

retailthinktank

KPMG | Ipsos Retail Performance

# Annual. review

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Fickle demand,  
reducing margins and  
rising costs continued  
to be issues in need of  
urgent attention.

## KPMG/Ipsos Retail Think Tank Review of 2018

**2018 marked yet another troublesome year for the retail industry, which had already been facing strong macroeconomic and geopolitical headwinds, along with the barrage of longstanding structural upheaval, driven by ever-changing and varied consumer behaviour.**

The troubles began right from the year's starting blocks, with the KPMG/Ipsos Retail Think Tank's (RTT) health assessment in the first quarter recording the lowest score (79) in five years. This followed disappointing Christmas trading, and marked the second consecutive deterioration in retail health – a reality many retailers were understandably reluctant to digest.

Reflecting on the first quarter's performance, the RTT members pointed firmly to lacklustre non-food sales as the primary drag. They added that adverse weather – including the 'Beast from the East' – soaring levels of personal debt which dis-incentivised spend; as well as one of the poorest year-on-year footfall figures, all added to the challenges faced by the industry. While the grocery sector did counterbalance overall performance to a degree, much of the growth was inflationary, with volumes falling in light of increased pricing.

The adverse conditions proved too much for many players, with a number of sizeable and established retailers entering administration – further reinforcing the deteriorating health of the sector. Whilst many of the casualties had been visibly struggling for some time, the turbulent trading conditions proved to be the straw that broke the camel's back. Meanwhile, for those that remained, fickle demand, pressurised margins and rising costs continued to be issues in need of urgent attention. So too were issues including: heavy discounting in a bid to 'buy' consumer demand, poor stock management and inefficient supply chains.

As 2018 progressed, the think tank's members showed concern about retailers' ability to navigate rising costs – including National Living Wage rise, increased commodity prices and automatic pension enrolment – especially against the growing pressures on their margins. However, while these concerns certainly pulled at the heels of many players, events like the Royal Wedding and Football World Cup, coupled with their 'feel-good' factor, provided a much-needed boost which ultimately prevented retail health deteriorating further. Retail health instead stagnated in quarter 2, with the RHI holding at 79.





By the third quarter of 2018, retail health in the UK had failed to make any further traction, with yet further stagnation and the RHI once again remaining static at 79 – the tenth consecutive quarter of flat or negative performance. The RTT members were all too aware of how volatile consumer demand had become, and how costs and margin pressure continued to plague retailers.

Having said that, there was significant divergence in the performance online versus the high street, and between food and non-food, and some retailers were faring better than others. Grocers and apparel benefitted from the extended summer weather, particularly at the beginning of the quarter, but a lack of engagement in key events like back-to-school, quickly overshadowed any traction made. Reflecting the lack of improvement in health, the think tank thought that the quarter was simply less bloody than it could have been, resulting in rather benign performance overall.

With many retailers yielding a significant proportion of their annual sales in the all-important ‘golden’ quarter, high hopes were understandably placed on the final months of 2018. Unfortunately, October proved to be quiet, whilst November also proved disappointing, despite Black Friday and Cyber Monday. And according to the BRC-KPMG Retail Sales Monitor for the month of December, it was the worst witnessed in a decade.

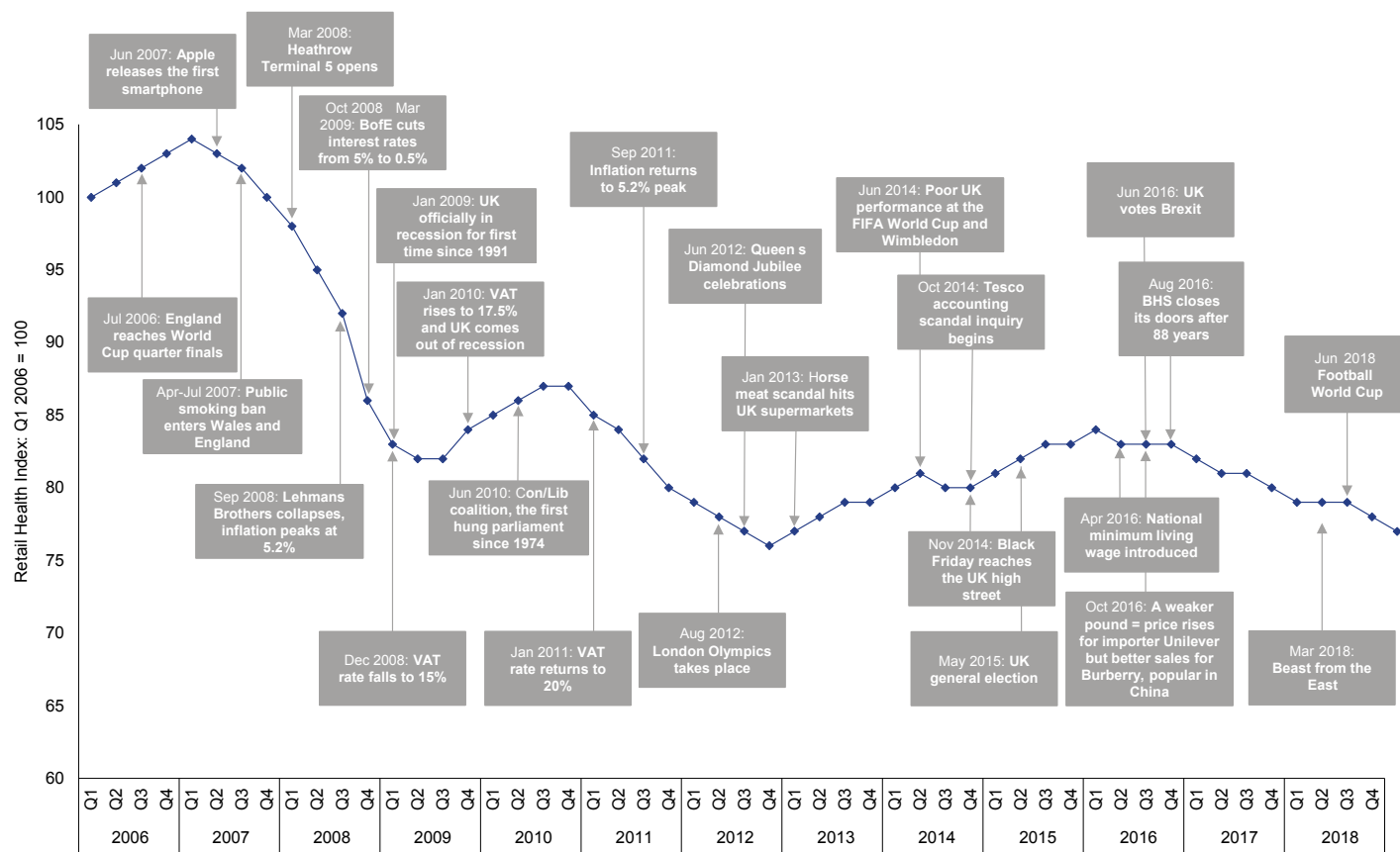
The RTT was in agreement that health in the final quarter of 2018 was poor, but they also noted the slew of Christmas trading reports that pointed to the positive impact of the late Christmas rush. Despite providing some relief, it wasn’t enough to turn the tide on deteriorating health of the quarter overall, and the RHI fell by one point to 78 – perilously close to the historic low of 76 witnessed during the double-dip recession 2012/13.

Looking to the year ahead, the think tank predicted further deterioration in the first quarter of 2019, but stressed that much still depended on the outcome of Brexit negotiations and subsequent impact on retailers and consumers alike. Similarly, in the RTT’s broader look ahead to 2019, the members believed that the struggle would intensify, regardless of Brexit.

The RTT members felt that, Brexit aside, the industry still needed to address changing consumer behaviour; the over supply of physical stores; high levels of legacy debt, as well as increased regulatory and compliance costs, to name just a few long-standing issues. Retailers would also need to continue navigating macro-economic and geopolitical challenges, and needed to address the lack of talent that could inject much-needed change into the sector. Many of these factors are at a retailer’s disposal, and as such the RTT stressed they need to focus on “controlling the controllable” in the year ahead.

## RHI movement over 12 year period

Retail Health Index







## About the Retail Think Tank

### Creation of the Retail Think Tank...

The Retail Think Tank (RTT) was conceived and created in 2006 by Helen Dickinson (former Head of Retail at KPMG) and Tim Denison of Ipsos Retail Performance (Ipsos) to provide an authoritative, credible and trusted window on what is really happening in retail and to develop thought leadership on the key areas influencing the future of retailing in the UK. The intended audience for the outputs of the RTT is primarily retailers as well as anyone with an interest in all aspects of retail and retailing.

### Who are we?

**Nick Bubb**, Bubb Retail Consultancy

**Dr Tim Denison**, Ipsos Retail Performance

**Jonathan De Mello**, Harper Dennis Hobbs

**Martin Hayward**, Hayward Strategy and Futures

**Maureen Hinton**, GlobalData

**James Knightley**, ING

**Paul Martin**, KPMG

**Martin Newman**, The Customer First Group

**James Sawley**, HSBC

**Mike Watkins**, Nielsen

### What do we do?

Our primary objective is to give a balanced, considered and unbiased view of the true state of the health of the retail sector. We aim to provide an authoritative, credible and trusted window on what is really happening in retail.

