

INTERVIEW

Thinking ahead

Richard Brown at Cognosis Consulting believes that despite economic recovery, the drinks industry won't return to the way it was pre-crash, with premium brands really feeling the pinch. He tells Patrick Schmitt his projections for the new decade

AS WE'RE yet to hear of anyone in the drinks trade with a fully functioning crystal ball we are reliant on past information and current patterns for making future projections. It's a form of educated and informed guesswork, and judging by what we've published over the last 90 issues, it's been pretty accurate. However, at the conference hosted by the drinks business in October last year, Richard Brown, managing partner at Cognosis Consulting, presented the audience with a set of scenarios which were so convincing, it was as though he had a window into the future and we'd peered in and caught a glimpse of tomorrow's world.

The vision, however, was not altogether comforting. Economic recovery, he stressed, will not mean business as usual, and his forecasting contained five outcomes including what he called the "Austerity Agenda" – a new environment of asceticism that sees savings ratios soar (see box, p15).

To understand more, we followed up the conference presentation with an interview at Brown's offices in central London where he explained the basis for the projections.

"In the past decade, premiumisation has been the major driver of profit growth in spirits," he begins, "as much as 60-80% since 2001." However, looking at the financial crisis onwards, "our analysis suggests some big changes and rebounding consumer confidence won't reignite the patterns of the past".

In other words, Brown believes, "The rate of premiumisation will reduce and the rules of premiumisation will reshape."

THIS RECESSION WILL DESTROY OVER £150 MILLION FROM THE UK'S MOST PROFITABLE SPIRITS BRANDS

Referring to his Drinks Business Conference presentation – "Bye Bye to Bling? Where are premium spirits headed post recession" – Brown points out that premium spirits are particularly GDP sensitive. "Our model says that on average they grow at 2.5 times the GDP growth rate. If GDP falls below 2% they don't grow at all. And if GDP stalls, standard volumes fall by 4%, premiums by 8%."

Hence in October 2008, assuming GDP declines of almost 5% from peak figures, Cognosis projected a premium spirits decline of 13-20% by mid 2010. Since this forecast, Nielsen data has shown actual declines of between 4% and 7%, but the Cognosis model suggests there's more to come.

"Looking at previous recessions such as the 1990-'92 downturn," recalls Brown, "in an upturn premium spirits lag GDP growth by 6-12 months." This means that by the beginning of this decade, the spirits market is just beyond halfway to the low point. "Even without a 'double dip', premiums will decline in 2010." In terms of value, Brown believes this recession will "destroy over £150 million from the UK's

most profitable spirits brands." Globally, that's £2 billion. As for recovery, we'll have to wait until mid-2011.

