive discounting, particularly in clothing and footwear. While this will have sustained volumes in early January, it seems likely that falling prices will not be able to stave off the inevitable decline, with a major impact on these retailers' bottom line. Experian forecasts that volumes will fall by at least 1% during the first three months of 2009, which would be the worst performance since Q2 CY1981.

It is worth noting that the retail sector will also see its own set of 'winners' and 'losers' in the short term. The wave of administrations that began in late 2008 will continue in early 2009. These will be centred largely in household goods, DIY stores and electrical stores as the correction in the housing market continues to impact and consumers reduce their spending on fitting out a new home.

Again, the supermarket chains are likely to be amongst the few 'winners' in the short run. The supermarkets' continued aggressive discounting of electricals and white goods means they are set, along with the other major discounters, to weather the next few months.




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## Consumers take control online

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

Consumers are turning to the Internet looking for value for money, information and empowerment online. The winners in the online world will be those who positively interact with their customers, and integrate with a strong offline presence.

### Q4 CY08: Major trends

As the economic downturn really started to bite during the latter half of 2008, people turned to the web for information and advice in record numbers. Searches for terms such as 'credit crunch' and 'recession' increased significantly and economics-related terms were amongst the top searches sending traffic to Wikipedia, the web's favourite information source.

The banks may have suffered, but online banking was more popular than ever during 2008. Consumers logged on in record numbers to find the best mortgage deals, while searches for everything from 'interest rates' to 'petrol prices' shot up following even minor changes in the market. Traffic to property websites fell by 14% during 2008, but searches for 'house price crash' increased by 44%.

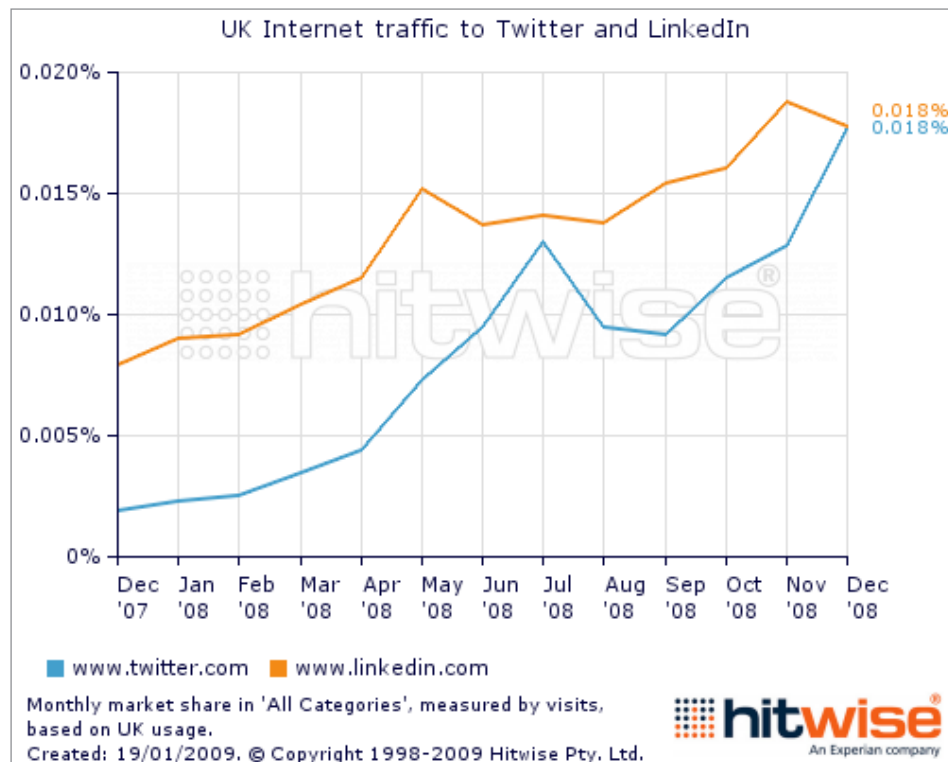
However, searches for bad news stories are not the only way that people are responding to the downturn online. Consumers have quickly realised that the web is a massive source of deals and discounts. Searches for discount vouchers increased by 143% during 2008, and a wealth of new websites emerged to feed this new British appetite for discounts. A typical online retailer now receives 1 in every 100 of its UK Internet visits from a voucher website such as HotUKDeals or MyVoucherCodes.

The thirst for discounts had a big impact on the Christmas shopping season. The sales were more important this year than ever, with many retailers starting before Christmas. As a result, online retailers experienced increases in traffic during the week leading up to Christmas, although in many ways this was an extension of the discount culture that took hold as early as November. Marks and Spencer, for example, experienced its busiest ever day online thanks to its 20% discount event on 20 November.

The real beneficiaries during the sales this year were the high street stores, both offline and online. During December the websites of high street retailers received 32% more UK Internet visits than their online-only rivals. High street retailers also did well online after Christmas, receiving 68% more Internet visits than those with an online only presence. Indeed, increased online sales seemed to have helped a number of high street retailers escape the worst of the credit crunch. Meanwhile, following a decrease in visits to stores before Christmas, Experian Footfall® reported an annual increase of 12.5% on Boxing Day.

During 2009, online will continue to steal shoppers from the high street, but the biggest beneficiaries will be web-savvy high street retailers. Spending shifted from the high street to online this Christmas, but more of that online spending is going to familiar names than web-only start ups.

