



retailthinktank  
KPMG | Iposos Retail Performance

# annual. review

2 0 1 6 - 2 0 1 7

RELEASED FEBRUARY 2017



2016 was as expected, challenging for retailers, however the UK's retail health remained relatively stable, with the year ending with the Retail Health Index of 83. Put into context, retail health has never remained as stable for such a prolonged period since the RTT Index began over 10 years ago.

The year ahead will be tough, with retail growth expected to stagnate over the course of the year in light of consumer price inflation set to rise to 2.5 – 3%. Retailers will have to be agile however, despite the challenges retailers are facing, the environment does still present opportunities.

## Ipsos/KPMG Retail Think Tank annual report foreword

The past year was expected to be challenging for retailers, with strong headwinds coming in the form of: disposable income traditionally spent on retail being cannibalised by leisure; the roll out of the National Living Wage (NLW); and ever-changing consumer shopping habits prompting a rethink in strategy and operating model for retailers. Then of course there was the EU Referendum.

2016 started on an optimistic note, with the KPMG/Ipsos Retail Think Tank's (RTT) Retail Health Index (RHI) rising one index point to 84 in the first quarter – a level not seen for five years. This followed a period of stagnation in the final quarter of 2015, as demand failed to hit expectations with Black Friday 2015 having disrupted the regular shopping patterns noted in November and December. Subsequently, the rise noted in January was welcome news for the sector.

Strong demand was the main contributor to the uplift in the early months of the year, with shoppers feeling encouraged by strong employment levels and some wage growth. Sales figures noted in January and February were consequently particularly strong. However, an early Easter failed to deliver any boost in demand for food in the quarter, whilst weather conditions conspired against categories like DIY and outdoor related items. Nevertheless, health improved for the retail sector on the whole, in the first quarter at least.

Rising costs were very much on the radar of retailers from the start of the year onwards and many were developing plans to absorb cost hikes – including the NLW increases. Despite this, the result of these efforts were not set to take effect until later in the year and UK retail health was predicted to suffer as a result.

Running in parallel to accommodating these increased costs, retailers were also continuing their quest to adapt to changing consumer habits. The RTT's white paper – Millennials vs Grey Pound: who holds the key to future retail success? – highlighted the importance of looking to the future. It concluded that knowing what drives the current 'grey pound' is useful in the short-term but in the long-run this generation will be replaced. Therefore, future retail success lies in being able to adapt to the millennials way, whilst making changes evolutionary rather than revolutionary.

As 2016 progressed, the optimism in Quarter 1 proved to be short-lived and the RTT RHI fell to 83 in the second quarter – the first decline since the third quarter of 2014. Weakened demand amongst consumers; reduced margins and rising costs following the implementation of the NLW were signposted as the main contributors to the decline.



Despite consumer confidence having continued to improve alongside a rise in the public's finances – with both employment and wages increasing – there was no real uplift in sales and unseasonably poor weather hurt fashion retailers in particular. Moreover, Thursday 23 June 2016 marked a pivotal moment in 2016 and indeed history, with the UK voting to leave the EU.

Whilst the unexpected Brexit vote was unprecedented and resulted in considerable uncertainty, the RTT stressed that it in itself was not the driving force behind the acceleration in the downturn mid-year. Members also flagged that Brexit represented opportunities for retailers such as pursuing internationalisation strategies as a means of overcoming the lack of growth in the domestic market. A weaker sterling would also make the UK an attractive proposition for foreign tourists.

The RTT's white paper, published in August 2016, outlined the short and medium-term impact of Brexit on the retail sector. It suggested that in the immediate aftermath of the Brexit vote and the political uncertainty that ensued, consumer confidence would begin to dampen. In the medium term, the RTT acknowledged that retailers would be exposed to further increases in costs as currency hedging unwinds and over the longer term key considerations will be the sector's reliance on non-UK workers and future trade deals both in and outside the EU.

Despite the wave of negative sentiment captured by consumer confidence measures immediately following the Brexit vote – and indeed the predictions of a significant fall in retail health noted by the RTT's RHI predictions – consumers defied expectations and the health of the retail sector flat-lined in the third quarter of the year.

The RTT's white paper – Consumer confidence: can it be accurately measured and does it drive consumer spending? – highlighted some of the factors at play that resulted in the divergence between consumer confidence and consumer spend. It concluded that consumer confidence indices never tell the whole story and whilst there is a strong correlation between consumer confidence and spend in the long-run, shock events like Brexit can result in discrepancies between the two data sets, as noted in the quarter.

In the third quarter of 2016, once again it was consumer demand that remained resilient. Grocers in particular, benefitted from buoyant food sales and limited promotional activity. Less fortunate in the third quarter, however, were fashion retailers who suffered despite heavy discounting. Following the Brexit decision in June, initial fears of a dramatic drop in retail health were alleviated, as new appointments within government and swift fiscal action helped repair consumer confidence – this resulted in demand holding firm.

