

Sustainability: Are consumers buying it?

Are consumers buying sustainability?
Yes, and in increasing numbers. The majority of UK consumers buy the notion of sustainability and demonstrate awareness and concern about the issues. As a result they are changing lifestyle and behaviours.

This is a complex and changing environment, impacted by regulation and competitor action. We assess the options open to retail and consumer goods businesses to protect and secure future value, from both an internal and external perspective.

Some might argue the hype will exceed the reality in the short term. However, rather as the internet is revolutionising retail, sustainability is an issue which will change the world. Retail and consumer goods companies need to prepare now.



Introduction

Sustainability is becoming a business imperative; doing nothing is no longer an option. It is about securing your business for the future.

Converging influences are forcing sustainability issues to the top of the corporate agenda. Consumer awareness, pressure on commodity and energy prices, scarcity of raw materials, together with regulator and competitor actions are combining to ensure business cannot ignore the environmental and social dimensions of how they operate.

Consumers are buying it, both notionally and at the tills. Mainstream awareness and concern exists and behaviours are changing. Consumers want to act and buy more sustainably, but are restricted by three key barriers – high price; confusion and lack of trust; and availability of alternatives.

The consumer dimension offers both opportunity and risk. Today's consumers know, and care more about what they buy, how it is made, what it is made from, how far it travels and how it is packaged.

The way consumers gather and share information has also changed; they are empowered and linked as never before by the internet. Information can spread globally in an instant. The consequences of being found to be operating unethically, or in an environmentally unfriendly manner, can be damaging and long-term.

Equally important to retail and consumer goods businesses are the operational, cost and regulatory impacts of sustainability issues. These are having tangible effects upon every aspect of the business model, from the availability and price of raw materials to the types of products on the shelf and beyond.

Those organisations moving first and fastest, are building sustainable solutions that create value. These leaders are starting to change the rules of the game. The risks of being left behind are becoming too great to ignore.

The Consumer

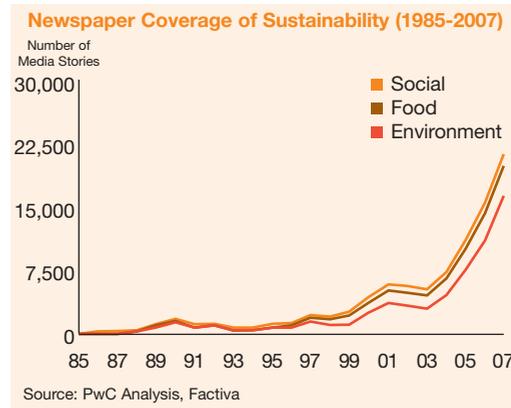
Sustainability issues are higher on the UK consumer agenda than ever before. PwC commissioned independent research into the attitudes and habits of 4,000 UK consumers and the results clearly demonstrate the existence of mainstream public awareness and concern about sustainability issues.

Over 60% of consumers stated that sustainability issues (climate change, poverty, food and water shortages) were the most important issues facing the world. When asked about climate change, 80% said they were 'worried'.

Drivers of awareness and concern are varied. The ordinary and everyday are being impacted and consumers are feeling economic pressure in food, fuel and utility prices. In addition they are seeing increased volatility in global and local weather patterns.

Awareness has clearly been influenced by an explosion in media coverage. The number of articles appearing in the mainstream national UK press has increased ten-fold over the past decade and doubled between 2005 and 2007.

This awareness and concern is motivating action and changing behaviour. When asked if they had made significant changes to their lifestyle over the past two years as a result of their environmental concerns, 75% of the population claimed they had.



Actions consumers have taken are:

- Recycling (73%);
- Turning off lights/electrical appliances when not in use (32%);
- Switching to energy efficient light-bulbs (28%).