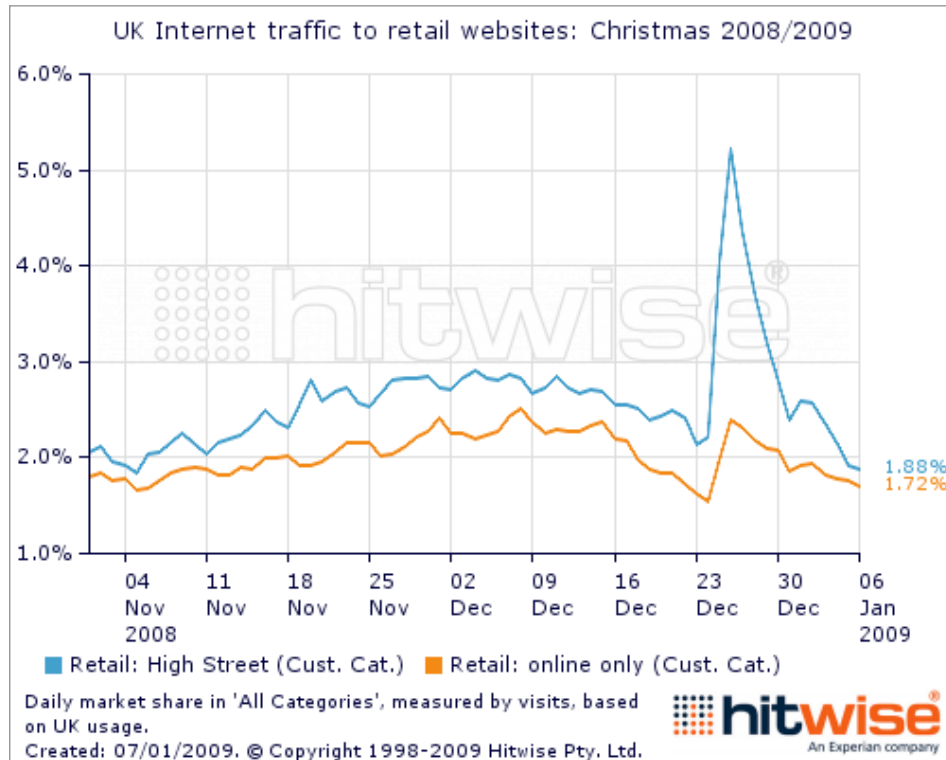
## Q1 CY09: Predicted market opportunities and red flags



It is interesting to compare the massive increase in discount voucher searches with the more moderate increase in sales searches this Christmas. While sales searches are driven by the retailers themselves – they typically shoot up while the sales signs are on display on the high street, but soon drop off as the signs disappear – the popularity of discount vouchers has been a consumer driven affair. Many of the most popular sites with bargain hunters contain a lot of consumer input. The interactive forum section of the 'consumer revenge' website MoneySavingExpert, for example, now receives more UK Internet visits than the main site.

The success of such websites has proven that user generated content is useful for more than just teenage gossip on MySpace. Social media sites continue to gain popularity in the UK, and they now account for 10% of all UK Internet traffic. Facebook is the second most popular website in the UK after Google, while YouTube sits at number three. Video content is an important ingredient in the social media mix, and the market will continue to expand in 2009 following a 68% growth rate during 2008. The biggest success was the BBC's iPlayer website, which went from launch in December 2007 to become the 21st most popular website in the UK by December 2008.

Smart companies will continue integrating user generated content and social elements into their websites in 2009. Many of the sites that will continue to grow rely on user generated content. These include Facebook, Youtube, and MoneySavingExpert, as well as Twitter (the 'micro-blogging' service that experienced a nine-fold increase in traffic during 2008) and LinkedIn, the professional networking service that was the second most popular job website in the UK after Christmas.



### Turning insight into action

The Internet has long empowered consumers, and social media has played a big role in that process. However, with the economic situation worsening and customers fewer and further between, consumers will take even greater control during 2009. The most successful web businesses will be those that are able to tap into this mood of empowerment by responding to genuine consumer demands.

Even businesses that don't naturally fit in online can use the potential of the Internet. During the last few months of 2008 the restaurant sector successfully won new customers despite the tough economic conditions. By offering discount and two-for-one vouchers via email and social networking sites, a wide range of restaurants managed to bring customers onto their premises despite a decline in consumer spending on socialising over Christmas. This type of success proves that all business can benefit from listening to and interacting with their customers. And there will be no better place to do that during 2009 than online.

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**Smart companies will continue integrating user generated content and social elements into their websites in 2009.**

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# Summary of recommendations:

## The consumer landscape

As our insight shows, consumer confidence is unlikely to improve significantly in the near future. Having said that, our analysis also shows that consumers will all react in very different ways to the downturn, depending on their socio-economic profiles – a key point for any organisation to bear in mind.

Many consumers have already changed or are planning to change their behaviour in response to the downturn, yet it is clear that the perceived threat does not always match the reality. Ironically, it is those people who are least likely to be significantly impacted who will be amongst the most likely to change their spending patterns in a knee-jerk response to the current economic climate.

To date, the symptoms of this change in mindset have centred on small, day-to-day and easy to make cut-backs. However, we are going to witness a major tightening of the purse strings around big ticket items such as holidays, cars and white goods. This will be compounded by concerns around the threat to household income.

Value for money is going to be at the top of the agenda for consumers in 2009. People will purchase, but only as long as it satisfies their appetite for a good deal. This incredible desire for value and a bargain is evident in the massive increases in discount vouchers searches on the internet and will continue to play out throughout the year. It is a phenomenon that has largely been driven by consumer demand and word of mouth. Furthermore, it also dovetails into another key trend and opportunity - websites encouraging user generated content and demanding consumer input are gaining popularity across the board, from teenagers to professionals. The bargaining power resides with consumers and they know it.