### We assess the 'Health' of the UK retail sector

- Traditionally it has proved incredibly difficult to get a true view of the state of affairs with different sets of statistics due to:
  - sheer volume of data; and
  - large variation in how it is generated and then interpreted
- Since inception, the RTT's activity includes:
  - a retrospective look at the past quarter – looking ahead to the next three months
  - taking into account the three key drivers of retail health: Demand; Margins; and Costs
- The Retail Health Index (RHI) outputs provide analysis and a visual snapshot of how health is changing on a quarter-by-quarter basis covering the past six years

### We write White Papers

- Thought leadership on the key areas influencing the future of retailing in the UK
- Issued quarterly throughout the year
- Highlighting issues and investigating areas of topical relevance to retailers
- The 2018 White Papers are included in this review and we have previously covered topics including:
  - Millennials vs Grey Pound – Who holds the key to future retail success?
  - The short and medium term impact of Brexit on the retail sector
  - Consumer confidence – can it be accurately measured and does it drive consumer spending?

### Where to obtain further information?

[www.retailthinktank.co.uk](http://www.retailthinktank.co.uk)



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# UK retail prospects for 2019:

## The struggle will intensify regardless of Brexit

Thursday 27 December

The UK retail industry will likely struggle to grow in 2019, regardless of the unknowns of Brexit, according to the latest forecast from the KPMG/Ipsos Retail Think Tank (RTT).

RTT members highlighted systematic challenges that retailers will have to work hard to overcome in 2019. Paul Martin, UK head of retail at KPMG, said: *"It is too easy to point the finger at Brexit as the singular cause of all the woes in the industry. There is in fact a much wider array of forces at play currently. These forces have been gathering momentum for a number of years and are by no means new."*

Changing consumer behaviour, the over-supply of physical stores, high levels of legacy debt, regulatory and compliance costs, macro-economic and geopolitical challenges, and a lack of talent at the top of retail businesses to help deliver much-needed change, were all highlighted by the RTT as forces that would impact negatively on the industry in 2019 – regardless of the outcome of Brexit.

The RTT was however, united in stating that many factors – including Brexit and the health of the wider economy – were out of a retailer's control in 2019, but that 'controlling the controllable' would provide the best chance of survival in the next 12 months.

### Looking ahead to 2019

The RTT acknowledged that 2018 has marked yet another difficult year for retailers and warned that there will undoubtedly be more casualties to come, especially on the high street when the next rental payments are due. With so much hinging on the Brexit deal, members agreed that the outcome would bring a period of economic uncertainty in 2019 that would further damage consumer confidence and industry investment well into the first half of the new year. Conditions could also become even more turbulent if a hard Brexit results in delays at the border or issues in the supply chain, on top of the already-weak pound and low consumer demand. James Knightley, chief international economist at ING advised: *"We are approaching crunch time in the Brexit process and this is increasingly weighing on both business and consumer sentiment."*

His comments were echoed by Mike Watkins, head of retailer and business insight at Nielsen UK, who said: *"The uncertainty around Brexit will put a brake on spend"* and Martin Newman, Founder of The Customer First Group, who added: *"The longer the negotiations go on, the more uncertainty there will be. People won't splash out at the tills, and retailers will have to entrench themselves in deeper and deeper discounting to buy demand."*

The RTT feared that many retailers are late to initiate contingency plans that will allow them to trade whatever the outcome. Paul Martin said: *"Businesses should already be increasing their inventory were appropriate in the event of a no-deal Brexit, and looking at options for re-routing their supply-chains."*

Mike Watkins went on to say that demand in non-food was evaporating, but many retailers cannot afford to discount further: *"Those who are left have to protect their margins and they may accept fewer sales at a higher price. In some cases, no sale is better than a bad sale."* However, the Retail Consultant, Nick Bubb suggested the *"weaker players could continue to discount heavily as they become desperate for sales."* This could hit the mid-market fashion sector in particular, which is still suggested to have at least 30% over-capacity.

The changing ways in which consumers are shopping were also discussed at length, in particular the swing towards online channels. Maureen Hinton, group research director at GlobalData said: *"The nature of demand has changed inexorably. Consumers want convenience and value and the UK is way ahead of any other country in its penetration of online shopping; 18% of total retail spending is already online, but in a sector such as electricals, online is over half of total spending – while clothing and footwear is already over 20%, and heading for 30% in the next five years."*

RTT members agreed that although online retail was already well developed in the UK, 2019 could see a slight correction back in favour of physical stores, as shoppers seek out a more tangible experience, and awareness grows around the true cost of home delivery.

Martin Hayward, founder of Hayward Strategy and Futures went on to say: *"There are a range of factors that could benefit the high street and 'level the playing field' for traditional retailers in 2019, as the true cost and environmental impact of home delivery will become better understood among consumers. As with most fast developing trends, it is likely that home shopping has overshot its natural share of the market, and that the many social, sensory and practical*

*benefits of real world shopping will again be realised with a little help from legislators and consumers."*

Bricks-and-mortar retailers could also be granted some reprieve in 2019, in the form of favourable rents. Jonathan De Mello, head of retail consultancy at Harper Dennis Hobbs said: *"Commercial rents are now under so much scrutiny that they can't really go up. Property costs are lower, especially when rent-free periods are taken into account. But London is still in a bubble and rents are increasing, particularly in the suburbs experiencing gentrification."*

While it is apparent that there are serious challenges and turbulent times ahead, the think tank members were keen to stress that there were opportunities and good news stories to be found. James Sawley, Head of Retail & Leisure at HSBC UK said: *"It's important to add that the sector isn't all doom and gloom, there are shoots of growth and rays of sunshine out there. Value retailers are marching on with successful store openings, countering the wider sector trends. Also, the 'last man standing' retailers, which are left trading in categories in which disruption has almost been fully played out can now reap the rewards of fighting a hard battle."*

The RTT agreed that there were still a number of untapped opportunities in 2019, including around click-and-collect. Members agreed that click-and-collect had significant cost benefits over home delivery for retailers, and more could be done to integrate it into the customer experience when collecting from a store.

Elsewhere, Dr Tim Denison, Director of Retail Intelligence at Ipsos Retail Performance, suggested that fashion retailers may continue to see the value of investing in their store teams via training programmes, knowing that people do make the difference in converting browsers into buyers.

The RTT also raised the growing awareness of corporate social responsibility (CSR) amongst retailers and consumers alike, particularly over the use of single-use plastic and employee wellbeing. Even though implementing ethical practices takes time, transparency in supply chains and the ethical sourcing of materials is beginning to influence the purchasing decisions of consumers, especially younger generations. Although it was argued that price would maintain its importance in the current climate.

The RTT agreed that in the troublesome times ahead, maintaining brand identity and delivering a clear and focused proposition to their customers remains critical.

There is no question that the coming months will prove pivotal to the structure and success of the retail sector, and that it will set the tone for not just 2019, but also for years to come. It remains to be seen how the landscape will shift after 29 March – when the UK is officially due to leave the European Union – but the RTT advised that Brexit is no reason to avoid tackling the fundamental and systematic issues that have impacted negatively on the sector for some time now.

The RTT agreed that the ongoing challenges the sector faced in 2018 will not go away, and could well intensify further. Yet members were optimistic about the future for retailers that focused on five key areas of delivering growth: suppressing cost and boosting efficiency, putting the customer first, taking people on the transformation journey and building brand and reputation.

Paul Martin concluded: *“2019 is forecast to be a turbulent year for retailers in the UK. Certain developments and events will sit beyond their control. But it is controlling the controllable, acknowledging the challenges and addressing these whilst proactively embracing the opportunity, which can deliver success.”*





## Part II:

In detail – individual views of the KPMG/Ipsos Retail Performance Think Tank members



**James Knightley**

Chief International Economist – ING

This broad range of possibilities in an environment of political flux means no-one can have much confidence in their forecasts for 2019.

### Outlook for 2019

2018 has been a tough year for the UK economy and the retail sector in particular. The main direct effect from the June 2016 Brexit vote so far has been the collapse in the pound, which pushed up import prices and led to broad rises in inflation. Unfortunately wages have barely kept pace meaning a squeeze on spending power. At the same time, business continues to face an uncertain period due to a lack of clarity on what is going to happen. Consequently, the UK has been one of the worst performing major economies, likely expanding around 1.3% in 2018 versus 1.9% in the Eurozone and 2.9% in the US.

2019 is unlikely to get any easier. We are approaching crunch time in the Brexit process and this is increasingly weighing on both business and consumer sentiment. Fears of a potential “hard Brexit” linger – one in which trade is heavily impacted to due customs and regulatory checks that result in long port delays. This implies a risk of a lack of fresh food, medicine, manufacturing components and consumer goods. In a worst case scenario it could mean empty shelves, factory shutdowns and rampant inflation.

Recent scenario analysis produced by the Bank of England also talked of a deep recession, surging unemployment and collapsing asset prices in such a situation. However, there is little appetite for such an extreme form of Brexit within the House of

Commons, aside from a handful of Brexit “purists”. Moreover, recent parliamentary votes and proposed amendments suggest a “softer” form of Brexit remains the most likely outcome. Indeed, there is growing talk of a “Norway plus” model, which would leave things relatively unchanged (Customs Union + single market, but without any say on the rules) while betting markets continue to see the odds of a second referendum slashed – 18 months ago it was priced at 20/1, today it is as low as 6/5.

This broad range of possibilities in an environment of political flux means no-one can have much confidence in their forecasts for 2019. I for one think a hard, severe Brexit will be avoided, but things are likely to get worse before they get better in terms of both market moves and economic data – politicians often need a nudge. Indeed, there are strong parallels when US congress initially didn't back the proposals to deal with the sub-prime crisis in 2008. A steep equity market sell-off and a realisation that action needed to be taken now led to a swift re-appraisal of what to do.

As such the first half of 2019 is likely to be very challenging, but as the Brexit crescendo gradually subsides confidence should start to return with consumers increasingly willing to open their wallets. With the Bank of England signalling a desire to see higher interest rates should conditions allow it we could see borrowing costs rise. However a likely rebound in sterling may help margin pressures for retailers.



**Dr Tim Denison**

Director of Retail Intelligence –  
Ipsos Retail Performance

Nobody can be sure  
of how the consumer  
economy will play out  
in 2019.