'I think consumers are already showing signs of a real willingness to change their behaviour when it comes to the whole area of sustainability... I don't think this issue is confined to being a concern for the middle classes. I think it is pretty universal.'
Charlie Mayfield, Chairman, John Lewis

These changes are convenient, enabled by external action (e.g. recycling and doorstep collection), relatively easy for them to understand and will save them money. Our research shows that consumers have changed their purchasing habits too. When asked if they regularly bought organic, free range or Fairtrade food, purchasing penetration has increased significantly.

For example, within our sample, Fairtrade food penetration has grown from 20% of shoppers three years ago to 50% now. Organic food purchasing has grown from 22% to 43%. Non-food shows similar growth, albeit from a lower base. For example, the proportion of shoppers buying organic and Fairtrade clothing has grown from 7% three years ago to 17% now.

In addition, consumers clearly indicate they want to buy more sustainably; 58% buy fewer sustainable products than they would like to. The greatest growth in intent is indicated in non-food categories such as clothing and homewares.

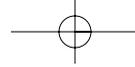


'I believe the consumer has actually shown real leadership in this field. They've sent a very strong signal to retailers and consumer goods companies, that they do want products that are produced sustainably for people and for the environment.'
Harriet Lamb, Executive Director, Fairtrade Foundation UK

However, while purchase penetration across the population may have grown rapidly and the desire to buy more sustainable products clearly exists, the share of today's ethical or environmentally friendly products remains small. We estimate these products accounted for under 4% of total consumer expenditure on retail goods in 2007.



'We've seen the trends in shoppers change over the years. First of all we started to distribute our products to the real green consumers... over the years we've seen the audience for our type of products broaden considerably.'
Mick Bremans, Managing Director, Ecover



Barriers

Our research indicates consumers are prevented from acting on their desire to buy more sustainable products by three key barriers:

- **Price** – when asked what prevented them from buying more products that are better for the planet or the people who make them, price was the number one inhibitor. 48% of consumers are either unwilling or unable to pay the premium associated with more sustainable goods. This barrier was significant across all socio-demographic groups. We investigated this further to see if this perception was justified. A comparison shop of 75 items at the top six UK grocers resulted in an average price premium of c.45% for environmentally and ethically friendly products. When we examined consumer willingness to pay a social or environmental premium on everyday items the result was closer to c.20%. Reducing this disparity is one of the challenges for retailers and consumer goods companies.



'If one looks widely across organic, Fairtrade and higher husbandry meat, then the premium is still there and therefore the consumer has to believe, genuinely believe that there's a real benefit for the animal or for the farmer, if they're going to pay that price premium.'
Justin King, CEO, Sainsbury's

- **Confusion and trust** – nearly 20% of consumers rate confusion about the implications of their choices and the social and environmental trade-offs of their purchases as a key barrier. The contradictory and often overwhelming information about the implications of buying one product over another leaves consumers confused and unable to act on their concerns at the point of purchase. They want to make sustainable choices, but are hampered by unclear messages. This confusion, coupled with high prices, leads to a lack of trust among shoppers. Over 50% of consumers questioned stated they trust Non-Governmental Organisations (NGOs), such as Greenpeace and the Fairtrade Foundation in the area of sustainability, whereas only 9%-16% gave the same level of trust to consumer goods companies and retailers.

Who do you trust to tell you the truth about the environmental impact of a product?

NGOs	Government	The Media	Producer	Retailer
51%	20%	20%	16%	9%

Source: PwC Analysis of 2,000 UK consumers, February 2008

- **Lack of alternatives** – almost 20% of consumers said the lack of availability of alternative sustainable products was the key reason why they did not buy more. Quite simply, sustainable alternatives do not currently exist for all product categories, and choice is limited in those in which they do. Our research indicates that c.60% of basic grocery products have sustainable alternatives available in store, although this percentage decreases to c.40% for some grocery sub-categories. In clothing and non-food, availability of alternatives is considerably lower.

Turning sustainability on its head

Consumers are aware and concerned about the social and environmental issues the world is facing. Fairtrade has provided an outlet for consumers on the poverty issue, and organic for their health and wellness concerns. However, they do not yet have a clear path for acting on their environmental concerns.