Moving into the final part of the year, the health of the UK retail sector remained flat for the third consecutive quarter on 83. Retailers suffered from a disappointing performance in October, which only got worse in early November as consumers held off making purchases until the Black Friday sales. As expected, however, demand improved during the last six weeks of the Quarter, with seasonal promotions around Black Friday and Christmas driving sales throughout the end of November and December.

For the most part, margins worked against retailers in Quarter 4 with promotional activity extending into the weeks either side of Black Friday. However, in the run up to Christmas the RTT noted that much of the discounting was more 'cosmetic' so had less of a bearing on margins towards the very end of the quarter. Costs also impacted retailers in Quarter 4, as a shift to online sales during November and December increased the cost of fulfilment, the effect of which was exaggerated further by rising fuel prices at the pump. Added to this, retailers also saw their wage bills increase, as they had to budget more when employing temporary seasonal staff, as the majority are now paid the new National Living Wage.

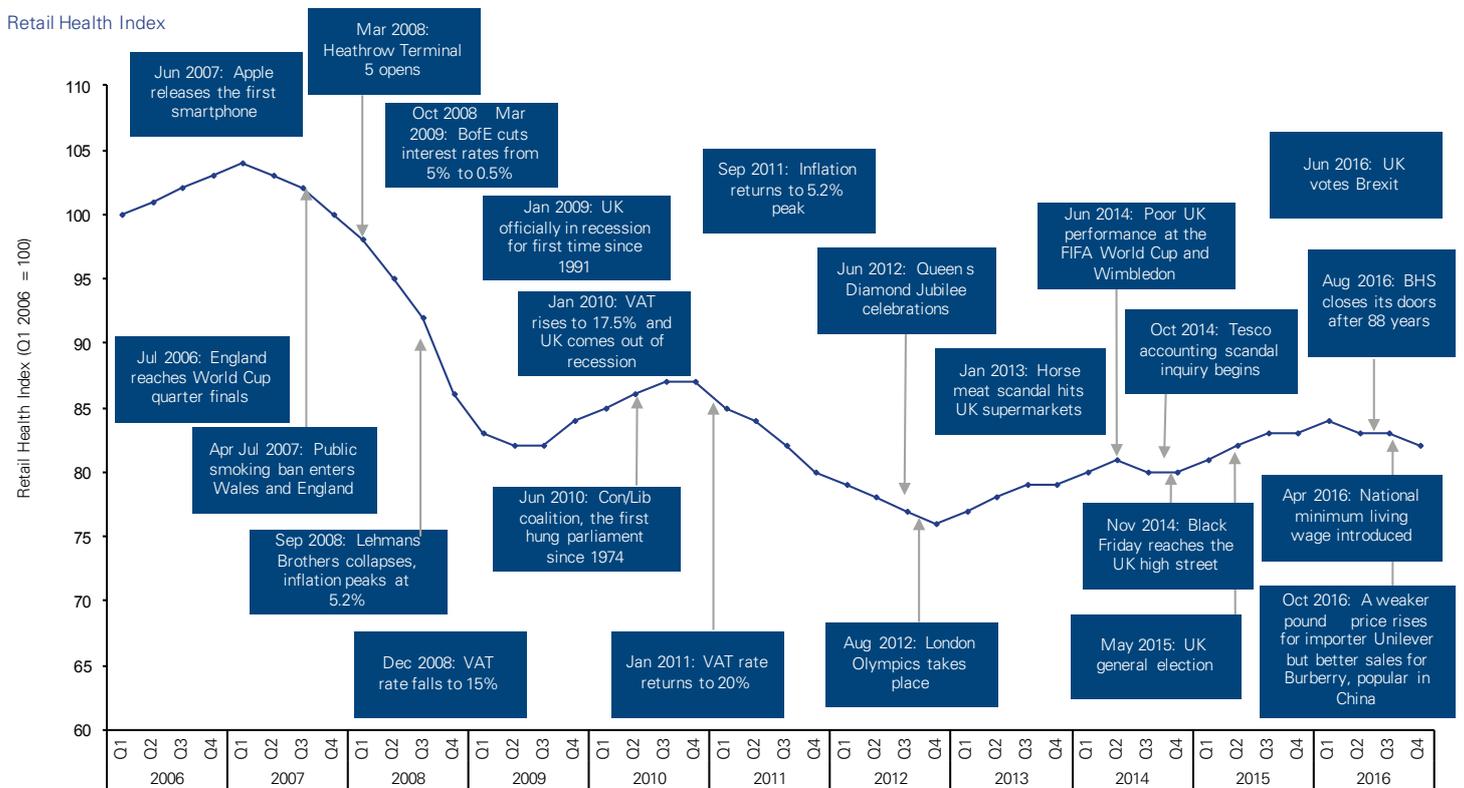
As in 2015, 2016 ended with the Retail Health Index again static on 83. Put into context, retail health has never remained as stable for such a prolonged period since the RTT Index began over 10 years ago.