Against this backdrop, the early part of 2009 will be especially challenging for retailers. Lower demand and higher supplier costs will put pressure on retailers' margins as they absorb increased costs rather than pass them on to consumers. We are likely to see aggressive discounting, particularly on clothing and footwear and the electrical and DIY sectors are expected to struggle. All this will do for consumers is underline to them the position of power they now hold at a time when, as incredible as it might seem, some car dealers are now running 'buy one, get one free' offers.

### Turning insight into action – recommended learning points

Consumers' hopes and fears combined with their incessant drive for value, access to 'always on' media and information makes for a potent cocktail for organisations. All of these factors will see consumers become far less loyal and much harder to please. This is the age of what we call the 'empowered consumer': they hold all of the cards, know it and want more-for-less without compromising quality of service.

#### 1. Make every conversation count

For any organisation, our recommendation is to make every interaction with a customer count. This means using scientific-like customer insight to anticipate and respond to changes in each customer's behaviour. This is about enriching the customer experience, knowing what makes purchasers' tick and responding at every opportunity to capitalise on new trends emerging between the customer and brand. It all begins and ends with data and analytics by tapping into a rich vein of customer data and augmenting it with additional intelligence gleaned across every touchpoint.

## 2. Focus on a cohesive contact strategy across all channels

In this new consumer landscape, tone of voice will be just as important as the message itself. That means organisations need to focus on really understanding their customers and what drives their behaviour. Now is the time to focus on re-establishing, reinforcing and reinvigorating relationships with current customers by placing greater emphasis on the exploitation and application of existing data assets. The enhanced knowledge derived from this approach and the move to a coordinated customer contact strategy will lead to more profitable and longer relationships between brands and consumers

## 3. Work with consumer control, not against it

Consumers are taking control online, and will continue to do so in 2009, across all of their relationships with organisations. The most successful businesses will be those that are able to tap into this mood of empowerment by responding to genuine consumer demands through integrated communications channels. Even businesses that do not naturally fit in online can use the potential of the Internet, as seen by the basic example of the restaurant sector using its successful of two-for-one discount voucher formula.

The world is changing quickly, both in terms of consumers' hopes and fears and also the prosperity of the communities they are part of. Customer insight driven by data and analytics capabilities will become even more important in delivering up to the minute information to organisations to enable them to react at speed to subtle changes in consumers' circumstances. Adapting rapidly and sensitively to these changes as control switches between the company and consumer will be vital to fostering long-term goodwill and brand loyalty.

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**Now is the time to focus on re-establishing, reinforcing and reinvigorating relationships with current customers by placing greater emphasis on the exploitation and application of existing data assets.**

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# 2. The business landscape

## The business distress index

Rolf Hickmann, Managing Director, pH, an Experian company

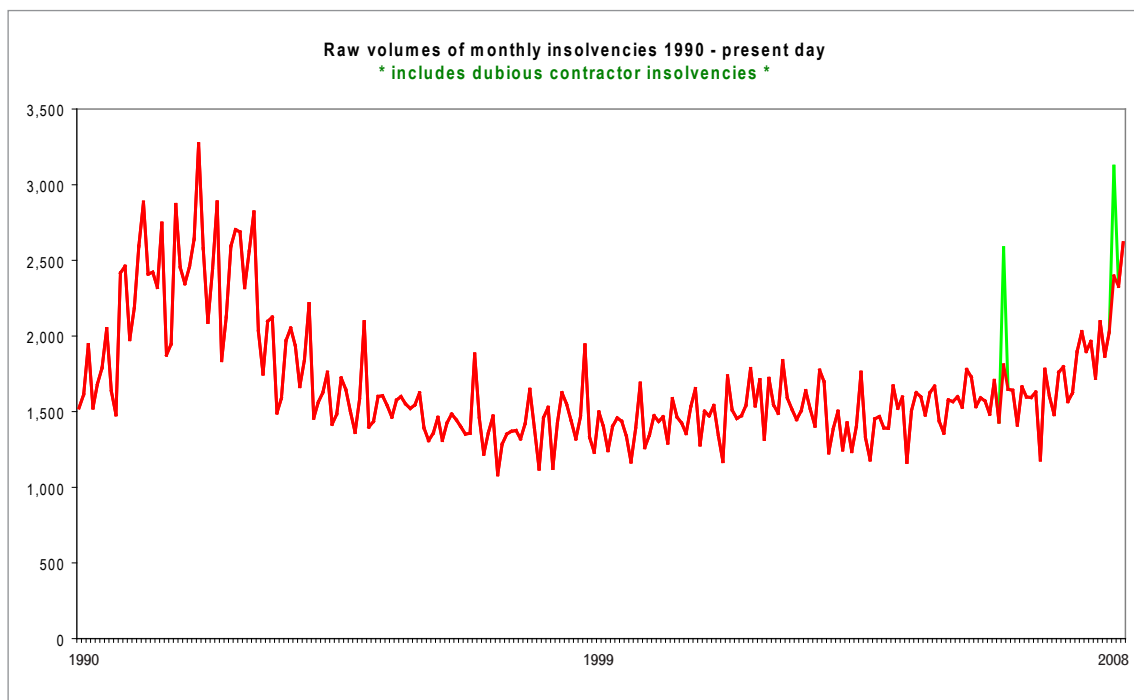
High profile business failures are grist to the mill for those predicting a deep recession. While failures are on the rise, credit is tightening and business start ups are feeling the impact, there's still time to protect the many healthy businesses from the worst of a recession.