### Outlook for 2019

2018 was always going to be another tough year for retailing and brutal to those retailers that failed to be agile and responsive to the market dynamics– and so it transpired. Retail footfall fell by 7% in 2018, its steepest decline this century. Announcements of CVAs, store closure programmes and swathes of job losses littered the headlines and UK high streets. Retailers and reputations, built up over decades, were brought down in mere months. For many others though, the hardship of working through business transformation programmes should help them savour success again in the future. These times are like no other in the history of retailing especially with Brexit now looming larger than Trump, but I will leave other, more notary RTT Members, to pick their way through the implications of that modern-day version of “no man’s land”.

Technology continues to play a significant role in the future direction that retailing is taking. Three streams, in particular, are worthy of a call out. AI and machine learning are beginning to deliver results in supply chain efficiency and inventory management, much needed in the omni-channel world. They are also producing direct benefits to shoppers, for example by offering personalised discounts on items bought regularly. Scan-and-go and checkout-free facilities are also making headway and stand every chance of hitting mainstream retailing in

2019, thanks to the omnipotence of mobile technology and payment apps. Finally, voice-recognition technology shows every sign of replacing the popularity of text-tapping. Over 1 in 5 households in the UK now have a smart speaker and seem open to the idea of using it to shop.

Making bricks-and-mortar retailing more experiential and turning stores into social spaces will continue to be a theme that resonates with shoppers in 2019. Store events such as fashion shows, DIY masterclasses and cookery demos take us back to the formative days of in-store DJs. Watches of Switzerland has recently become the first retailer in New York to open a bar within the store. IKEA has opened a small format store on Tottenham Court Road, London, complete with planning studio, cognisant that fewer young city dwellers now drive, calling for a new urban retail model. The year will see many more clever, little ways in which shopping experiences become more relevant and rewarding.

Nobody can be sure of how the consumer economy will play out in 2019. It’s likely that the year will start off on a sluggish footing, given the amount of uncertainty surrounding the Brexit negotiations. The British shopper, however, is nothing if but resilient, and as the mists begin to clear I expect sales to recover from their ponderous start and footfall to end the year only 5.1% down on 2018.



**Paul Martin**

UK Head of Retail – KPMG

It is too easy though to point the finger at Brexit as the singular cause of all the woes in the industry.

### Outlook for 2019

There is no doubt that the retail sector has had a challenging year in 2018. We have witnessed multiple business failures and we have seen a large number of retailers reporting distressed trading conditions. Looking ahead, unfortunately it isn't going to get any easier. 2018 was by no means the end, but was likely to be just the beginning of significant change and upheaval, but opportunities do still exist.

all too easy to focus only on the negatives but we should remember that the UK retail sector is a £360bn economy which, whilst changing, is likely to have grown by approximately 2% in 2018. Growth in 2019 is likely to be similar, but the main caveat to short-term growth is the political landscape. A no-deal Brexit will significantly dent the growth potential of certain parts of UK retail, including increased shop-floor prices for the consumer, reduced profitability for the retailer and accelerated distress for those businesses particularly exposed.

It is too easy though to point the finger at Brexit as the singular cause of all the woes in the industry. There is in fact a much wider array of forces at play currently. These forces have been gathering momentum for a number of years and are by no means new, albeit 2018 did see many of them connect to create a toxic cocktail.

There are six main forces to highlight:

- Macro-economic and geopolitical challenges
- Regulatory and compliance-related initiatives and costs
- Structural changes to the sector, including changing consumption behaviour

- The over-supply of physical stores
- High levels of legacy debt (financial, IT infrastructure investment and changes to the ways of working)
- Lack of leadership talent to deliver change

These 6 points will continue to play out in 2019 and will result in further change within the sector. We have already witnessed some sub-segments of the retail market undergoing a high-level of restructuring, such as consumer electronics or toys. However, other categories, such as the fashion sector, still have this task ahead of them.

To survive, and more importantly to thrive, retailers should focus on five points in 2019 and beyond:

- 1. Growth** has to remain a firm agenda topic for retail businesses, whether that takes the form of M&A, product and/or service innovation or perhaps through partnerships, which is increasingly the case these days. M&A should not only take the form of defensive consolidation, businesses increasingly need to 'care and dare' and think outside of the box.
- 2. Cost & efficiency:** Most retail businesses continue to carry excess costs, so exploring ways to become even more cost focussed in the future is crucial. Many cost optimisation initiatives have not delivered the expected results in the long-term, but this shouldn't deter retailers from revisiting their approach. At the same time, becoming more efficient is also paramount – increasing productivity and using cognitive and physical automation will undoubtedly divide the winners from the losers.



**3. Customer:** Those businesses that know who their customers are, and why they choose to visit and interact with them, hold the recipe for success. The days of being product-centric or having great store locations are over – it is no longer good enough. Winning access to the consumer's wallet is only going to become more competitive, especially if the economic backdrop deteriorates. As such, establishing a customer centric culture (this doesn't mean adapting everything for the customer at any cost), as well as engaging and rewarding a retailer's workforce, will go hand-in-hand.

**4. People:** The word 'transformation' is certainly overused, but the concept is here to stay. Many successful organisations consider themselves to already be in a permanent state of transformation. Historically many transformation projects have focussed on IT architecture, processes and organisational structures, but often these have forgotten the most important ingredient which is the workforce behind these tasks and procedures. It is evident that customer behaviours have changed over the last 20 years, but so too have the behaviours of a retailer's employees. With this in mind, without taking employees on this journey of change, success is unlikely.

**5. Brand & Reputation:** It's often cited that "a brand that is built over many years can be destroyed in minutes", and that is especially true today. Brand and reputational risk has become a top-3 CEO issue for many organisations. Retailers are facing a plethora of regulatory and compliance-

related initiatives and they need to demonstrate how they are addressing these. Ignoring these can result in the most significant ramifications, whilst embracing and shaping these can deliver a competitive advantage.

2019 is forecast to be a turbulent year for retailers in the UK. Certain developments and events will sit beyond their control. But it is controlling the controllable, acknowledging the challenges and addressing these whilst proactively embracing the opportunity, which can deliver success.



**Martin Hayward**

Founder – Hayward  
Strategy and Futures

The real cost of home  
delivery on urban  
congestion

## Outlook for 2019

For those who seek uncertainty, challenge and change, 2019 will again be a great year to work in retail management as the industry continues to adapt to new technologies and consumer behaviours.

In many ways though, the path to success is clearer now than it has been for some time as the industry, legislators and consumers begin to better understand the new landscape and look to integrate the strengths of traditional stores with the benefits of new distribution models.

On balance it does seem that 2019 should begin to offer traditional retailers a more level playing field as the big drivers of change look to favour the high street for the first time in many years.

Online will continue to grow albeit at a slower rate than previously and will particularly benefit from the growth of voice activated devices in home making ordering even easier. However, a longer list of factors will begin to support the high street at a crucial time:

- The real cost of delivery/returns is now being better understood and will begin to influence charges and business models in favour of in-store shopping or click and collect models.
- A mass of legislation will begin to emerge that will address:
  - The tax avoidance that international internet based businesses have enjoyed for many years
  - The real cost of home delivery on urban congestion
  - The employment practices and costs of unregistered couriers
  - The unfair loading of business rates onto traditional retailers

- A renewed focus on the importance of local shopping for the quality of life and economic viability of smaller towns
- Consumers will begin to realise that home shopping is useful, but that it is sedentary and often less fun or inspiring than browsing in a real store (c.f. the resurgence of real books, live music, food markets) – there is a wonderful irony in the uptake of fitness tracking devices to encourage movement at the same time as a growth in devices that remove the need to move at all to change TV channel, turn on lights etc.

As with most fast developing trends, it is likely that home shopping has overshot its natural share of the market, and that the many social, sensory and practical benefits of real world shopping will again be realised with a little help from legislators and consumers in search of a life outside their voice activated living room.



Maureen Hinton

GlobalData

### Outlook for 2019

There is no question that 2019 will be an extremely tough year for UK retailers. In Q1 we will see a raft of casualties from retailers that have not generated enough cash in Q4 2018 to meet debt and rent obligations.

But even those that manage to survive are under immense pressure. Apart from the uncertainties of Brexit and fragile consumer confidence, the nature of demand has changed inexorably. Consumers want convenience and value and the UK is way ahead of any other country in its penetration of online shopping; 18% of total retail spending is already online, but in a sector such as electricals online is over half of total spending, while clothing and footwear is already over 20% and heading for 30% in the next five years. This has put vulnerable clothing retailers in this highly fragmented sector under even more pressure as the shift to online pureplays has diluted spend in physical retail.

There does remain a place for physical retail but the pace of change has outstripped retailers' capacity to resize their store portfolios. Stuck with rising costs, long leases and declining margins, many do not have the means to invest in their stores and product, and give consumers a reason to visit or spend, or to invest in technology to offer the seamless online experience pureplays deliver.

Despite Mike Ashley's comprehensive analysis for the Housing, Communities and Local Government Committee on the

problems of the high street and how to fix it, the government is unlikely to do anything to help in 2019, (even if it really understood the problems) and even out the costs/taxes for physical and online businesses, it is too preoccupied with Brexit.

Meanwhile the uncertainty that continues to prevail around the outcome of any deal with the EU is putting the pound under further pressure pushing up import prices, and there is the continuing fear about how we will actually import goods should we end up with a no-deal. The latter is a particular problem for food & grocery retailers where there is little scope to store fresh food. Indeed Morrisons and the Co-operative who have built up their UK supply chains, are in a better position than the market leader Tesco, while Sainsbury's appears to be struggling with its product availability even before a deal is done.