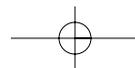
Our research indicates 62% of consumers think that reducing the amount of packaging on products is the most important action retailers or consumer goods companies could take to help the environment. In addition 38% think retailers should stop providing plastic bags and 24% feel they should encourage people to waste less and recycle more.

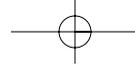
While consumers are witnessing some changes in packaging, they want more rapid action. They continue to be bombarded with messages about reducing their carbon footprint, but lack the mechanisms to differentiate products on the basis of their relative impact. Carbon labelling has begun to appear on some products. If this proves to be easy, trustworthy and product penetration increases, it may serve as a new competitive battleground in the brand proposition of mainstream products, but it is still early days.

Waste and carbon are also areas where governments are taking the greatest action to regulate and encourage changes in consumer and corporate behaviours. In a world of rising energy and commodity prices, the most environmentally friendly products could become the low-cost alternative – a win-win for environmentally concerned consumers in a more price sensitive world.



'I think there's definitely the case that they're [customers] a bit confused and I think there's a major job for government to make sure that it helps educate customers about what the issues are and what it needs to do. But equally retailers, who are at the forefront because they have direct contact with their customers, have a major job to do.'
Stuart Rose, Chairman, Marks & Spencer





The Commercial Impact

Sustainability is tangibly affecting retail and consumer goods companies across every point of the business model. The issues are at the top of the corporate agenda and are reaching into every function and business unit. Environmental and social performance is moving out of corporate silos, driven by external reporting requirements and internal financial and strategic objectives.

Understanding the strategic implications of the drive for sustainability and factoring it into corporate decision-making is about securing the future and enhancing commercial performance. The business case for investing in sustainable business models is becoming increasingly clear to all organisations and not just to those operating in 'green' niches.

Put simply, using fewer raw materials costs less. In an age of rising commodity and raw material costs, it is economically rational to act. In addition, a credible sustainable customer proposition is a source of differentiation for retailers and consumer goods companies operating in an increasingly competitive environment.



'Sustainability is such a huge area that it impacts every element of our P&L... it's something that we're embracing because what's good for the environment can also be very good for the bottom line.'

Fiona Dawson, Managing Director,
Mars Snackfood UK

Sustainability:
Are consumers buying it?

Internal implications

The commercial logic for assessing and minimising energy, carbon, water and commodity usage is clear. More efficient use of key inputs and reductions in waste offer cost-saving opportunities. Underlying structural changes in the world economy, such as continued growth in the economies of Brazil, Russia, India and China, mean competition for resources is intensifying, and resource scarcity is likely to become a greater issue in the future.

Leading companies are taking action. Firstly, by reducing the levels of resources they use. For example, consumer goods companies such as Ecover are building more efficient factories that use less electricity and recycle water, thus reducing cost impacts on their bottom lines. Similarly most major UK grocery retailers, such as Sainsbury's, Tesco and M&S, are investing in technology to make their fridge and freezer units use less energy and emit less hazardous – and potentially taxable – emissions.



'Sustainability is good business, and it's good business because it protects the firm and its cashflows, and ultimately as a commercial enterprise that's what it's about for the long haul.'

Paul Walsh, CEO, Diageo



'At the moment for actions that we're taking with regard to sustainability, such as reduction of waste, reduction of packaging and reduction of energy, our investment is offset by cost savings.'

Terry Duddy, CEO, Home Retail Group

As costs continue to rise the payback period for such capital investment is reduced. The best organisations are investigating which technology investments can reduce their cost and regulatory exposure.

Secondly, truly pioneering companies are adopting innovative solutions to secure the quantity and quality of materials they need to manufacture and operate. From a supply chain perspective this has resulted in organisations forging better links with farmers, growers, NGOs and other external certification bodies.

Producers and retailers that are investing directly in suppliers and farmers are finding real strategic advantage. This collaborative model delivers the continuity and consistency of supply essential to meet the commercial needs of a business. In addition it brings real benefits to farmers and producers and is reputation enhancing for the corporate. This model is as relevant to relationships with developed world farmers as it is to developing world suppliers.