### Q4 CY08: Major trends

How much have businesses in the UK been affected by the current liquidity crisis? And when exactly did the downturn start to impact on small businesses? While there have been numerous media reports and debates around these questions in recent months, a glut of very high profile retailing insolvencies and job losses, much of the evidence relating to small and medium sized enterprises (SMEs), in particular, has been heavily anecdotal.

Our contention is that, although there has clearly been damage to the economy, the situation is far from terminal and the SME population can be protected from a recession if we act quickly enough.

It is true that the raw insolvency data shows the number of insolvencies in the UK has been rising since CY07, after ten years of stability. Certainly, the insolvency figures make good headlines. Overall in Q4 CY08 more than 7,000 businesses failed, an increase of 53% compared to Q4 CY07. The retail failures of well-known high street names are dominating the business pages, but in reality it's the business services and building and construction sectors that have experienced the highest failure levels. Over 1,600 companies in the business services sector and over 700 in building and construction failed in the final quarter of the year, increases of 49% and 44% respectively on the situation in Q4 CY07.<sup>4</sup>

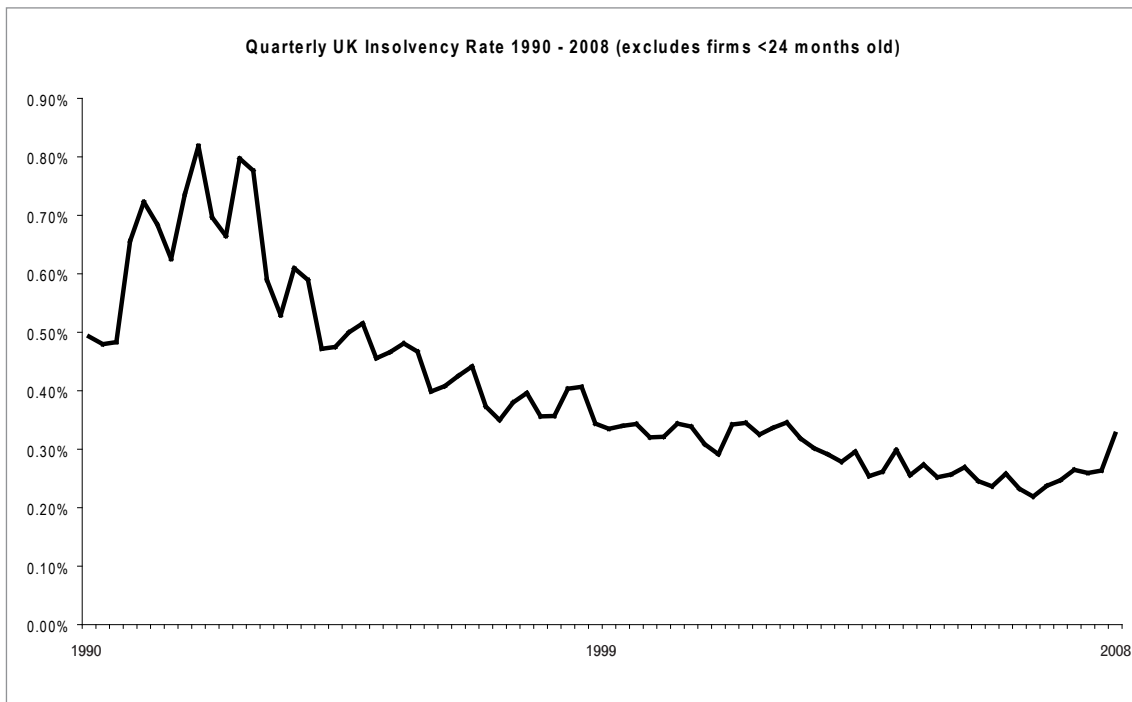


<sup>4</sup> Note that the 'raw' data has twice been polluted in recent years by abnormal default events (i.e. in October 2006 and 2008, see the green line peaks on the raw insolvency data chart), when some 700 insolvencies all occur on the same date at the same address, above the trend line of 1,500 to 2,000 per month. These turn out to be associated to one umbrella organisation each time, so the time series is adjusted accordingly.

It is important to recognise that raw insolvency data does present a good overall measure of what's happening in the economy. What we need to be mindful of, however, is that as well as an increase in failures, the underlying business population has also been rising in recent years.

To determine the extent to which the economy really is suffering, we need to consider insolvencies as a percentage of the overall business base to give an insolvency rate. This reveals a somewhat different picture.