Walmart is obviously keen to leave the UK market, but Amazon is expanding and will be putting food incumbents under further pressure as it opens its Amazon Go stores. Consolidation seems inevitable in the food & grocery sector quite apart from the proposed Sainsburys/Asda deal.

Amazon could still make an acquisition or a strategic partnership, as could the Chinese, and use their tech capabilities to disrupt the market further. With such pressure on demand, and overcapacity in the retail industry, there is no room for new entrants unless they can offer something very different from that on offer from incumbents.

Amazon could still make an acquisition or a strategic partnership, as could the Chinese, and use their tech capabilities to disrupt the market further.





**Martin Newman**

Founder, The Customer  
First Group

Just as in 2018,  
retailers with the  
biggest challenge in  
the year ahead will  
be those stuck in the  
middle.

### Outlook for 2019

Despite the challenges over the last couple of years, I believe that we have arrived at the perfect storm for retailers.

Consumer confidence is low. Lower than it's been for years. And consumer spend continues to edge away from 'buying stuff' and instead move towards 'having experiences'.

Although many retailers have made plans for Brexit, crucially some have not, and it continues to cast a shadow over the retail landscape.

Add to this the pressing requirement for retailers to become socially responsible. Consumers today are increasingly taking issue with single use and plastic packaging, demanding that retailers pay more than just lip service to their supply chain and how they look after their employees.

And of course, retailers are having to continually adapt their operating models to accommodate the demand from consumers to 'shop their way.' Customer expectations for their shopping experiences have largely been defined by the disruptive retail brands who have created new and more convenient ways for customers to buy and have their orders fulfilled.

Just as in 2018, retailers with the biggest challenge in the year ahead will be those stuck in the middle. Retailers with a homogenous product and price proposition or a lack of clarity over their value proposition, purpose and relevance are at risk. Especially as many also find themselves with too many under-performing

stores in their portfolio. These brands need to re-think what their customer value proposition is, how they can maintain the relevance of their products and services and make plans for extending the lifetime value of customers to their business.

Food retailers will not be immune to the issues affecting the rest of the retail sector. With increasing numbers of consumers leveraging Uber Eats, Just Eat and Deliveroo, and with more of a focus on both healthy eating as well as the significant number of those opting for a vegan lifestyle, 2019 will see more people opting for home delivery of their favourite food rather than settling for a microwave dinner.

In 2019, I expect to see more third-party entities supporting high street retail, just like Visa and others have done in recent advertising campaigns. However, landlords need to re-think their approach to leases and provide the opportunity and flexibility for both artisan brands and pop ups to fill the empty spaces in high streets around the UK. Do this, and it will provide consumers with more reason to visit their local high street.

Last but not least, retailers would do well to remember that a customer is for life and not just for Christmas. It's never been more important to focus on customer lifetime value and how to drive engagement with customers. To achieve this, retailers need to become service providers, finding ways of making life easier for customers and in doing so, giving them more reasons to be loyal.



**Mike Watkins**

Head of Retailer and  
Business Insight, Nielsen

The challenges for the 'big4' will continue notwithstanding the potential of new 'top2' with a combined 58% market share.

### Outlook for 2019

The end of 2018 was a turning point in the fortunes of many food retailers.

After indulgences during the hottest summer in many decades and a brief uptick in expenditure very late in the festive season, shoppers hit a tipping point and finally started to hold back grocery household spend in Q4.

With inflation stable the overall fmcg value growth in 2018 was 3% the same as in 2017 but shoppers spent differently and at different retailers. (Nielsen Growth Reporter).

These trends and a more subdued trading environment are expected to continue in the first half of 2019 and Nielsen expects industry growth to slow to around 2.5%. So broadly in line with CPI which means flat volumes at Supermarkets. This assumes an orderly exit from the European Union.

The challenges for the 'big4' will continue notwithstanding the potential of new 'top2' with a combined 58% market share. The structural change in how we shop – away from very large stores towards smaller stores and shifting to disruptive e commerce platforms – will be amplified as Aldi and Lidl continue to aggressively open new stores. Discounter market share will hit a new high of 15% with a further 5% of fmcg sales being purchased at High Street Value Retailers. (Nielsen Homescan).

The good news is that shoppers will continue to buy and consume more fresh and chilled foods, drinks and snacks.

However to balance household expenditure, this will be at the expense of grocery nonfood, non-edibles and discretionary general merchandise; super categories where trading down can be expected particularly if there is a sudden economic shock April onwards. With caution around the global economy and uncertainty around Brexit, it's very likely that the trading environment will get even tougher over the second part of 2019.

With supermarket spend under pressure, retailers and their supplier partners must think and act differently. As well as planning for the inevitable disruption to supply chains and preparing for the potential of accelerating inflation, this is the time to work together to bring new and exciting products to market. And to capture a larger share of the shopper wallet which is spent on food and drink away from home.

This means moving beyond just seeking efficiencies through range rationalisation, or price reductions to drive short term volumes, but bringing innovation to categories where shoppers are willing and able to spend more. Inspirational marketing will also help drive footfall, conversion and increased spend in store.

Sentiment has turned, consumer behaviour is going to be less predictable and the expectation of shoppers continues to evolve. Retailers in all channels need to move faster to reimagine stores, deepen customer interaction and improve the overall shopping experience. 'The Times They are a-Changin'.



**Nick Bubb**

Retail Consultant

The Retail casualty list in 2018 has been long, but there will be more casualties in 2019.

### Outlook for 2019

Stockmarkets are pretty good at discounting the future and the fact that the equity market has fallen back by over 10% in 2018 is a sign that there may generally be trouble ahead. Relative to the overall UK stockmarket, however, the Food Retail sector has outperformed quite well in 2018, whereas the General Retail sector has had a tough year.

Dig beneath the surface of the Food Retail sector performance and it is clear that things would not look so good without Ocado and Sainsbury, which have significantly outperformed their stockmarket peers. In Ocado's case, however, this has been driven by a series of Overseas licensing deals, whilst in Sainsbury's case the City is betting that the CMA will allow the planned Asda merger to go ahead without too onerous a level of store disposals and that the merger synergies are compelling. The regulatory treadmill will grind on for many more months, but by spring 2019 it should be clear enough what the CMA thinks of the Sainsbury Asda deal.

For the rest of the quoted Food Retail sector, 2018 has not been all plain-sailing. As memories fade of the benefits of the long hot summer, the relentless growth of Aldi and Lidl is not making life any easier for the likes of Tesco (whose share price has continued to flatline). The huge problems that the convenience store chain McColl's has run into should not be forgotten, because these show that, outside the core supermarket business, allied activities like wholesaling have not been a licence to print money.

But people still have to eat, so Food Retailers have some defensive strengths, in a sector with relatively low Online sales penetration, whereas the General Retailers are exposed to the vagaries of discretionary consumer spending and the pressures of greater pure play Online competition. And the quoted General Retail sector has had

a very difficult year, with share prices on average over 20% down so far in 2018.

Yet there has been a wide gap between the winners and the losers in the General Retail sector in 2018. A handful of major companies have been able to make some modest progress on the stockmarket, including Next and JD Sports, but the equity value of retailers like Debenhams, Mothercare and Carpetright has all but been wiped out, whilst a wide range of significant retailers like B&M, Kingfisher and Sports Direct have performed disappointingly.

And if 2018 has been a tough year, 2019 could well be even more difficult, regardless of the exact outcome of Brexit, with the likelihood of prolonged political uncertainty adding to the continuing structural pressures in the industry and the growing cyclical pressures in the economy, with the risk growing of a recession.

The Retail casualty list in 2018 has been long, but there will be more casualties in 2019. "Big ticket" retailers are likely to have the toughest time, given the impact of weak consumer confidence on the housing market, but the over-capacity that still exists in the department store and fashion retail sectors will continue to drag down even the best operators, as well as even the best shopping centre companies. If 2018 always looked likely to be the year when the fate of House of Fraser was decided, 2019 is likely to be the year when the death agonies of Debenhams are played out.



**James Sawley**

Head of Retail & Leisure  
HSBC

I must summarise in saying  
that the sector isn't all  
doom and gloom, there are  
shoots of growth and rays of  
sunshine out there.

### Outlook for 2019

It's difficult to be optimistic in the run up to this Christmas, and the promise of changing fortunes in 2019 is looking less likely even when taking into account the fallout of 2018. Some capacity has been taken out of the sector via CVAs and closures but we are still some way off equilibrium of supply and demand. In addition, there is little improvement in the macro situation. Wages might be growing modestly but confidence is low. The key potential change which may bring a glimmer of hope is Brexit uncertainty fading away, which would hopefully lead to consumers loosening those purse strings.

For some, the continued squeeze on margins and capital buffers will mean drastic action must be taken. Many are running out of levers to pull. The prospect of further CVAs and sadly administrations is inevitable. Continued consolidation will ensue, with the stronger failed brands being acquired and weakest being run off.

I anticipate the erratic and prolonged promotional activity to remain in the market throughout at least H1, which will partially help bolster sales in the short-term but will ultimately lead to an indifferent and at times confused consumer, unwilling to pay full price. This cycle is going to take time, passion and leadership to bring to an end.

I must summarise in saying that the sector isn't all doom and gloom, there are shoots of growth and rays of sunshine out there. Value retailers are marching on with successful store openings, countering the wider sector trends. Online is still unparalleled in terms of growth and

demand, trading without borders with the globe as their market place. The 'last man standing' retailers, i.e those left trading in categories in which disruption has almost been fully played out and are now reaping the rewards of fighting a hard battle. And lastly, retailers with the strongest brand value and identity, and in most cases having loyal followers, these are the types of retailers I expect will continue to perform well, winning market share in 2019.





Jonathan De Mello

Head of Retail Consultancy  
Harper Dennis Hobbs

The outlook  
for UK retail in  
2019 is hugely  
uncertain at  
present.