From a macroeconomic perspective, 2016 was a positive year with the UK delivering an impressive 2% growth in GDP. However, the year overall is not likely to be remembered for this but rather the UK's decision to leave the EU; the election of the new President of the United States, and the repercussions these events may entail for the years to come.

With this in mind, the RTT have predicted a tough start to 2017 and that retail growth in Britain will stagnate over the course of the year. With UK consumer price inflation set to rise to 2.5 - 3%, the RTT note that any growth in non-discretionary retail – including food and grocery – will be largely offset by a decline in discretionary spend. Inflation, coupled with continued foreign exchange fluctuations could also amount to a 5-8% increase in prices over the course of 2017 – albeit varying across retail categories.

However, the year ahead won't be all 'doom and gloom' as the RTT also stressed that, despite the geopolitical shake up, the sky didn't fall down in 2016 so it's very unlikely it will in 2017. The industry will undoubtedly have a tough ride but if retailers can be agile to respond, then there are opportunities to ensure that they at least survive, if not thrive.

## RHI movement over 10 year period





## 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 LLP) 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**, Retail Consultant

**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**, Practicology

**James Sawley**, HSBC

**Mike Watkins**, Nielsen UK

Recent appointments are as follows:

- Paul Martin, UK Head of Retail at KPMG replaced David McCorquodale, Former UK Head of Retail at KPMG as co-chair of the KPMG/Ipsos Retail Think Tank in December 2016.
- James Sawley, Head of Retail & Leisure at HSBC replaced Richard Lowe of Barclays in June 2016.

### 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 2016 White Papers are included in this review and we have previously covered topics including:
  - What is the future of the shopping centre in a digital world? November 2015
  - Black Friday - Where does this now fit into a retailer's sales/promotion strategy? September 2015

### Where to obtain further information?

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



# contents

Prospects for 2017 - Individual views of the KPMG/Ipsos Retail Think Tank members	09
<b>James Knightley</b> , Senior UK Economist, ING	09
<b>Dr Tim Denison</b> , Director of Retail Intelligence, Ipsos Retail Performance	10
<b>Paul Martin</b> , UK Head of Retail, KPMG	11
<b>Martin Hayward</b> , Founder, Hayward Strategy and Futures	12
<b>Maureen Hinton</b> , Group Research Director, GlobalData	13
<b>Martin Newman</b> , CEO, Practicology	14
<b>Mike Watkins</b> , Head of Retailer and Business Insight, Nielsen UK	15
<b>Jonathan De Mello</b> , Head of Retail Consultancy, Harper Dennis Hobbs	16
<b>Nick Bubb</b> , Retail Consultant	17
<b>James Sawley</b> , Head of Retail & Leisure, HSBC	18
Whitepapers	
<b>Millennials v Grey Pound - Who holds the key to future retail success?</b>	<b>21</b>
In detail – Individual views of the KPMG/Ipsos Retail Think Tank members	23
<b>The short and medium - term impact of Brexit on the retail sector</b>	<b>35</b>
In detail – Individual views of the KPMG/Ipsos Retail Think Tank members	38
<b>Consumer confidence - can it be accurately measured and does it drive consumer spending??</b>	<b>51</b>
In detail – Individual views of the KPMG/Ipsos Retail Think Tank members	54



# Prospects for 2017

Individual views of the KPMG/Ipsos Retail Think Tank members



**James Knightley**

Senior UK Economist, ING

A more cautious stance by British business may feed through into weaker consumer confidence.

## Outlook for 2017

The strength of the economy following the Brexit referendum has surprised many, but we must remember that Article 50 is still to be triggered. Scheduled to happen before the end of March, it will coincide with Dutch elections and possibly Italian elections while French Presidential election campaigning will be in full swing.

Mainstream parties right across Europe are being challenged by anti-establishment/anti-EU movements and Britain could get caught in the crossfire. Incumbent governments trying to make “change” look as unpalatable as possible could, for example, offer dire warnings over what Brexit will mean for Britain. This could prompt an intensification in the war of words between the UK and EU officials. At the very least it means the UK makes next to no headway in Brexit negotiations until after German Federal elections in September.

Even in the current period of relative calm, businesses are wary. Surveys from the Bank of England (and others) are pointing to a sharp slowdown in both hiring and investment spending over the next twelve months. This is largely due to the perception that uncertainty will increase once the Brexit countdown clock starts. An intensification of UK-EU hostilities could result in more businesses sitting on their hands.