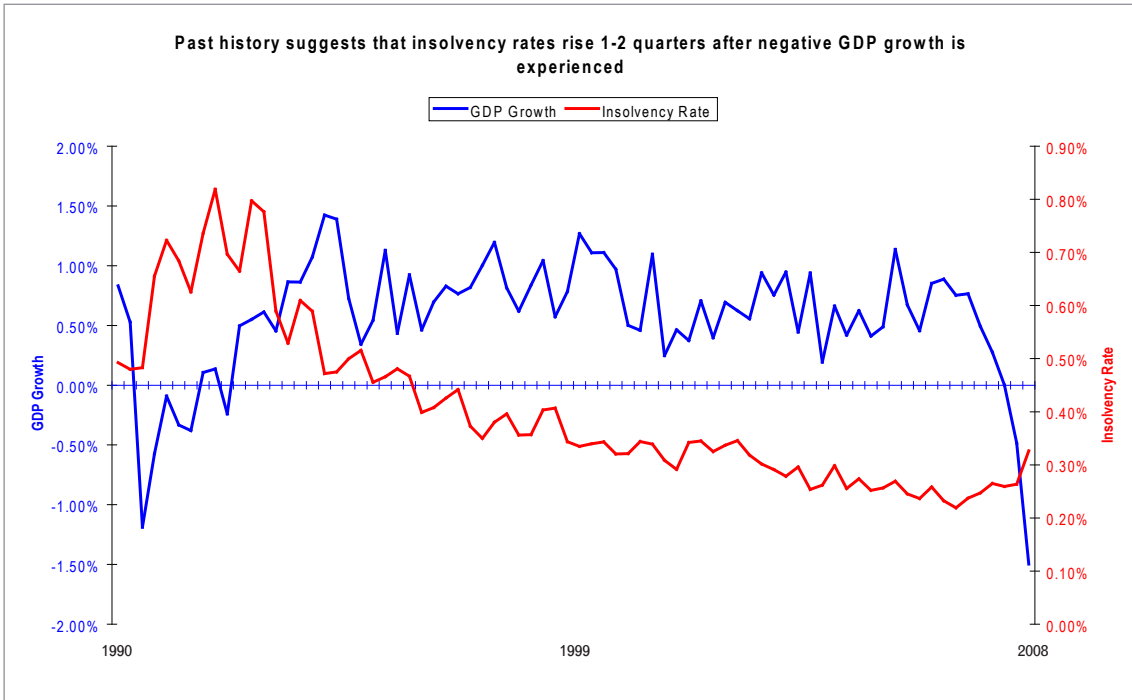
Our analysis of the financial and insolvency data of every business registered at Companies House<sup>5</sup>, suggests that early reports of significant damage to the SME economy at the end of Q3 CY09 brought about by the developing recession were exaggerated: the business-to-business population in the UK had not yet suffered significant insolvency rates from the credit crunch as of September 2008<sup>6</sup>, despite the fallout in the financial sector. The first real evidence of distress, as measured by insolvency rates, only appeared at the beginning of Q4 CY08, although even as of the end of December 2008, this was still far from reaching recession levels. In fact, the current insolvency rate is only back up to the levels of 2004, a very benign year.



Going back to 1990 and tracking the insolvency rate forward to Q4 CY08 shows that the default rate has actually been steadily improving all the way from 1992 until Q3 CY08. Only with Q4 CY08 did an increasing trend line become apparent from mid-2007, although even at the end of the quarter, the real rate of insolvencies amongst the B2B population was less than half that experienced during the recession of the early Nineties. As the chart comparing GDP and raw insolvencies highlights, there is a lag of between two and three quarters between a shrinkage in Gross Domestic Product (GDP) and a corresponding increase in insolvencies. This suggests that the insolvency rate could jump over the next six months, which does give a window of opportunity to take action. So, this leaves six months for intelligent new policies to prevent a huge increase in default rates reaching back to 1991 levels.

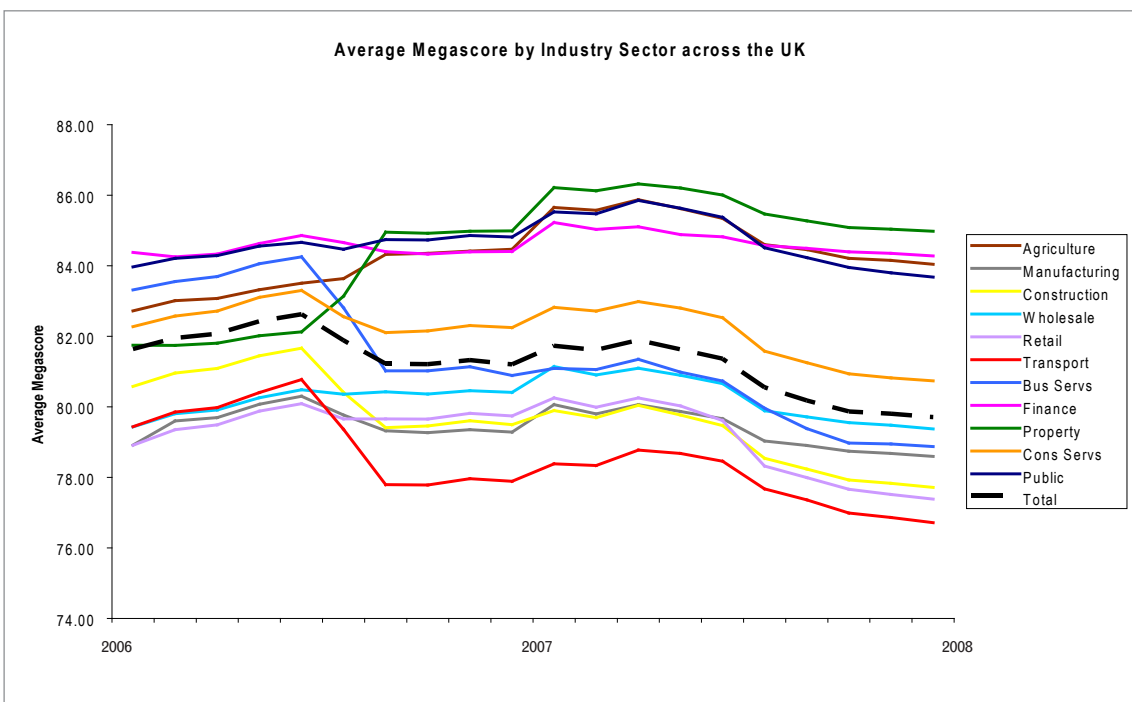
<sup>5</sup>Excluding firms that are registered at Companies House but do not trade. Excludes Partnerships and Sole Traders as these are not registered at Companies House. Excluding firms less than 24 months old