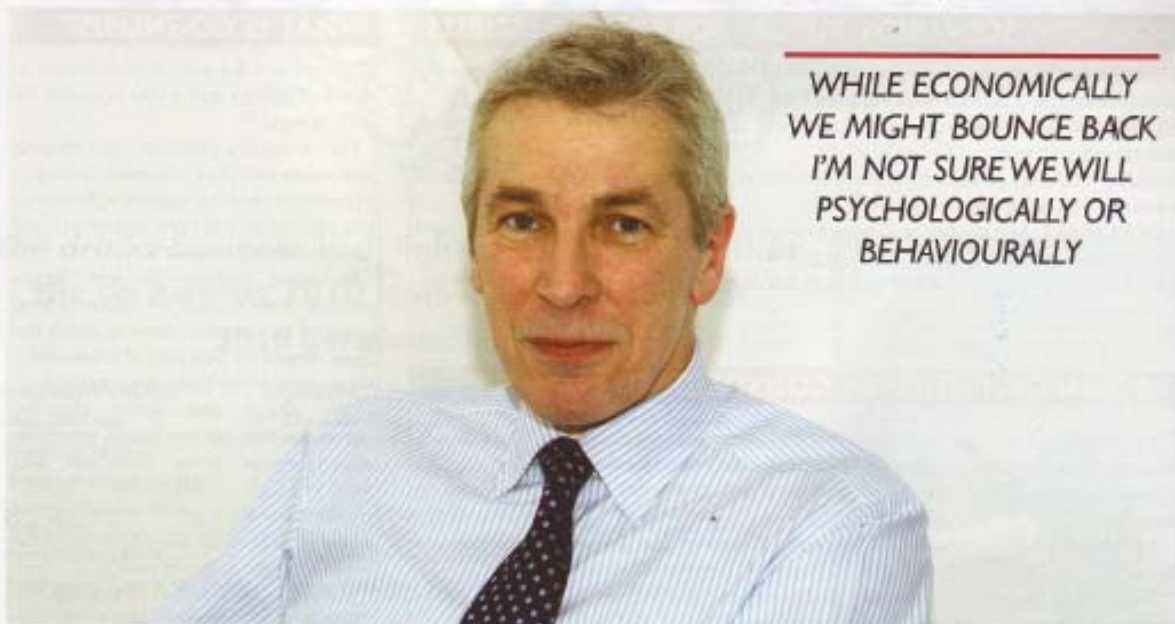
Permanent change

Over the longer term, however, Brown fears more than just a decline in profits but a major and permanent change in consumption patterns. As he says, "Deep recessions often trigger structural shifts – Japan's economic meltdown in the '90s trashed imported spirits, replacing them with local premium *shochu* while the last deep downturn in Spain in 2001 caused a switch from Scotch to rum."

For this reason, continues Brown, "executives are having to ask themselves – is our core strategy right? Is it fit for recession?"

Thankfully, as the economy starts to show signs of recovery, Brown believes there is less chance of "a shock structural shift". Of the scenarios Cognosis has identified, he admits that some UK consumers are definitely in the "Austerity Agenda" – but far from all. "If you are a small manufacturing business in the West Midlands you may have been doing well two years ago but suddenly business has gone down you are going to live that full-on austerity agenda – cut right back on consumption and down trade massively."

"But, one of the things that struck me about this recession is how partial its effect has been. So if you go into bars and clubs around London right now it has become a habit to sit there fighting for space on a Monday night thinking 'what recession?'



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BIOG: RICHARD BROWN, MANAGING PARTNER

Richard graduated from Oxford with a first-class degree in Biochemistry. He has 20 years' client-side experience spanning marketing, management and strategic planning in major multinationals including Coca-Cola, Guinness and Diageo. As United Distillers' planning director he led a team pioneering strategic change in a global business, gaining hands-on experience in over 50 countries. At Diageo, he played key roles in pre- and post-merger integration. Richard's client work focuses on business strategy, organisation development and team building. He enjoys helping business leaders find "whole brain solutions" to their thorniest issues.

because those people who are in a job, their money is going further."

However, they are not spending in a conspicuous manner, and a further scenario according to Cognosis encompasses the idea of "Luxury Shame". In essence, "there are areas of spending that can be described as super discretionary which are being cut back because it is largess and excess that is out of favour at the moment, such as popping Champagne corks in public."

There's also "New Rules", whereby the consumer is increasingly questioning the real value of things – being more selective and discerning in their choices. This will mean, believes Brown, that the likes of super-premium vodkas "are not going to enjoy the rates of growth in the future they have done in the past and I detect a scaling back of super-premium cocktails".

Essentially, as Brown summarises, "while economically we might bounce back I'm not sure we will psychologically or behaviourally. That irrational exuberance we've seen in the last five and longer years doesn't seem likely to come back in the same form".

Finally, among Brown's set of scenarios is the idea of "New Players". "This is the shift of economic power in an easterly

direction that is already happening and happening faster than ever and the big international players are looking even harder and faster to grow their brands and volumes in those markets.

"It's going to be an interesting one to watch because markets like India have tightly controlled markets and big indigenous players which will not roll over for international companies – so entry strategies are complex. But that's where the fastest growth of high-net-worth individuals are going to come from and that's where premium brands are more clearly set to flourish than elsewhere."