A more cautious stance by British business may feed through into weaker consumer confidence. Job insecurity could become more of an issue at a time when rising inflation will squeeze household spending power. The pound’s plunge is pushing up the cost of imports and is being felt most keenly in the price of food. Wholesale energy costs, typically denominated in US dollars, are up for the same reason, compounded by the rise in oil prices following OPEC’s recent supply announcement. Households and businesses are therefore facing higher utility bills and petrol costs.

As a result, headline consumer price inflation looks set to rise above 3% in the second half of 2017. Unfortunately wages are unlikely to respond given the caution being expressed within business surveys. This means that we could see a return of newspaper headlines warning of a “cost of living crisis”, which runs the risk of further eroding confidence and leading to weaker retail sales. Interest rates will not rise in this environment with the Bank of England leaving the door open for a further rate cut.



**Dr. Tim Denison**

Director of Retail Intelligence,  
Ipsos Retail Performance

The family-starting generation holds the key to retail success in the future, just as it has in the past.

### Outlook for 2017

Politics has finally caught up with retailing! For years now, shoppers have been voting with their feet, punishing 'safe-and-established' retailers that became disconnected from their customers, bringing them to their knees or, worse, sending them to the cemetery. In 2016 the same thing happened in mainstream politics; politicians experienced first-hand the damage that public disillusionment can inflict on the establishment. The ridiculous is no longer unimaginable.

The fallout from Brexit and 'Trumprance' will inevitably impact UK retailing in 2017, adding to the considerable challenges already in train for next year from the National Living Wage programme and the revisions to business rates. I'll leave it for other RTT Members more qualified to consider how these changes to the political and economic landscape will affect market conditions in the sector.

The consumer-led digital revolution has brought about massive change to the retail world in the last few years. Technological innovation is now a core strand of business strategy in the retailer's book, but it comes at a cost. Not all new technologies are winners. 2017 marks the tipping-point for some of these technologies, as Proof of Concept testing comes to an end.

Rationalisation of the first flush of dig-techs will ensue among the likes of Wi-Fi tracking, iBeacon BLE, smart mirrors, video analytics, 3D printing, virtual and augmented reality and contactless payment. The acid test, of course, is whether the value they add justifies the investment. I expect to see some fall by the wayside in the year ahead to be replaced in the R&D incubation hubs by a new wave of exciting technologies such as Just Walk Out and Li-Fi.

With the opening up of new shopping channels, retailing has become more complex. Operations have become less productive for the retailer and more frustrating for the customer. There is a need to put rationalisation right at the heart of retailing in 2017, looking to make things easier and more rewarding for the shopper and the retailer alike. Smarter and simpler is the future and we can expect leading players to adopt this thinking as a focus for some of their energy in the year ahead. Fresh ideas from outside the sector should be sought, bringing radical change to conventional practices. Whilst some may have been dismissive of the new approaches brought to market testing by the likes of Amazon, 2016 has taught us that complacency can be ruinous and alternative thinking should command respect. Radical can be realistic.



Paul Martin

Head of Retail – KPMG

For business the focus should be on controlling the controllable.

### Outlook for 2017

From a macro-economic perspective, 2016 was a positive year with the UK delivering what looks like to be an impressive 2.1% GDP growth – one of, if not the highest growth rate of any mature western economy. However, 2016 is not likely going to be remembered for this fact but rather the UK's decision to leave the EU and the election of the new President of the United States, both grabbing headlines along with the repercussions these events may entail for years to come.

The UK retail sector has delivered a mixed performance in 2016 and the structural changes the industry is facing remain an on-going challenge. You could argue that the “Great British” consumer has broadly ignored the result of the Brexit referendum, with consumer spend continuing to grow over the final months of the year. This is very likely to change in 2017 and the sector will face much stronger headwinds. We will see inflation rise, potentially up to 3% by the end of the year. In conjunction with continued FX rate fluctuations, prices will rise. The question remains how much will be absorbed within the supplier base, by retailers and actually be passed on to the consumer. A conservative view at the moment is that this will amount to 5-8% price increases over the course of the year (understandably varying across categories).

Although geo-political issues will stay at the forefront of many people's attention in 2017, for business the focus should be on controlling the controllable. For retailers this means an on-going focus on transforming their businesses in light of the structural issues they are facing – embracing new technologies, becoming truly channel agnostic and placing the customer at the heart of their organisations. Whilst this has to be the longer-term strategic objective, many companies will need to work much shorter-term profit improvement initiatives over the course of the year in light of increasing costs and weakening consumer demand.



**Martin Hayward**

Founder, Hayward  
Strategy and Futures

The sky didn't fall  
down in 2016, and it  
won't in 2017.