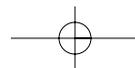
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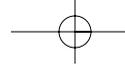


'The big commercial reason for why going down this route delivers business results is the fact that you get a more committed, more talented group of people in your business for longer.'

Richard Reed, Co-Founder, Innocent

Successful organisations use sustainability for their human resource strategies. Acting in a sustainable way is key to recruit, retain and develop staff. Historically this has been most applicable to knowledge based industries such as financial and professional services. However retailers and consumer goods companies are now using their sustainability credentials to attract and motivate staff across all functions. Being green helps you get, and hold onto, the best talent.





External implications

In the face of increasing competition and consumer interest, retailers and consumer goods companies are using sustainability to support their brand and develop range and price propositions that generate competitive advantage.

From both a retail and a consumer goods perspective what is clear is that 'greenwashing' no longer works. Consumers are smarter, better informed and more discerning. In today's tighter economic climate consumers want to understand why a price premium exists so they can make an educated choice on which products best fit their emotional, ethical and functional needs.

This change in consumer purchasing habits has resulted in a number of different approaches. Wal-Mart is perhaps one of the leading examples of the direction we might be heading in. Its response to sustainability has been both bold and market changing. At a customer level it is positioning itself as a leading retailer offering affordable sustainability. How this translates at a price and range level is best observed via its compact fluorescent lightbulb (CFL) initiative where it worked with suppliers to reduce the retail price premium by over 50%.

Alongside this, in-store point of sale (POS) and marketing was used to ensure consumers were aware of the benefits and that Wal-Mart would meet the required sales volumes for profitability. CFLs were given additional shelf space instead of standard bulbs, and in some cases were given unique POS.

Other retailers are also choice-editing using sustainability attributes. Sainsbury's for example only stocks Fairtrade bananas and has absorbed the additional cost from doing this. This move helps to establish a point of difference and improve overall consumer perception of the Sainsbury's brand; sales have also benefited, with the company delivering growth well ahead of the overall banana market.

From a consumer goods perspective, sustainability has consequences for product formulation, innovation and portfolio composition, in addition to branding. Heightened awareness of ethical and environmental issues has irreversibly changed consumer perceptions of brands and products.

Historically, more packaging, more powerful ingredients and more flavour variants have equated to a 'better' product. With higher raw material costs and retailers increasingly selecting products on their 'green' attributes, consumer goods companies are finding legitimate commercial advantages to modifying existing products and creating new ones.



'Sustainability impacts our business at every single touch point both internally and externally. From transport and inbound freight of packaged product it is absolutely key that we try and minimise our global footprint.'

Adam Smith, CEO, Adili

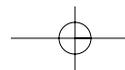
For example, concentrated laundry products use less packaging and raw materials, take up less shelf space and are easier for consumers to carry. This win-win situation illustrates how sustainability is driving change across the production, retail and consumption stages of the value chain, and how a category can fundamentally change in a short period of time.

This drive for sustainable brands and product portfolios has resulted in new entrants but has also driven increased merger, acquisition and disposal activity. Unilever and Ben & Jerry's, PepsiCo and PJ's, Cadbury's and Green & Blacks, Danone and Stoneyfield Farm are all examples of recent transactions where sustainability has been one of the key drivers of acquisitions.

In all cases the acquirer has been seeking to either engender a particular category with social, environmental or ethical attributes, or integrate operational capabilities into their existing business. We believe this will continue as established players jostle with each other to ensure their product and brand portfolios are relevant to future consumer tastes and demands.

Related to this will be the continued role for new entrants. As our research shows, consumers are distrustful of mainstream retailers and consumer goods companies. However, this distrust is much lower for niche operators such as Innocent, Abel & Cole, Dorset Cereals and Ecover. Organisations that develop a unique position will continue to prosper.

What is clear is that there is competitive advantage to be gained from looking at your internal and external strategy through a sustainability lens. However, it is unwise to just focus on external factors, such as brand. Consumers will not tolerate companies that make platitudes to sustainability, and such actions may well be harmful. Companies that want to succeed commercially must approach sustainability strategically and with conviction, determination and transparency.