He also points out that "a lot of people from India, China and Russia who are

affluent are going to come increasingly to the UK because there is still a gravitational pull exerted by European fashion brands and British heritage. The UK becomes a bit of a playground. For example if you go into Harrods, the people spending the money are coming from outside Britain."

New markets

So what does that mean for luxury spirits? "Demand in the UK is from visitors or expats for iconographic categories – so malts should do well and so should deluxe Scotch because these are popular in India and China. Cognac too will do well because the Chinese palate seems particularly well adapted to it."

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INTERVIEW

COGNOSIS SCENARIOS: FUTURE FOR PREMIUM SPIRITS

BOUNCE BACK: the economy and GDP recover and premium spirits rebound strongly. Unlikely because if bounce back happens it will be selective

AUSTERITY AGENDA: economic, social and political pressures conflate to cause savings ratios to soar

LUXURY SHAME: affluent consumers conceal premium purchases because of social pressures and rising unemployment

NEW PLAYERS: Asia continues to grow strongly releasing fresh waves of newly affluent consumers who want to consume luxury goods

NEW RULES: UK consumers still buy luxury but need more reasons to justify their choice to others

BROWN ON INDUSTRY CONSOLIDATION

"This is really the only game in town and there's more play left in it yet," says Brown. At present he identifies the potential tie-up between Moët-Hennessy and Diageo. "It's a battle between Gallic flair on the one hand and British grit and determination on the other."

Then there's Brown-Farman and Bacardi: "American can do-ness versus Latinate flavour."

"There's also the independents such as Grants, and new kids on the block: VJ Mallya and big Russian oligarchs with big brands attached."

The latter he says have "strategies not just driven by a return on investment but an emotional component: pride."

"It will be interesting to watch the interplay between the bigger players in emerging economies and the major players left standing in the West."

Interestingly, Brown makes the further point that international marketing budgets "chase the return, and if this is coming from emerging markets we may see manufacturer budgets under increasing pressure in established markets – so less advertising – and it could become a bit of vicious cycle in the UK".

Having considered the five scenarios, which does Brown think is the most likely? "I don't see full-on bounce back to where we were and I don't see full-on austerity agenda because part of the thinking was that GDP decline was only part of the story – it's the after wash of rising unemployment that causes people to pull in even more and the numbers we're hearing for unemployment are not rising anything like the rates we thought they might."

"The focus is on the near certainty of new players. The increasing importance of BRIC and emerging markets and the acceptance and learning to live with and

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WHAT IS COGNOSIS?

Cognosis is a £4 million consultancy in terms of billings and drinks accounts for 40% of that.

The company focuses on helping businesses with their corporate strategy – in particular making sure the right brands are playing in the right segments, and their marketing is effective.

Managing partner Richard Brown records "there is a sudden and increasing demand for scenario planning which has been absent for best part of a decade" – a speciality of the Cognosis approach.

"We design and deliver planning processes that get top teams engaging with strategy, in a particular way that builds emotional belief," explains Brown.

"We've worked for over 20 of 50 of the world's largest spirits brands."

The company describes its approach as "Whole-Mind Planning". This is "rigorous and fact based, but also emphasises innovation and engagement".

Cognosis Consulting is Thought Leader Partner to the drinks business.

thrive in new rules – and new rules is about either adding rational supports for consumers to buy premium brands or pump up the emotional attachment even more – and that could be about attaching your brand more closely to respected celebrities or incorporating some form of personalisation."

One aspect that is clear for established markets is that it is time to say goodbye to bling.

"What five years ago passed for artistic decanter suddenly looks rather trashy," exemplifies Brown. In place the likes of social responsibility and transparency are crucial. "If I feel your branding is one big confection purely to get me to part with my money then why should I be interested?" says Brown.

"The future consumer wants something that looks and feels authentic and when you pick at it, it is."

In other words, it's up to the brand owners to adapt. **db**