### Outlook for 2019

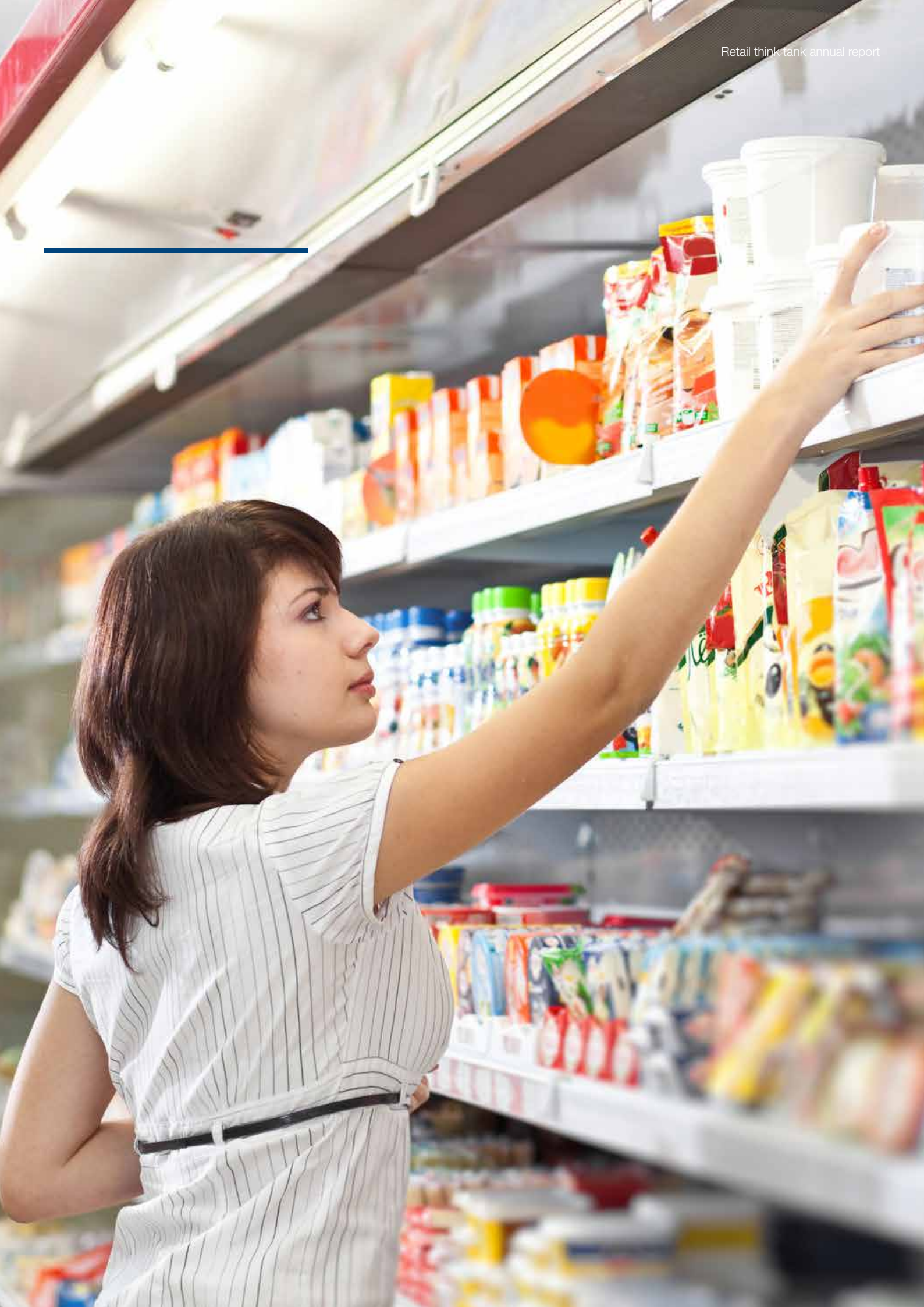
The outlook for UK retail in 2019 is hugely uncertain at present. Daily news highlights continued dithering by the political establishment over Brexit, and this continues to dampen consumer confidence, and consequently retail sales. 2018 (YTD) has been the worst year for retail business failures since 2012, with 38 multiple retailers failing, affecting 2,892 stores and – most pertinently – 43,292 jobs. This included major high street players such as Toys R Us, Maplin, House of Fraser and New Look; some of which continue to trade but from a smaller store base. There are myriad reasons for these failures – but some commonalities do exist such as falling demand, a shift in spend to online, and poor management/an outmoded brand. Rising costs have also played a significant part, some of which have been driven by the depreciation of sterling, though rents in all but the best locations have actually come down, paradoxically.

Whilst landlords have not been keen to damage overall rental tone in their shopping centre or building, they often offer generous incentives for new retailers, or to existing tenants near lease expiry. Average lease length has reduced considerably, and 10 year leases have become the norm even in major regional centres and malls, with the ability to break the lease in year 5 if needed – and sometimes even in year 2 or 3 – written into rental contracts these days. Retailers also ask for – and usually get – 12-24 months rent free as an incentive, and in addition to this are often negotiating lower base rents with turnover top ups; albeit landlords are more reluctant to agree to this as property valuations are wholly biased towards ‘contracted future income’ – as opposed to income that may or may not materialise depending on retailer performance.

The increased flexibility within property leases certainly helps retailers, but clearly

does not deal with the other issues retailers face such as exorbitant business rates, and falling demand. Retailers entering CVA or administration prior to rent quarter day (in order to renege on property debts – among other debts) occurs more and more frequently these days – but landlords have arguably never been as pliable as they have been before as they know that – without their tenants – they themselves would face ruin. A lot of the over-rented stores retailers have in their portfolios are self-inflicted; down to over-aggressive expansion – typically driven by private equity ownership. This is particularly true in the casual dining market – where a prime West End unit would a couple of years ago have had 20+ bidders bidding aggressively for it. In this context, it is clear to see that the business failures we have seen in the casual dining sector in 2017 and 2018 were pretty much inevitable. From the viewpoint of landlords’ willingness to do deals and retain tenants in their centres, Mike Ashley’s stance against Intu – which would essentially be shooting both House of Fraser and Sports Direct in the foot if he pulled their stores out of all Intu schemes – is pure hyperbole in my opinion; designed to make a statement and pressure Intu into giving him the deal he actually wants. It is an aggressive tactic but one that is likely to work in Intu’s case – given the state of their share price following the very public discussion around this issue, and John Whittaker’s subsequent withdrawal of the acquisition of a controlling stake in Intu.

While I don’t see many – if any – retailers entering CVA prior to December 25th, Q1 2019 rent day (March 25th) will be an interesting one to watch, given likely poor Christmas trading for many physical retailers over Christmas – if early indications from Black Friday (and the huge amount of promotional activity seen in-store) are anything to go by. Having some certainty on Brexit either way is key right now for retailers – and the wider consumer – and the sooner the better.







# Just how bad is 2018 going to get for retailers?

May 2018

## Introduction

- 2018 had certainly not started on a positive note, with retail performance being compared to that of the financial crisis of 2008/2009, but for different reasons
- Higher costs, lower demand and over capacity were the prevailing trends highlighted alongside the ongoing structural changes the industry faces
- The RTT members agreed that difficulties in the sector were only likely to continue for the foreseeable, and therefore retailers needed to take an 'adapt or perish' mentality

A mere glance at news headlines will paint a rather gloomy and oppressive picture of the health of the UK retail sector currently. As Jonathan De Mello, Head of Retail Consultancy, Harper Dennis Hobbs, put it: "Only three months into the year, many commentators are already dubbing it the Year of the CVA (Company Voluntary Arrangement)", adding to that "over 12 retailers have already failed this year".

But just how bad is 2018 likely to get, and is there light at the end of the tunnel? These were the principal questions the KPMG/Ipsos Retail Think Tank (RTT) set to tackle when they met in mid-April 2018.

## A look back at recent retail performance:

Reflecting briefly on the first quarter of the year's performance, the RTT members were in unanimous agreement that 2018 certainly had not started on a positive note. Indeed, Paul Martin, RTT Co-Chair and UK Head of Retail at KPMG, said that "many retailers had predicted a difficult start to the year and had been proven right". Meanwhile, Dr Tim Denison, RTT Co-Chair and Director of Retail Intelligence at Ipsos Retail Performance, added that the first quarter had been one of the worst for non-food retail that he could remember, "as bad as 2008 and 2009 but for different reasons", he added.

Looking at the UK's economic performance in a global context, James Knightley, Chief International Economist at ING said that:

"While the UK economy has performed better than the doom and gloom forecasts published in the wake of the Brexit vote, its overall performance must still be regarded as poor when put in an international context." He added that: "The UK has grown at roughly half the rate of the US and European economies since mid-2016, with the UK's consumer sector particularly badly hit".

Of course, the first quarter of 2018 was plagued with bad weather – whether that be the 'Beast from the East' which resulted in widespread store closures, or the rather washout Easter. However, the UK retail industry has been undergoing significant upheaval for a number of years now. With this in mind, not all underperformance can be wholly attributed to adverse weather conditions – despite the UK's affinity to do so.



### What are the principle drivers holding the overall sector back?

When considering the principle drivers behind the rather dreary picture more closely, Maureen Hinton at GlobalData highlighted that the “prevailing trends in retail are higher costs, lower demand and overcapacity”, whilst Tim Denison pointed to the “relentless squeeze on gross margins and costs that have beleaguered retailers at a time when sales have been flat”.

Tim added that an “unpalatable soup”, comprising of deflation beset on the non-food sector for years; devaluation of the sterling; fallout of the Brexit referendum, as well as increasing operational costs and progression of omni-channel “has been cooking away in the cauldron for 12 months or more and for some retailers, it is now bubbling over”.