Where next?

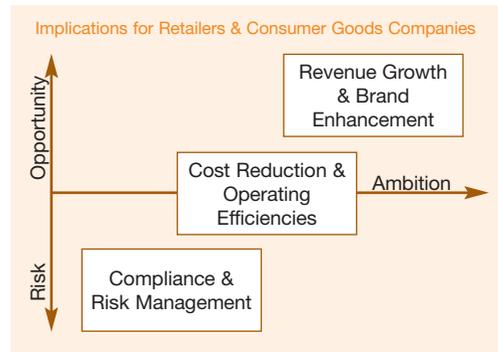
The majority of retail and consumer goods businesses have developed some form of response to the issues of sustainability. The minimum requirement today is to deliver compliance and risk management. However, responses are becoming more sophisticated and have begun to address the issues on a tactical basis to deliver cost reduction or optimise resource use.

Further opportunity lies in strategically using sustainability as a source of defendable competitive advantage. Brand value, customer and employee loyalty, higher top-line and margin growth, cost savings and supply advantages may be some of the potential benefits.

The pace of change is accelerating as understanding of the issues and how to extract value from sustainability strategies develops. In addition, regulation is forcing action. The minimum requirement today will move rapidly, and the bar is being raised. It is better to lead this development than risk being left behind as others – including regulators and consumers – set the pace.



'I think if you ignore the risks that are out there, you will progressively marginalise your business... the flip side is that if you get it right, the positives are huge.'
Paul Walsh, CEO, Diageo



Pressure wave

The forces converging on consumer and retail businesses are, in combination, extremely powerful. Their confluence is creating a 'perfect storm' that cannot be ignored. The emerging combination of consumer empowerment and awareness, pressure on resources and government action are set to transform the retail and consumer environment. This is not an issue that is going to disappear. Like the growth of online retail it is a game-changing trend. The leaders are making market interventions and decisions that have consequences for all.

Consumers as catalysts: The long standing perception that sustainability attributes have to cost may ultimately be true for Fairtrade and organic products; by definition these items are more costly to produce. However, environmentally friendly attributes such as low carbon, reduced packaging, less waste and

reduced resource use should actually reduce cost. This will change the sustainability price equation. As consumer awareness of this increases, sustainable products could also become the more affordable alternative.

Retailers as catalysts: Competition among retailers adds to the pressure wave. We have seen tactical responses, but there remains an opportunity for a consumer champion to mainstream sustainability. Satisfying demand and removing barriers require leveraging scale: creating the market by encouraging suppliers to develop more sustainable products, reducing price premiums and allocating greater shelf space and promotion spend.

However, as our research shows, this is not just about addressing price, accessibility and availability, although these are significant challenges, credibility and trust need to be built to enable better communication of sustainability messages.

Producers as catalysts: The role as innovator to create supply and build availability is crucial. Greening of long-established and powerful brands presents a number of major challenges. However, the opportunity for innovation and new products in this space is high.

We have seen significant growth in numerous categories driven by new entrants. While many of these remain niche, momentum is building and own label development has been significant. We are witnessing success stories

from established operators acquiring and developing sustainable from 'birth' brands.

Suppliers also have a role in creating greater trust and understanding among the mainstream. Leading brands have the power to change and influence behaviours.

Regulators as catalysts: Governments are influencing sustainable consumption using tax and regulation, incentivising the good and penalising the bad. Implications here will not just be restricted to waste and land-fill taxes or carbon emission legislation.

Protectionism in the face of scarcity and potential changes in international trade instruments (duty and import agreements) have implications for continuity and cost of supply.

Regardless of market position or scepticism of the science, consumer awareness, competitor action, resource scarcity and regulation changes mean all retailers and consumer goods businesses need to develop a strategic response to sustainability issues.