<sup>6</sup>97 per cent of UK firms employ less than 20 people. Source: Federation of Small Businesses

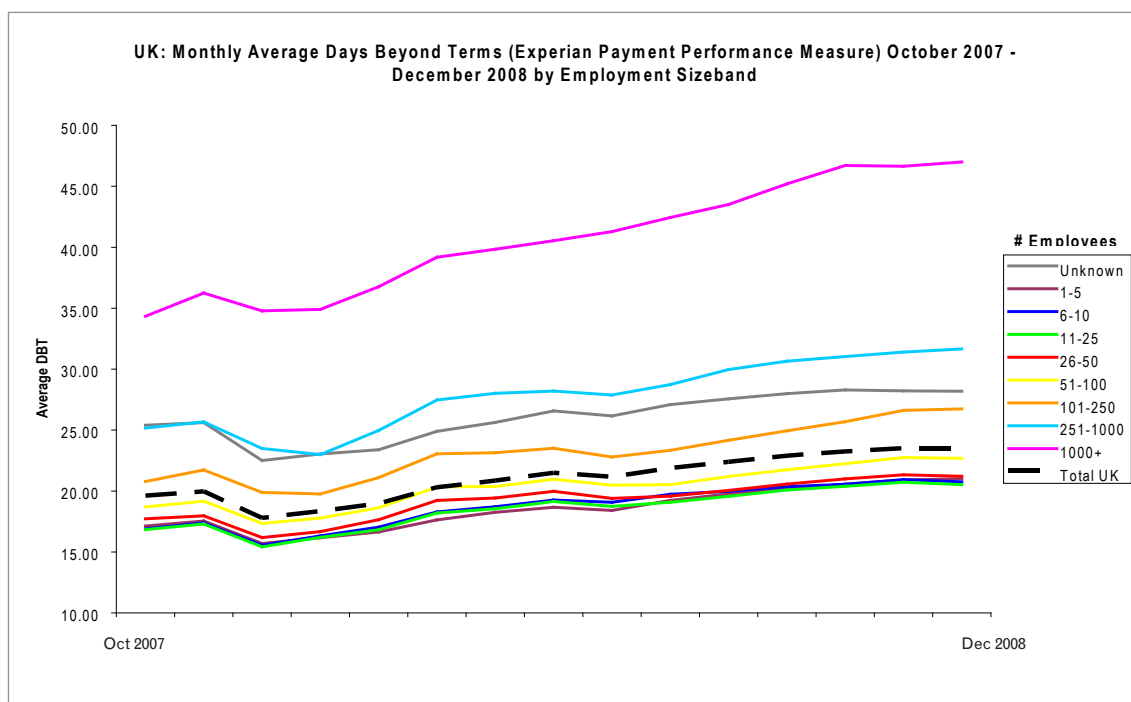


The real insolvency rate is one measure, but this general trend in Q4 CY08 is confirmed by looking at other measures, such as the financial solidity of SMEs. This can be gained by looking at the pH Megascore, a default probability model. The Megascore takes balance-sheet and P&L factors into account, such as liquidity and gearing, to generate a score of between one and 100 that measures the financial solidity of the business population and it is validated as a strong predictor of default rates 12 to 24 months out.

Looking at the average Megascore by key industry sector from 2006, it's clear that there has only been on average a very gentle decline in the financial strength of the business population since late 2006. But this decline is well within normal historical variations, even in Q4 CY08 and remains at around 80 out of 100.



The speed at which businesses are paying their bills provides a good indicator of liquidity. Such analysis is gained by collecting millions of invoices across the economy, and calculating, every month based on last month's captured invoices, the average days beyond terms (DBT) which characterise each firm covered by the data during that month. Looking at this measure it's evident that, much like the Megascore measure of financial strength, the DBT has been rising but only very gradually, since the end of 2007, from just under 20 days to 23 days in December – and with no spike at all.



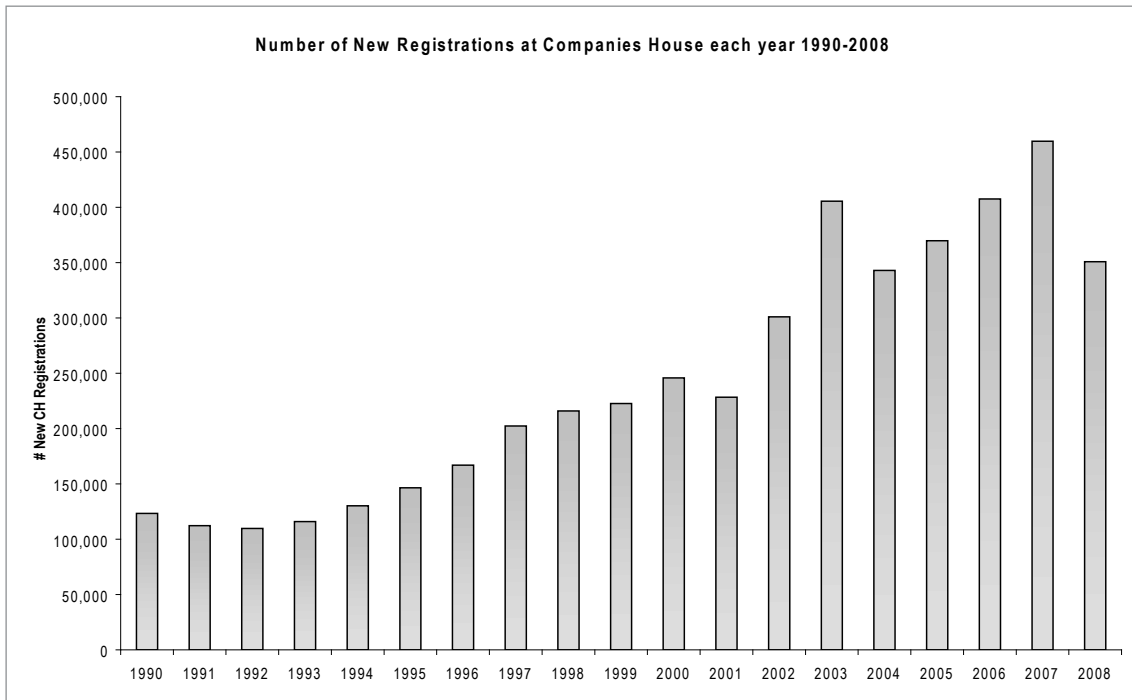
Similar to the consumer environment, it seems that perception has played a part in driving reality in the business sector.