Several of the RTT members made comparisons to the financial crisis of 2008/09, however they were quick to differentiate the set of circumstances retailers were now faced with. Martin Newman, Chairman of Practicology, stated that the main difference between then and now is that: “...pressure on retailers from the migration of consumers online has massively increased. Long leases on stores that can’t maintain footfall and the fierce price and proposition competitiveness online are combining with Brexit and consumer uncertainty to make a perfect storm”.

Indeed, further stressing this point, Jonathan De Mello added that: “Even London’s West End – Europe’s and arguably the world’s strongest shopping areas – is experiencing a circa 10% footfall decline year on year due to falling demand. This – at a time when business rates are set to rise in the West End by an average of £50,000 per retailer – will clearly lead to more failures of retailers heavily invested in the West End.”

Paul Martin also flagged that retailers

are currently facing increased costs due to regulatory and compliance-related factors – including National Living Wage, the Apprenticeship Levy, business rates or the upcoming General Data Protection Regulation (GDPR). He also highlighted the growing importance of a retailer’s ability to “resonate with the paying public” today, stressing that “it is more important than ever to have established a customer-centric proposition”.

All this clearly poses a key question: are certain retailers weathering this ‘perfect storm’ better than others?

### A closer look at retail categories and retail channels:

Clearly with such a multitude of factors impacting the retail industry from all angles, some players have been better positioned to weather the storm than others. James Sawley, Head of Retail & Leisure at HSBC, stated that 2018 is “not going to get worse for every constituent part of the retail landscape”.

The RTT was quick to highlight the successes of the grocery sector in particular, with Martin Hayward, Founder of Hayward Strategy and Futures, stating that: “Despite the challenges, our supermarket sector has survived largely intact and despite online and discounter threats, the big players are still the big players”. Of course, his comments came ahead of the news that Sainsbury’s and ASDA are considering a merger, in yet another act of defensive consolidation of epic proportions.

Nick Bubb, Retail Analyst, added that food retailers have been: “...helped by a benign food price inflation and margin background, and have outperformed the overall stock market, rising by over 10% overall so far this year”. In contrast, general retail has been under far greater top-line sales pressure – with the number of casualties mounting – but well-managed players, like Next, have coped with the adverse condition helped by having an online presence, he added.

Mike Watkins, Head of Retailer and Business Insight at Nielsen UK, also pointed to grocery sales outperforming non-food categories, but stressed that: "...shoppers are economising but not compromising and this is reflected in the +3.5% growth of FMCG own label sales last year. The shift in sales towards higher margin own label and fresh food categories and the 'little and often' shopping behaviour is underpinning food retail performance". In essence, RTT pointed out that despite the overall lift in food retail, there was also disparity amongst categories of grocery, and there has also been a significant change in how and when customers are choosing to purchase, leaving certain channels more exposed than others.

As mentioned earlier, CVAs have been rife in 2018, with Tim Denison adding that: "Hardly a week has passed this year without news of another retailer announcing profit warnings or plans to re-finance. CVAs abound, contrasted around rent reductions and store closure programmes. From department stores to DIY shed, carpets to clothing, casualties are emerging". In short, the RTT members highlighted that it was non-food, physical players who were seemingly most exposed to the adverse elements.

Paul Martin flagged that many retailers are heavily loaded with high debt burdens, adding to their exposure. In light of the difficult market conditions "small hick-ups can lead to the failure of these highly leveraged businesses", he added.

Jonathan De Mello shed further light on this issue, having suggested that many businesses failures observed over the past 10 years have been retailer owned by private equity companies. "In their rush to expand the store footprint to facilitate a lucrative sales or float on exit, a number of private equity businesses have pressured retailers into expanding too quickly; paying higher rents than they should, for sub-

optimal locations", he said. So a retailer's financing also clearly plays a critical role in its ability to overcome current challenges.

Of course, the pressure of mid-market, non-food retail has been widely reported against the current backdrop of growing competition – both physical and online. Tim Denison added that: "For well-established middle-market retailers, trading on market success of the past, reincarnation is not optional, it's compulsory."

### So what does the future hold?

Clearly the economic environment has a significant impact on the future health of consumer industries. James Knightley showed concern over high inflation and the squeeze on household spending, which has meant that a growing proportion of consumer spending has been funded by household borrowing and running down savings – a process that cannot last, he stressed.

James Knightley warned: "The risk is that it could come to a halt quite quickly given that the Bank of England (BoE) has reported that the availability of unsecured credit to the household sector fell "significantly" in Q1, as lenders tightened lending criteria for personal loans and credit card borrowing", which will naturally impact on retail spend.

Added to this, James Knightley also stressed that: "Following recent comments from the Governor of the BoE, Mark Carney, and terrible Q1 GDP, market expectations have swung wildly from virtually fully pricing in a May interest rate rise, to now signalling little or no prospect of it happening. Nonetheless, the BoE continues to hint at future moves to pre-empt an inflationary uptick linked to wages. While there is the possibility of an August hike, I am sceptical that the economy can withstand a series of rises and increasingly believe monetary policy will remain unchanged until Brexit talks are concluded next year."

On the other side of fence, James Sawley pointed to more promising news that we 'should' see the headwinds soften throughout the year. He said: "Inflation is now moderating and wages are growing underpinned by full employment, FX has recovered to circa 5% up on pre-Brexit levels, and consumer confidence has improved in the last few months".

Looking at consumer confidence the picture was a little bleaker. Maureen Hinton pointed to Global Data's recent monthly Retail Consumer Sentiment tracker which found that "every region in the country has a negative outlook on the economy, their personal finances and prices over the next six months, while 55% expect interest rates to rise". Maureen added that "the majority intend to spend less rather than more in retail, except for food and grocery, which is being driven by inflation rather than higher volumes."

That said, Mike Watkins suggested that if there is any significant fall in consumer confidence to come, it's likely to prompt caution, not concern, as it would take some six months to be reflected in the likes of food sales. Indeed, he added that an "early spring and the upside of the World Cup are other reasons to be cheerful."

Of course, at the forefront of many retailers minds will be future trade arrangements, as the geo-political environment continues to unfold. This will undoubtedly impact the health of the sector, with retail highly dependent upon the outcome of trade negotiations in particular. James Knightley, stressed that: "We have to be cognisant of the threat of a global trade war. The UK is the world's fifth largest trading economy and is vulnerable to damaging trade disruptions in terms of both pricing and slower growth". Meanwhile, Martin Hayward suggested that: "Consumer incomes look set to grow in real terms and Brexit hasn't led the sky to fall in".

## Conclusion

As has been highlighted, many of the drivers of change have been longstanding – it's only the pace of change that has been accelerated by recent economic and geopolitical events. When looking at whether the trend will continue, Tim Denison said: "I'm reminded of the words of Lao Tzu in the 6th century who said that those who have knowledge don't predict; and those that predict don't have knowledge". He added: "Those [retailers] that persist in swimming in the seas of sameness and legacy will risk drowning. The boring, the undifferentiated, the unremarkable, the irrelevant stores, disconnected from the needs of today's shoppers, will perish."

The vast majority of RTT members believed that the difficulties in the sector were only likely to continue for the foreseeable, and as such retailers needed to take an 'adapt or perish' mentality. Paul Martin stressed the need for new blood to be injected into the industry by looking beyond the relatively limited pool of seasoned retail leaders that tend to move around the industry from one businesses to the next. Meanwhile, James Sawley pointed to the words of Charles Darwin, who stated: "It is not the strongest of the species that survives, nor the most intelligent, but the one most responsive to change".

Other RTT members pointed to the futile efforts to overcome the inevitable change. Martin Newman, for example, suggested that "cost cutting in this environment is inevitable, but it's not enough to save a business that is struggling with fundamental structural changes in its market, as well as weaker consumer demand."

Meanwhile, pointing to the recent bout of CVAs, Jonathan De Mello, said: "CVAs – once an absolute last resort mechanism – are increasingly being used in 2018 to ensure fitness for purpose in today's multichannel world, and also as a buffer against the Brexit storm to come". However, whilst there are notable examples of successful downsizing and restructuring over the past decade, "it is often a case of delaying the inevitable; full administration", he added.

It's not all doom and gloom though. Jonathan De Mello highlighted that "there are always winners as well as losers when a retailer fails. From the ashes of retailers failing in 2018, new brands will rise – likely with leaner business models and seamless integration with online and mobile commerce". Meanwhile, Tim Denison emphasised his hope that "2018 will mark a year in which more retailers embarked on programmes of change rather than suffered collapse".

**For detailed individual views of the KPMG/Ipsos Retail Think Tank members on this topic, please visit our website, [www.retailthinktank.co.uk](http://www.retailthinktank.co.uk).**











# What does the future hold for the UK grocery sector?

September 2018

## Introduction

In light of consolidation and diversification, what does the future hold for the UK grocery sector?

The UK retail market is currently in the midst of seismic change, a once in a generation shift that is impacting on the way that retailers operate and sell. Driven by a consumer that is undergoing a demographic and lifestyle evolution, retailers in every sector are having to adapt in order to both survive and thrive. The grocery sector is no exception to this rule, and here the KPMG/Ipsos Retail Think Tank (RTT) set out to discuss, in light of consolidation and diversification, 'what does the future hold for the UK grocery sector?'

Members were in unison that fundamental changes are taking place, with a wide spread of factors discussed and taken into consideration. Members agreed that the following five 'influences' were having the biggest impact on the UK grocery sector, and as such hold the key to shaping its future: the rise of the discounters, shifting consumer shopping habits, technology, consolidation & diversification, and Brexit.

Whilst change can be disruptive, the RTT was keen to express that they felt optimistic about the future of the grocery sector, with Nick Bubb, retailing analyst, noting "that the Food Retail sector has been one of the best performing sectors in the UK stock market so far this year, implying that the City is optimistic about the outlook for the main players".