### Outlook for 2017

The sky didn't fall down in 2016, and it won't in 2017. The rather hysterical reaction to a democratically agreed Brexit, mirrored to a degree by the Trump victory in the U.S. masks some very important lessons for retailers to understand about changing consumer attitudes to life, commerce, politics and shopping. Despite the enormity of the votes, these are still weak signals in the marketplace, but 2017 will be the year that they start to manifest themselves as fundamental changes in the consumer psyche.

Looking behind the politics, it is clear that the aspirations of the 'chatterati' and many international businesses could be drifting away from the aspirations of the mass population. Globalisation of politics, cultures and business is looking less appealing as some of the realities become clearer – many people don't want to be nationless and equally don't want to deal with nationless companies who have interesting takes on tax and employee benefits.

The digital economy is in many ways behind a lot of the changes, opening markets beyond their traditional geographic borders and driving ever more efficiency. On-line shopping is clearly popular, but the realities of what this new digital world looks like are starting to be better understood. It's not much fun buying and reading books online so we're starting to see e-books decline and real bookstores open again. Buying music online isn't much fun, so performance concerts are becoming over-subscribed.

But we're telling consumers that the new digital economy is the future, friction free and painless, with everything delivered to our door in moments. No need to go out ever again. The much lauded 'gig economy' is

however sometimes just transferring decent pensioned jobs into minimum wage and contract free roles as companies like Amazon recruit warehouse workers to walk in circles and frequently subcontract deliveries to cash in hand couriers.

Many of these 'new economy' companies rely on a pool of low paid, off the radar employees to make the economics work. Interestingly, in the grocery sector where delivery is by real employees, the industry estimates that the supermarkets make a loss on every order - home delivery isn't really economic. The dream of these new businesses is ultimately to have no employees at all and to deliver by drone and driverless vehicles at which stage they can dispense with their 'non-employees', but that is a way off.

But, the reality of 'efficiency' is beginning to dawn on consumers just as it did with cheap flights, where the budget airlines were forced to improve customer service, and just as it did with call centres which are now frequently being re-located back to the UK.

Despite the continuing economic pressure on some households, 2017 will still be a great time for retailers to rediscover customer engagement. Yes, price and efficiency are important, but not always at the expense of human interaction, trained staff, provenance and an enjoyable experience. Tesco's turnaround this year has been as much about the staff in the stores as it has about operational issues. The tide is turning on having life delivered to your door, and returning to a search for meaning and enjoyment. Technology is great at taking out the bad friction from your operation, but make sure to invest in good friction to give customers a reason to want to shop with you, not just on price.



Maureen Hinton

Group Research Director,  
GlobalData

The main inflationary impact will be in food & grocery which accounts for 45% of all retail spend.

### Outlook for 2017

Retail expenditure will be stronger in 2017 than in 2016, but not because of increased consumer demand but price inflation. The higher price of imported goods following the EU referendum, and the fall in the UK pound, has been masked by currency hedging in 2016, but this starts to unravel in Q2 2017 and all retailers, struggling with cost inflation and squeezed margins, will be forced into passing on price rises to the consumer.

However the main inflationary impact will be in food & grocery which accounts for 45% of all retail spend, so a main drag on spending in other sectors. GlobalData forecasts inflation in food & grocery will average 2.4% over the year, the highest since 2013 and the highest in any sector. To compensate for these higher prices consumers will be even more careful with their spending which means lower volumes and an even more competitive sector. Indeed it is the competition among the big players in the food & grocery sector, and the extra pressure from Amazon's entry, that will stop inflation being even higher.

The clothing & footwear sector will continue to face challenges in 2017 quite apart from inflation and yet more unpredictable weather. Mass middle market players will lose even more share to distinctive brands with differentiated product who have a much better understanding of the modern consumer. On the other hand luxury retailers and department stores such as Harrods, Selfridges and Harvey Nichols, will benefit from the increase in tourists taking advantage of the lower prices the weak pound offers.

The most resilient sector will be health & beauty. Our obsession with how we look and, particularly for an aging population, maintaining health, means that yet again health & beauty will produce the strongest growth.

In home related sectors and technology much of the big ticket spending will have been brought forward into Q4 2016 and the New Year Sales as consumers anticipated big price rises in 2017. This factor and a sluggish housing market will slow down growth. Meanwhile Bunnings will start to push harder on lower prices as it re-brands Homebase, which will drive competition harder in the DIY sector.

The online channel and in particular, Click & Collect, will continue to outperform. However investment in fulfilment to keep up with consumers' high expectations will place yet more pressure on profitability. This combined with weakening consumer confidence as the Brexit negotiations begin will make 2017 another extremely testing year for retailers in the UK.



Martin Newman

CEO, Practicology

If retailers can be agile to respond then there are opportunities to ensure that they at least survive, if not thrive.

### Outlook for 2017

Through the last recession, the continued double-digit growth of online retail was one of the few bright sparks for the industry. With unclear Brexit plans impacting consumer confidence, retail is likely to feel as though it's in recession during 2017; even if the economy as a whole does not meet the strict definition.