Despite the fact that there were clearly a great deal of healthy and financially stable SMEs in the economy as at Q4 CY08, the rate of business formations points to problems ahead. The business birth rate is a good immediate and flashing indicator of a developing recession, reflecting both economic confidence and factors such as access to funding and development capital.

Our analysis of business births, gained by monitoring all firms that register at Companies House, shows a decline in company formations in 2008 back to 2004 levels. In 2008 just over 350,000 new businesses were formed, in contrast to over 450,000 registrations in 2007, and the lowest figure since 2004 when just under 350,000 new businesses were established.

It comes as little surprise then that fewer companies have been getting together and that deal volumes and values are down for 2008. According to information on deal activity from the Worldwide Deals database from Corpfin<sup>7</sup> overall in 2008 a

<sup>7</sup> Corpfin deal analysis covers the following types of deal: Acquisition, Acquisition – tender offer, Development Capital, Divestment, Employee Buy-In, Employee Buy-Out, Exit, Partial Exit, Flotation, Investor Buy-In, Investor Buy-Out, Tender Offer, Leveraged Buy-Out, Management Buy-In, Management Buy-In/Buy-Out, Management Buy-Out, Merger, Minority Stake, Minority Stake – tender offer, Reverse Takeover, Secondary Buy-Out or Share Buy-back. Data includes transactions with deal value of £500,000+, property deals must be over £15 million. Stakes in oil and gas fields and bond issues are not covered. Pending deals included, completed deals included, cancelled deals excluded, rumoured deals excluded.



total of 5,251 transactions were announced, which represents a 21.5% decrease on the figure from 2007 with 6,691 deals. Deal values have declined by a greater magnitude with year end analysis showing that 2008 saw a total of £207.4billion transactions, a 54% decrease in comparison with 2007's figure of £450.5billion.

The final quarter of the year is traditionally a slow quarter in corporate finance. Although there was a decline compared to Q3 CY08, deal activity has not stopped altogether. Across the UK there was an 18.5% decline in the number of deals announced during Q4 CY08 compared to Q3 CY08. Still, 892 deals were announced. Deal values in Q4 CY08 declined to £30.4billion, a decrease of 48.1% on the Q3 CY08 figure of £58.7billion.



### Q1 CY09: Predicted market opportunities and red flags

What the company birth rate clearly shows is that those who may have previously been considering starting up a new business are either deciding to postpone and remain in their current employment or are finding it too difficult to obtain funding for their new venture.

If little action is taken to address this issue then we would expect the company birth rate to slow further in 2009. Of course, our statistics shows that 40% of new businesses formations never trade or file accounts, but simply dissolve within two years of being established. Nevertheless, new business formations are essential to maintain a vibrant and buoyant economy, creating the medium-sized and big businesses of the future.

Meanwhile, for three months in a row business failures have hovered around the 2,500 mark. On a very benign trend and from a very low death rate, this is in itself not catastrophic – again, provided businesses can still get access to credit. Without this, over the course of 2009 the death rate could double and we could start to see insolvencies increase to an average level of 5,000 per month.

Deal activity is slowing, but it has not stopped. What is happening is that deal financials are being re-worked many times with offers trimmed and renegotiations started. It doesn't take much of a disagreement, even in normal circumstances, to de-rail a deal.

In the deals market, the new reality is that the level of activity seen in Q4 CY08 should be considered as a comparator for Q1 CY09 performance. The final quarter of 2008 should be the baseline against which we measure deal activity going forward.

### Turning insight into action

Both the insolvency rate and the Megascare have a built-in time lag. The death rate is an unassailable measure, but can only flash when there are no longer vital signs for a given business, it cannot provide prior warning of distress. The Megascare is based on filed accounts, and thus represents a firm's solidity as of several months ago. Nonetheless it is an excellent predictor of default, because it captures the ability of a firm, with a given set of past, but recent financials, to weather new negative external stimuli, such as a world-wide liquidity crunch, or a sudden reluctance of high street banks to continue to extend credit. Payment performance is a good non-lagged measure of how businesses are faring.

Taken together, what our data insight shows is that the SME population was on the whole holding up well until September 2008. In Q4 CY08 there was a decline, but businesses are still not exhibiting catastrophic financial behaviours.

Looking at the relationship between Gross Domestic Product (GDP) and insolvencies, and with the news that the economy shrank in Q4 CY08, there is clearly still time in 2009 to prevent a substantial increase in business deaths and avert a deep or long recession insofar as the SME population is concerned.