## The rise of the discounters

The discounters' rise in popularity has forced the hand of the 'big four' into adapting their offering and changing how they operate as retailers. The RTT wanted to stress just how seismic the impact of Aldi and Lidl had been, and also how there is room for further expansion. Mike Watkins, head of retailer and business insight at Nielsen UK, said: "In 2011 Aldi and Lidl had 6% market share, and by the end of 2018 this will have more than doubled to 14%. A market share of 20% no longer seems impossible, which incidentally is still below the European average of 22%. Put another way, £15 billion sales per annum are being lost by supermarkets each year, which is equivalent to a retailer the size of Morrisons."

RTT members also pointed out that the pinch being felt by the 'status quo' of supermarkets was not just in food sales from the likes of Aldi and Lidl, but homewares and general merchandising were also being impacted on. Maureen Hinton, group research director at GlobalData, stated that: "Not only have Aldi and Lidl taken market share, and will take even more as they open more stores, the general merchandisers such as B&M and Poundland are diluting spend at the big players. So, from having 58% of all consumer spending in food & grocery in 2008, the big four grocers will have just under 52% in 2018."

Driven by uncertainty in politics and the economy, the popularity amongst consumers to shop for better value products is a trend that the RTT didn't

expect to fade away anytime soon. The supermarkets, whether through lethargy or ignorance, underestimated the discounters and failed to react quickly enough to their rise. The discounters tapped into what the customer of today valued in their grocer, and now we are seeing the big four consolidate and diversify in an effort to catch-up with themselves.

### Shifting consumer shopping habits

The way that people in the UK shop is changing, whether that is for cars, clothes, technology, property or food, as we see, the next generation of consumers spend money in a very different way to their parents.

Up until five years ago, it could be said that the majority of 'food shops' were undertaken in the same way that they had been for decades before. Yet the RTT members agreed that in the future it was "inconceivable that this generation would be spending nearly two hours every Sunday walking around a supermarket for a weekly food shop".

With people shopping more often, more frequently and increasingly online, the RTT members stated that, "brand loyalty to specific supermarkets is now a thing of the past, it doesn't exist in the mind of the next generation of consumer". The grocers are going to have to re-invent their loyalty schemes and offerings, at a time when people are happy to buy their meat from one store, fresh vegetables daily and then have larger bulky items delivered weekly, grocers have a challenge ahead of them and could look to the likes of Amazon Prime and the non-food sector for inspiration.

Experiential shopping has been a strategy adopted by swathes of non-food retailers in an effort to combat the rise in online shopping, persuading consumers to put down their laptops and smartphones, leave the sofa and enjoy shopping on the high street in physical stores again. Dr Tim Denison, director of retail intelligence at Ipsos Retail Performance said,

"supermarkets need to provide immersive experiences and a compelling reason for people to choose to spend time in them."

The way that 'millennials' and 'generation X' consume and use services away from food shopping will no doubt influence the offering of the grocers, and Martin Newman, CEO of Practicology, believes this has already started: "Tesco now talks of frictionless shopping, and one of its most interesting developments is same-day delivery in one hour. Thinking about where future competition for service and solutions-focused offerings come from – Amazon, but also Deliveroo and Uber Eats-style services – this is particularly relevant."

### Technology

The digital revolution, unlike the industrial revolution is not a long-drawn out cycle of engineering and construction. The digital revolution re-invents itself almost continually as technology improves, and as such retailers have to adapt their offering to ensure that the consumer's demands in terms of convenience, ease of use and experience, are met.

The RTT looked to Amazon as having the potential to lead this shift-change in utilising technology, or depending on how they enter the market, force the supermarkets themselves to start adopting solutions that make the shopping experience more appealing to younger generations.

James Sawley, head of retail and leisure at HSBC, commented: "Online grocery is still a minority channel for supermarkets in terms of sales, which I have no doubt will grow, but in terms of penetration, I can't foresee it reaching the heights of non-food retailers. The till-less supermarket, however, is a space I see excitement, with Amazon leading the way in the US and Tesco currently testing smartphone scan/pay as you go technology in the UK – this way of shopping will possibly be a game changer in taking the customers experience to a new level."

The RTT acknowledged that Amazon would have a huge challenge ahead of itself to gain market share in the UK grocery space, but its breadth of product, existing customer base and Prime 'loyalty' offering will all work in its favour. The RTT believed the big four supermarkets would be best advised to not directly compete with Amazon, as it will offer something very different to what makes them so successful, although that's not to say there isn't anything to learn from the internet giant. If the dust settles on the Sainsburys/Asda merger, with their partnership with Argos, they would have a product range that appeals to the general consumer to compete with Amazon.

Martin Newman added: "Online developments are not always the answer for the incumbent main players, but with Amazon taking an increasing interest in becoming a platform to supply grocery products, then they should certainly be keeping a close eye on further signs of digital disruption."

It isn't just initiatives from supermarkets and the likes of Amazon that are changing and disrupting the online grocery space, with Nick Bubb pointing out "that Ocado's recent success in licensing its online grocery delivery software and systems to overseas food retailers has propelled its market capitalisation to £7.5bn (which makes it bigger than Sainsbury's) and elevated into the ranks of the prestigious FTSE 100 index". This blurring of lines between retailer and tech company is a trend that the RTT expects to continue, as businesses seek opportunities to take full advantage of improvements in technology that are changing consumer habits.

### Consolidation and diversification

Headlines have been made in recent years as grocers look to consolidate their positions with mergers and acquisitions, with deals such as Sainsbury's/Asda, Tesco/Booker and Co-Op/Nisa to name but a few. Paul Martin, head of UK retail at

KPMG, commented on recent activity: "This is happening due to increased competition within the sector, alongside rising costs resulting in decreased margins. Therefore the perception is prevailing that scale and buying volume is one of the few means to survive and to demonstrate growth."

The RTT called the proposed Asda and Sainsbury's merger a 'defensive move' to shield themselves against rising competition in the grocery sector. Whilst it has been proposed that the increased buying power will result in price cuts of up to 10% for the consumer, the RTT delivered a warning regarding staff redundancies and store closures.

Jonathan De Melo, head of retail consultancy, Harper Dennis Hobbs, said: "In the case of Asda and Sainsbury's, consolidation is inevitable – whether Asda and Sainsbury's want it or not. The overlap that exists and the fact that both chains offer product from relatively similarly sized stores, will mean the CMA will have to step in – with all the ramifications to store closures and job losses that will bring."

In terms of how this series of deals could impact on the grocery sector, the RTT suggests a series of interesting implications, unintended consequences, opportunities for smaller brands and even a direct market response from supplier brands. The RTT also discussed what the catalyst was for such a sudden burst of activity that resulted in a strategy of consolidation and diversification.

Martin Hayward, founder of Hayward Strategy and Futures, said: "The underlying driver of consolidation across the major grocers lies in their 'success' at making price such an overwhelmingly important driver of trade."

The supermarkets know that with the pressures that come from the rise of the discounters, ensuring low prices and great value is key to driving demand, something they believe they can achieve through

increased buying power. This is supported by recent research, which Maureen Hinton shared: "research at GlobalData shows that UK consumers in 2018 are looking primarily for value for money (92% cite this reason) in their food and grocery shopping."

Martin Hayward went on to paint a picture of what this ramped up consolidation could mean for consumers: "The ultimate state of efficiency is commoditisation – everyone gets the same products, from similar, faceless, efficient outlets at a bargain basement price" – a statement that is further supported by the increasing popularity of own-brand products within supermarkets.

In a world where the price of goods has been driven to rock bottom lows, the RTT discussed how opportunities would emerge for smaller retailers. Unable to compete on price, message and marketing will play a key role in selling to consumers these retailer's 'own unique way', whether that be improved customer service, innovation in offering or provenance in product. This was echoed by James Sawley, who expected "a renaissance of farmers markets and both boutique and independent food stores, as the millennial generation matures and is happy to take the time to enjoy the food shopping experience again if it is something unique and different."

### Brexit

Brexit and the negotiations currently being undertaken by the UK Government and the EU will certainly effect how the grocery sector operates. The RTT discussed at length the varying scenarios, negatives and opportunities for the supermarkets, but Brexit is a moveable beast, and it will be years before the dust has settled and its true impact can be assessed. What was unanimously agreed amongst members was the sense of the danger Brexit brought with it – James Knightley, ING chief economist, called Brexit "from a macro point of view, the biggest threat right now to the grocery sector".



The trade deals that are signed, and the details within those agreements have the potential to require grocers to completely overhaul their supply chains. James Knightley continued: “40% of food consumed in the UK is imported with the majority coming from the European Union, Netherlands, Ireland and France being the big three, via roll on roll off ferries.”

The RTT feared that many supermarkets currently did not have enough of their focus on sourcing ‘shadow supply chains’, in an effort to minimise the cost and disruption in the event of a Brexit deal that either priced out the EU or made it logistically impossible to import certain goods. The natural direction to take would be to look closer to home, however the UK food manufacturing sector would require sizeable expansion in both farming and production in order to even come close to fulfilling demand.

RTT members were quick to suggest that Brexit shouldn’t take all of the focus, as it is not just European borders that retailers may find importing and trading through more difficult in the coming years. Macro and geo-political lines are shifting all of the time, US-China and US-EU trade barriers and tariffs could all lead to changes that will mean grocers need to be agile in their supply chains, with the RTT members suggesting both the price and size of produce ranges could change extensively in the future.

## Conclusion

Undoubtedly, UK grocers are undergoing a step-change in nearly every aspect of their businesses. Their customers are shifting, technology is evolving, new competitors are entering the market and of course, there is Brexit. The future of the sector is one where supermarkets ensure they understand their new generation of customers, following the path of the non-food sector with experiential instore experiences, true multichannel shopping and of course, great value.