'We're going to see prices coming down because businesses are now investing significantly and some of the scale economies will flow through to the product... we should expect to see some rapid progress in the demand for sustainable products over the next few years.'
Charlie Mayfield, Chairman, John Lewis

Conclusions Actions Today for the Future

Consumers are ready but need help

- Consumers want to live and buy more sustainably but are restricted by barriers; demand is not being satisfied.
- The price premium for sustainable products is likely to come down. Nevertheless, it is likely to persist to some degree for organic and Fairtrade items. However, we believe that environmental sustainability should not come at a premium. The cost savings associated with well managed carbon, packaging, resource and waste reduction strategies means these attributes can be added to mainstream products, whilst reducing the retail price. This turns the perception of sustainable products on its head, and as consumer understanding of this develops, expectations will change. Consumer goods companies and retailers will need to ensure their products take on these environmentally sustainable attributes or be superseded by others that do.
- Consumers are now at the point where they increasingly expect sustainable attributes to be an inherent part of the products and services they buy.

It is economically rational to act; sustainability has internal and external implications for costs, risks and commercial performance

- From both a cost and revenue perspective it is evident being sustainable pays. The era of cheap and readily available raw materials and energy has gone. Physical supplies are running out faster than previously predicted, competition for remaining resources is intensifying, and in the medium-term we are likely to see changing weather patterns leading to lower production levels.

- The regulatory burden has increased, and is likely to continue. Organisations that predict and react to this regulatory environment will benefit, and in some cases, will be able to shape regulations to their advantage and the detriment of competitors.

Doing nothing is not an option

- The best run companies will become the most sustainable, and the most successful. Those building sustainable solutions are creating resilient models for the long term and are generating commercial advantage.
- These leaders are changing the rules and raising the bar. The risks of being left behind are too great.

Secure the future with today's actions

- Leading organisations are taking the strategic steps to ensure they are well placed to compete in the future. This is taking place via supply chain and sourcing strategies, as well as capital investments in technologies that lower energy use, use less raw material, and improve performance.

There are a variety of options but a clear strategy is essential

- Impacts at all stages of the value chain and in every element of corporate activity mean retailers and consumer goods businesses need to understand and measure how their individual models are impacted. Responses will vary and change as businesses look to develop advantage and competition intensifies. It is essential that credible and transparent sustainable solutions are developed and embedded in the strategic decision-making process. Sustainability is now a business imperative.

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PricewaterhouseCoopers UK Retail & Consumer Group has more than 1,000 people working with all types and sizes of retail and consumer goods – multi-nationals, UK companies, privately-owned organisations, family businesses – as well as entrepreneurs and private individuals. The group provides industry-focused assurance, tax and advisory services to over 75 of the top retailers in the UK. We have specialist teams and individuals within our service lines, working exclusively with retail organisations.

Our Transaction Services team helps companies to make acquisitions, divestitures and strategic alliances and access the global capital markets. In each case we have the same overriding objective – to help our clients to maximise the return on their deal. We are uniquely positioned to focus on the longer-term return from each deal as our services span the entire deal spectrum from strategy definition through deal evaluation, to post-acquisition integration. Within the retail and consumer sector, we have a dedicated team of specialists with strategic, financial and operational skills, able to offer a multi-disciplinary strategy development and deals advisory service.

PricewaterhouseCoopers is the first major UK advisory firm to offer sustainability expertise fully integrated into all its business consultancy services. We have over 700 dedicated sustainability practitioners across the firm globally, and a 15-year track record of thought leadership and hands-on experience, much of it gained with the world's largest international companies.

As we work collaboratively with our clients to help them understand and manage the sustainability issues they face, we are putting strategic thinking at the heart of sustainability, and sustainability at the heart of corporate strategy. By combining our specialist capability with extensive industry know-how we offer our Retail & Consumer clients advice on both sustainability aspirations and commercial realities, and make those two different agendas work in tandem.

We can support our clients through the whole process from high-level sustainability strategy to its practical implementation on the ground. We can look at how evolving sustainability trends could affect your business as a whole, or provide an in-depth analysis of the specific sustainability issues that concern you most.

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