So will online retail once again provide some comfort to retailers?

Retailers have already put capex decisions on hold in the wake of the Brexit vote, and if sales over Christmas 2016 don't deliver growth, then it's likely that some will go further and swing back into cost-cutting mode.

What's different this time is that there is much less fat to be cut. There's little low-hanging fruit with existing multichannel operational models; but it could be quite a different story if retailers are prepared to more fundamentally change how they do business

Digital transformation is an inelegant way of describing fundamental change, but there are certainly plenty of retailers out there who could benefit from reorganising their businesses for the benefit of their customers and bottom lines.

In addition, I expect multichannel retailers to be looking much more at their cost of sale and the role of the store as the percentage of sales transactions completed online will continue to grow. Some in the industry

have nagging doubts about the profitability of selling online, while others are more focused on the overheads of legacy store estates.

House of Fraser has just announced plans to bring more leisure and hospitality brands into its stores, and it's likely others will review how their space is used.

Questions will also continue to be asked about discounting and the distorting effect of special Sale events. Peak trading patterns have been fundamentally altered by Black Friday (which has now turned into a week-long Sale event both online and offline). A downturn in consumer sentiment during 2017 will likely make it harder for retailers to pull out of the discounting tailspin many have steered themselves into.

However, it's not all doom and gloom. International ecommerce, particularly with non-European markets, is an opportunity for retailers to become less dependent on UK consumers to hit their growth targets.

Strong UK brands have already been successful selling into the USA, and Chinese consumers are accessible via marketplaces with the right support. In addition, the Middle East is ripe for fast ecommerce growth and it's a region where western brands are highly desired.

The industry will undoubtedly have a tough ride next year, but if retailers can be agile to respond then there are opportunities to ensure that they at least survive, if not thrive.



Mike Watkins

Head of Retailer and  
Business Insight, Nielsen UK

The uncertain economic, political and not least consumer outlook has the potential to be a catalyst to further structural change.

### Outlook for 2017

After another year of unpredictable retail growth and falling prices, the winner has again been the shopper. The supermarket industry in particular has embraced simplification and cost savings but with a few notable exceptions, real innovation has been left for another day.

Nielsen anticipates 2017 being a seminal year. The uncertain economic, political and not least consumer outlook has the potential to be a catalyst to further structural change, the like of which we have not seen since the global meltdown 8 years ago. Food retailers have to keep up with the evolution in shopping behaviour and focus on three levers for business growth.

### Improving the overall shopping experience

Low price on its own does not differentiate. Good customer service is expected so retailers will need to use technology to enhance the complete shopping experience. Expect the increasing use of data to make offers that are personal, and digitally linked to both point of sale systems for purchasing and rewards and with mobile for awareness and activation. This can then be supported with marketing messages that truly resonate with shoppers. Look out for some step changes in subscription services and business models as the ecosystem evolves.

### Lifestyle as well as location

Location has become less of a differentiator for food retailers. Smaller stores are better able to meet the 'little and often' shopping

trend and encourage frequency of visit, which is going to be the path to growth. However, we still expect the board room agenda to include the reinvention of large stores, to make them a compelling destination for lifestyle product choices, leisure and experiences and customer services as well as grocery shopping. There is also a lot of selling space that can be used differently.

### Multi-channel as well as multi-format

Making connected commerce a reality. Until recently, the big Supermarkets retailers have been reluctant to revisit non-food. However, with falling market share in food and drink which is the outcome of Discounter growth (which will continue in 2017) and the underlying shift of spend towards food service, the more fragmented non-food channel is back on the radar screen. This time it's different and there is no need to build new stores; instead build brand equity and 'go digital' before the technology titans transform how we shop.

We may not see a retail revolution next year but we will certainly see the foundations for a new retail landscape.



Jonathan De Mello

Head of Retail Consultancy,  
Harper Dennis Hobbs

Retailers need to make their businesses even leaner (if possible) and focus on store optimisation rather than expansion.

### Outlook for 2017

If I could summarise my outlook for 2017 in one word, that word would be 'concern.' For many traditional bricks and mortar retailers Black Friday 2016 could be the beginning of the end, given retailing during Christmas has now become a two tier event - where shoppers bring forward their purchases to benefit from the plethora of discounts on offer for Black Friday, and then 'panic buy' the week before Christmas. The former benefits principally retailers with a considerable online presence, whilst the latter benefits those retailers that have a strong physical presence on the high street.

Black Friday has hit margins at a time when they should be at their highest level - many high street retailers in fact make up to 50% of their profit from Q4 - Black Friday essentially wipes a lot of this profit out.