Consolidation and diversification has come about for many retailers as a defensive move, whether that be against Amazon, Brexit, the changing desires of consumers or the rising fortunes of the discounters. The RTT stated that those operating in the grocery sector that can quickly tap into the unique benefits that consolidation brings, whether that is with lower prices, wider product range or better margins, will be the ones to succeed and drive consumers to the tills.

Dr Tim Denison concluded: “To my mind, future success in the UK grocery sector is about putting the customer first, getting all the basics right, embracing new technologies to achieve this and creating more innovative and rewarding store experiences – that’s the way to ‘be in the money’.”

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## With Brexit looming, has there been a more critical Christmas period for retailers?

November 2018

**The golden quarter is historically the most important time of the year for retailers to 'get it right' – but with Brexit looming, has there been a more critical Christmas period for retailers in the last ten years (since the financial crash)?**

- RTT members thought that the non-food sector could have as much as 20% over-capacity and that this so-called 'Golden Quarter' could be the catalyst for the most struggling retailers to come under serious pressure. They think that Department stores and Fashion retailers will face the most problems in the months running up to Christmas – and for many it could be the most critical trading period in a decade.
- The RTT stated that retailers would be looking to the Autumn Budget for relief in alleviating the negative external influences on the sector.
- Supermarkets are expected to fare better than their non-food counterparts, but food shopping over the festive period could be more restrained and later in the year.

### Introduction

The Golden Quarter is traditionally the most important time of the year for the majority of UK retailers – with a huge increase in consumer demand in the lead up to Black Friday, Christmas and Boxing Day Sales. It's the time of year that many retailers focus on the most, and spend months planning for as 'getting it right' can make all the difference in delivering strong trading figures for the year.

Paul Martin, UK head of retail at KPMG highlighted: *"Trading during this time*

*may even determine a retailer's ability to survive, especially given that some retailers generate 80%+ of their annual profits in that quarter alone."*

With the health of the retail sector steadily decreasing over the last two years, and the uncertainty of a Brexit (no-)deal just around the corner, the RTT discussed just how crucial this coming period was for retailers. Compared to a decade ago, in the midst of the financial crisis when retailers faced dire trading conditions, the members explored just how critical the coming months are for retailers in general, and which sectors could



be hit hardest by a poor performance over the Golden Quarter.

### Now and then

Looking back a decade to the fourth quarter of 2008, James Knightley, ING chief international economist said: *"The UK economy was amongst the very hardest hit by the financial crisis with output contracting 6% peak to trough, and unemployment rising by 1.1 million".* Dr Tim Denison, director of retail intelligence at Ipsos Retail Performance, went on to say: *"The golden quarter of 2008 saw the RTT's Retail Health Index crash six points – more than any time since – as the financial crisis broke, discounting became the norm and Woolworths collapsed."*

They discussed at length how the current financial climate, while not as toxic as during the financial crisis, had still been working against retailers over a number of years – with the RTT's Retail Health Index falling two points since the start of 2018 alone. Paul Martin added: *"2018 has not been an easy year for a large part of the UK retail sector, and we have already experienced a multitude of high profile business failures."*

Tough trading conditions, political uncertainty, shifts in geopolitical trade agreements and rising costs are just a number of external factors impairing the performance of UK retailers, with the RTT agreeing that the margin for error in delivering a positive Christmas trading period has never been tighter. James Sawley, head of retail and leisure, HSBC, commented: *"This will be a pivotal couple of months for some retailers from a profitability perspective – those that miss a beat could face challenges with competition so fierce. Some retailers have little room for manoeuvre and could find themselves facing difficulties if they don't hit desired trading levels."*

### Brexit effect

Whilst 2008 clearly impacted heavily on the retail sector, and there were many 'unknowns' with what the future would hold in terms of financial recovery, the RTT acknowledged that with Brexit, this current quarter holds a unique pressure for retailers.

Martin Newman, CEO of Practicology, said: *"A relentless focus on trading will be required in the next three months by retailers who want to go into the unknown of Brexit in the New Year with businesses that are strong enough to survive further upheaval."*

The RTT commented that retailers must make the most of this Golden Quarter's increase in demand, and it will be a case of 'making hay while the sun shines', as the uncertainty of Brexit could impact negatively on consumer demand and retailers' costs and margin.

Dr Tim Denison added: *"With all the uncertainties building around Brexit, and the UK's trade agreements, the months ahead will be defining times for the industry, challenging the acumen of even the very best leadership teams in retailing."*

### At the sharp end

Against a backdrop of store closures and shrinking real estate, the RTT discussed in its latest meeting how a 'seismic' correction was underway within non-food retailing. James Sawley said: *"We are undergoing a once in a generation correction in the supply base of physical retail stores driven by short term cyclical, and long term structural and social factors."*

Members believed that this shift would highlight the notion of there currently being too many stores and retailers operating on the high street – and this correction in overcapacity, which would affect many different sectors, could reduce store portfolios as much as 20%.

Maureen Hinton, group research director at GlobalData, said: *"The UK retail market, along with many other major economies in the west, is suffering from maturity of demand and overcapacity of supply. That said, retailers' growth, particularly in non-food, is being boosted from casualties in the market. The survivors are picking up the spend that would have gone to these weaker competitors."*

The RTT highlighted the book and toy sectors as retailers that had already gone through this process, with the surviving businesses picking up the additional demand from competitors that had gone into administration.

Looking ahead to the sectors for which this Golden Quarter is most important, and at the highest risk of overcapacity on the high street, they pointed to department stores and fashion retailers as having real pressure to succeed in the coming months. Maureen Hinton continued: *"The ones that will find it toughest are the mass middle market fashion retailers and department stores that have little or no unique offering, and the home related specialists which will continue to suffer from the stagnant housing market."*

The RTT added that the UK high street shopper has become accustomed to a diet of discounting in recent years, something that is expected to continue through the Golden Quarter – impairing retailers even further. Jonathan De Melo, head of retail consultancy at Harper Dennis Hobbs, said: *"Retailers will likely be locked into a fierce downward spiral of discounting, which will start a few days before Black Friday and continue throughout the run up to Christmas. This will clearly serve to erode margins – which is the opposite of what retailers need right now – but if they don't discount then the alternative could be much worse."*

## Food

The RTT explained that the biggest pressures facing retailers this Christmas would mostly sit with non-food retailers. The grocers on the other hand are having a better time of it, with members agreeing that they looked in much better shape than their non-food counterparts.

Mike Watkins, head of retailer and business insight at Nielsen, said: *"The uncertainty surrounding Brexit and the rise of energy and fuel costs have not yet impacted grocery retail spend. There is more good news. Despite 12 months of inflation, volume growth in food retail has turned positive with a 1.1% growth so far in 2018 (Nielsen Growth Reporter)."*

As has been the narrative for the previous 24 months, the non-food sector is expected to continue to struggle, with the grocers providing the majority of positive news for the retail sector. They agreed that whilst any discussion around Quarter 4 being 'make or break' is only relevant for non-food, there are certain pressures that will be felt by the big 4 grocers this Christmas – in the form of the discounters and a shift in Christmas buying habits.

Mike Watkins continued: *"It's been a slow start and many food retailers are now becoming anxious about Q4 with business models stretched more than ever by the continued shift of sales to discounters and the additional costs of fulfilling online orders. What supermarket shoppers say they want is to reduce and to spread the cost of Christmas. Q4 for many stores is going to be set apart from previous years by being 'less big and more late' with shoppers expected to shop around for the most convenient to shop, good prices and best ranges."*

## What ingredients make for a good performance in Q4?

With the critical importance of this year's Golden Quarter for non-food retailers agreed, RTT members discussed a number of key factors that would distinguish successful retailers apart from the rest, and will be set to flourish in this key period.

A focused proposition, whereby retailers concentrate on being really great at one thing, is expected to be a common trait of those businesses that succeed in the run up to Christmas. The RTT members were keen to stress that with the stakes so high, and the competition so fierce, there is no room for error in delivering a shopping proposition that isn't up to scratch this Christmas. Retailers that don't have a single focus will risk diluting their offering and that could make the difference between surviving and thriving over the coming months.

Martin Hayward, founder of Hayward Strategy and Futures, said: *"Supermarkets have done a better job of addressing and promoting what they stand for, compared to their non-food counterparts. From a customer's perspective, many non-food retailers have spread themselves too thin, trying to be everything for everyone. This could result in smaller, more agile operators taking share from the bigger players as they are able to deliver a specific, niche proposition to consumers."*

Secondly, the RTT highlighted that retailers that have a tried and tested, true omni-channel shopping experience for customers will also be better prepared to take full advantage of the increase in demand that comes in the Golden Quarter. Dr Tim Denison said: *"The skills required to build a successful omni-channel business model should not be dependent solely on traditional thinking and expertise. Digital dexterity and technological transmogrify are dependencies, no longer luxuries."*

## Conclusion

The RTT concluded that this coming Golden Quarter will be of great importance to the whole retail sector, and given the external pressures being faced, they suggested that retailers will be looking closely at the Autumn Budget for any signs of relief from the Government.

Nick Bubb, independent retail analyst, said: *"Any additional external pressures could be enough to tip some struggling chains over the edge, so, given the impact of continuing Brexit uncertainty on consumer confidence, many will be hoping that the Chancellor does something in the Autumn Budget to 'level the playing field', via his promised Business Rates review and Digital Sales Tax."*

Members added that for certain sectors it will likely be 'make or break', meaning the tag of it 'being the most important trading period for a decade' could certainly ring true. Those retailers that sit at the sharp end will be in the non-food sector, with the most high profile businesses at risk of being casualties of the Golden Quarter, being fashion retailers and department stores.

The RTT warned that even the slightest deviance away from delivering a well thought through, focused proposition, could be the difference in survival over the coming months.

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