However, for this to be the case two things need to happen. Firstly, banks must have the confidence to start lending again. An average Megascare of 80 is a very positive score showing that there are many healthy businesses around. Secondly, large businesses must get quicker at paying their bills. These businesses are the slowest payers and speeding up payment to medium and small business will be pivotal in solving the problem.

What is clear is that the business environment is changing rapidly, putting new demands on organisations in terms of the level of insight and business information they need. Relying on sparse financial information to make business-critical decisions under these conditions could spell disaster. Deal appetite may wane over coming months. But, in challenging times identifying credible potential acquisition targets or buyers is even more crucial, as is pinpointing the advisors that other professional firms and businesses should be getting close to.

Real-time, up-to-date business information is essential to allow organisations to know the true financial position of their customers' businesses and business owners on a day-to-day basis. Vigilance is the watchword. That means using information that can give an early warning of a business heading for difficulties, such as a major reduction in share capital, late filing of accounts and adverse notices, such as County Court Judgements.

Payment performance data should be used to identify customers' payment patterns and worsening payment trends – a strong indicator of reduced cashflow leading to possible insolvency. This insight will not only give a view of *if* a customer is likely to pay, but also *when* – crucial information in times of tight liquidity.

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**Relying on sparse financial information to make business-critical decisions under these conditions could spell disaster.**

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## Summary of recommendations: The Business Landscape

The outlook for Q1 CY09 does not look any better than recent performance, with the economy set to contract by at least another 1%. All components of demand are set to shrink, except for government spending. With another 200,000 jobs to be lost in Q1 CY09, consumer spending will contract for the fourth consecutive quarter, by 0.8%. Investment activity will decline by close to 2%.

Some analysts are calling Q1 CY09 the trough in the downturn. While it is true that the worst declines might be behind us, economic activity will not hit bottom until Q3 CY09, with discernible growth postponed until CY2010. This presents one of the main risks: lofty expectations potentially resulting in further sell-offs on financial markets, with implications for sterling and UK asset prices.

| % change on previous quarter | Q3 CY08 | Q4 CY08 | Q1 CY09 |
|------------------------------|---------|---------|---------|
| Real GDP                     | -0.6    | -1.5    | -1      |
| Real consumer spending       | -0.1    | -0.8    | -0.8    |
| Unemployment (% workforce)   | 6.0     | 6.3     | 6.8     |

In terms of the business environment, the business birth rate is falling and without an improvement in the availability of business finance and an improvement in confidence it will slow further. Insolvencies are rising and helping to fuel the feeling of doom and gloom about the economy.

But it is important not to lose sight of the positives. With government infrastructure plans being brought forward, it is possible that the recovery in construction will lead the overall economy by a quarter or two. Inflation will no longer be a concern, particularly with prices for energy and later food falling significantly.

Meanwhile, the insolvency rate is still some considerable way off the levels experienced in the last recession (taking into account the increased business population). Indicators show that there are still a great many healthy businesses in the SME population in particular and if they can keep their credit lines open and cashflow positive, they may be able to avoid the worst of any recession. In this respect, the news of more job losses can be misleading; businesses are remaining healthy precisely because they are taking measures to manage their costs, including reducing employment costs.

### Turning insight into action – recommended learning points

#### 1. Anticipate and prevent exposure to losses by using data insight

Businesses of all sizes need to be taking action to minimise the threat of the downturn to their business. That means accessing real time, up-to-the minute business information and using this in two ways. Firstly, as the basis for choosing new customers and monitoring existing customers for early signs of distress, and secondly, for ensuring that their business maintains a low risk profile and remains in good shape to keep credit lines open.

## 2. Payment performance data – a critical tool

Within this business landscape, payment performance behaviour is one of the most insightful pieces of information a business can have. A worsening payment trend is one of the clearest signs of a business experiencing difficulties. Rather than relying solely on traditional profit and loss or balance sheet data, payment performance information can give an early warning of a business heading for trouble.

Companies that really understand these payment dynamics at an individual client level are the ones that stand a better chance of surviving the economic challenges of the next few years. Being able to customise credit collection strategies will be a source of significant competitive – and survival – advantage. Cash flow is king.

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**Rather than relying solely on traditional profit and loss or balance sheet data, payment performance information can give an early warning of a business heading for trouble.**

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# Conclusion

The UK has officially entered into recession. More brand name companies have gone into administration and 2009 has got off to an inauspicious start. With 24-hour media and the Internet, both scarcities during the last recession, consumers cannot avoid calamitous headlines or the ubiquitous blow-by-blow reports on the state of the UK economy. For the first time, consumers and business owners are more alive to the economy than ever before and this presents opportunities for companies.

Our analysis shows that perception is playing its part in fuelling the current situation with heightened sensitivity leading people to pull back on spending, through fear of redundancy or just a sense of foreboding. Our analysis also highlights precisely why, now more than ever, it is important that businesses focus on their existing customers to retain and maximise each individual relationship.

Today's consumer is not going to be wooed by subtle overtures – they want value for money and service par excellence, without compromise. This applies as much to the retail bank, utility company or credit card company as it does to the high-street retailer. We are in the era of the empowered consumer.

The big theme in 2009 is going to be insight-led customer management, whether this relates to marketing, customer risk or collections and recovery programmes. The same can be said of managing business relationships. At the heart of this new strategic thrust will be organisations' desire to anticipate and react to changes in consumer and business behaviours to ensure they adapt and diversify over the course of 2009. Quite simply, data and analytical insight knowledge will take centre stage in helping businesses to weather the storm and shape their future strategies.

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