Whilst Christmas Eve, Christmas Day and Boxing Day should be strong for bricks and mortar retailers - given Christmas Eve falls on a Saturday this year - I fear that this will not be enough to make up for the impact of Black Friday on margin; particularly given that Black Friday this year was - as with 2015 - largely an online phenomenon.

Whether Brexit actually happens next year remains to be seen, but I fear that a number of bricks and mortar retailers will fail next year given a perfect storm of falling post-Christmas consumer demand, currency hedging running out (a large volume of retailers have hedges that run out in Q1 2017) and a significant increase in business rates. A reduction in corporation tax would be most welcome, but would be too little, too late in the context of reduced consumer demand and rapidly increasing costs.

One thing that retailers are unlikely to need to worry about is retail rents however - as it is almost impossible to see how landlords can justify upwards only rent reviews in the context of the potentially substantial amount of retail business failures we could witness post-Christmas. This applies to major retail centres too given the increase in business rates retailers will have to bear in such centres, despite transitional relief. The physical retail market is becoming increasingly polarised given the advent of online - with fewer stores needed than ever before - and landlords with large dominant retail assets have fared relatively well in recent years. However, rental growth - at least for the foreseeable future - is hard to imagine. Even on London's Bond Street - with some of the highest retail rents in the world - there is more stock available than ever before.

2017 for many retailers, their suppliers and even their landlords is looking relatively bleak - many will need to make their businesses even leaner (if that is possible) and focus on store optimisation rather than expansion. The sooner retailers start this process, the better.



Nick Bubb

Retail Consultant

Retailers need to make their businesses even leaner (if possible) and focus on store optimisation rather than expansion.

### Outlook for 2017

Thanks to the support from the slump in sterling since Brexit, the economy hasn't fallen off a cliff at the end of 2016, but as the inflationary consequences and other effects slowly play out on the consumer the outlook for retailers in 2017 is poor.

A year ago, the Food Retail sector seemed beset by structural problems, with the discounters running riot, but 2016 has actually turned out to be a pretty good year for the sector on the stock market. The Sainsbury share price has been held back by uncertainty over the wisdom of the Argos acquisition, whilst Ocado has been under pressure, but the Tesco and Morrisons share prices have done pretty well (both c50% up), reflecting the recovery in their trading momentum, which has coincided with slowing momentum for Aldi and Lidl. Asda has been a big loser, but they have not launched the much-feared price war, in recognition that their problems are more deep-seated.

The industry remains very competitive, but the growth of Online Grocery shopping and top-up shopping at convenience stores has not destroyed the appeal of the "weekly shop" at the supermarket/superstore. And the return of some modest food price inflation is not a bad scenario for the sector, assuming that it does not impact on volumes, so 2017 could well be a better year for the major players in Food Retailing.

By contrast, the General Retail sector was riding high a year ago, but 2016 has been a disappointing year on the stock market, with some particularly marked underperformance from Next, Marks & Spencer and Dixons Carphone. The latter

has done nothing wrong, but the City is worried about the outlook for "big ticket" demand and gross margins. M&S has plenty of long-term problems in its Clothing business, notwithstanding the growth of its Food operations, whilst Next has not been immune to the difficult trading conditions in Clothing this year.

Online Clothing sales have sailed merrily on, however, and 2016 has been an "annus mirabilis" for Boohoo.com, just as it has been an "annus horribilis" for the beleaguered Sports Direct. Who would have thought a year ago that little Boohoo would end 2016 with nearly as big a market capitalisation (£1.5bn) as mighty Sports Direct?

M&A has been a growing theme in the sector, with Home Retail, Darty and Poundland all disappearing from the public arena. It will be very interesting to see how Argos and Homebase fare in 2017 for their new owners, Sainsbury and Bunnings respectively.

One sub-sector in the spotlight in 2017 will be Department Stores, with their heavy fixed cost bases, with House of Fraser evidently under pressure and new CEO's keen to make their strategic mark at both Debenhams and John Lewis.

Fashion retailers will hope that "the weather" will be more helpful in 2017 than it was in 2016, but they will also worry that persistently sluggish sales reflect the fact that consumers increasingly want to spend their money in other sectors, a situation that is unlikely to be improved if sterling weakness feeds through into higher clothing prices.



James Sawley

Head of Retail & Leisure,  
HSBC

2017 will be the year when business models, balance sheets and nerves will be really tested.

### Outlook for 2017

The year of 2016 was a game-changer for the UK and the retail sector, but 2017 will be the year when business models, balance sheets and nerves will be really tested. The largely unforeseen outcomes of the EU referendum, US election and most recently the Italian constitutional referendum have led to volatile market conditions; the effects of which will play out in retailers' strategies for years to come. With global interest rates at record lows and QE masking traditional market signals, "politics is the new economics" in influencing foreign exchange rates, and if the last year is anything to go by, we must be prepared for almost every eventuality.

Uncertainty and volatility will continue to have negative ramifications for UK retailers next year, as tough decisions are to be made on pricing and strategy in order to deal with cost headwinds and stay one step ahead of the competition. In recent months we have seen mixed messages from retailers regarding how the FX burden will be distributed between customers, shareholders and suppliers. Some, like B&M, see it as an opportunity to win market share, while other such as Next are messaging price rises in order to protect margins. Others stand to benefit, luxury retailers and London-based department stores in particular will be optimistic of a boost in sales from an uptick in inbound tourism.

As costs are set to rise in 2017, UK retailers will be identifying areas where operations can be streamlined, renegotiating with suppliers and investing in new technologies which can provide longer term cost-saving benefits. As a result, I expect CFOs to act defensively next year from a balance sheet perspective, with risk mitigation being at the heart of decision making. With appetite for new space likely to remain subdued, strategically, M&A will continue to play its role in achieving scale, differentiation and diversification as we trade through this challenging period. 2016 saw a 10% increase in deals completed by UK retailers including a greater focus on cross border transactions. U.S. and Dutch companies were the most popular targets and JD Sports and The Hut were the most active buyers, completing three material transactions each. Retailers acquiring leisure companies is one interesting trend which I expect to see gather pace as the lines between retail and leisure continue to blur.

In 2017 I expect the UK to continue being a rich hunting ground for foreign buyers, especially given the valuation benefit of weaker Sterling. The number of UK retailers being acquired fell in 2016, with inbound acquisitions down 16% year-on-year (2015 being an exceptional year). U.S. and South African companies have again come out on top as having the greatest appetite for the sector, as this year these 2 countries alone have snapped up 6 significant retail brands. Fashion continues to be the category in the highest demand as brands such as Whistles and Reiss fell into foreign ownership.

Despite the large volume of M&A, 2016 was a quiet year for the capital markets with only a handful of bonds issued and share listings. 2016 only saw 2 IPOs in the sector (Hotel Chocolat and Joules) compared to 4 in 2015 and 14 in 2014. The loan market continued to offer a stable and active home for retailers looking to raise funds for strategic events such as M&A, special dividends and recapitalisations. In 2017 I believe we will see more defensive financing activity with retailers looking to the loan and equity markets (public and private) in order to shore up balance sheets and give themselves more flexibility to trade through what will no doubt be an exceptionally challenging year from a cost perspective.

In summary, the banking community continues to closely monitor the structural changes in retail in order to manage risk, but also opportunity. While exciting discussions around product, technology, supply chain effectiveness and internationalisation continue to dominate my discussions with retailers, we must balance this with helping to ensure that our customers' business foundations are solid during the year of 2017.





## Millennials v Grey Pound

### Who holds the key to future retail success?

- Knowing what drives the current 'Grey Pound' is useful in the short term but in the long term this generation will be replaced
- Future retail success lies in being able to adapt to the millennial way whilst making changes appear to be evolutionary, rather than revolutionary, to the 'Silver Surfers'
- Or is it the generation behind Millennials which really hold the key to future retail growth?

29 April 2016

#### Introduction

Future retail success depends on retailers staying relevant to their customers. But, it's been a long time since any single retailer managed to conquer the Herculean task of being able to attract all types of customer within one format... Martin Hayward, Founder, Hayward Strategy and Futures, argued that perhaps "for a few years during its golden period, Tesco did manage this, attracting old and young, rich and poor, big shops and top-ups to its different formats and sub-brands but this time has passed."

So with retailers seemingly no longer able to attract all types of customer, where should they focus their efforts in order to drive growth?

Maureen Hinton, GlobalData, pointed out that, at its simplest level the answer to this question is obvious; Millennials should clearly be the focus for retailers given that they will physically be around for a lot longer than those consumers who fall into the 'Grey Pound' category, who, because of the point in their lifecycle are on the verge of dying out. As such, it's retailers such as "River Island, or H&M, that continually keep adapting their proposition to match the current lifestyle and behaviours of their target customer group [that] thrive."

However, who has the most to spend? David McCorquodale, UK Head of Retail, KPMG, suggested that "with high student debt and house prices being out of reach for first time buyers, it might seem unwise to seek success from the younger generation," and perhaps it is better instead for retailers to focus attention on winning "the Grey Pound who are living younger longer, are working harder, have the pensions to spend and who have adapted to technology."

The KPMG/Ipsos Retail Think Tank (RTT) met in April to discuss the future of retail success and whether it is Millennials or the 'Grey Pound' that will be the key to driving growth.

#### Grey Pound – the upsides

In considering this question, a number of the RTT members agreed that focusing on the Grey Pound offers retailers a variety of opportunities for retail growth, particularly in the near-term.

Most fundamentally, the Grey Pound is effectively bigger than the 'Millennial Pound'. Maureen Hinton highlighted that "there are more people aged 65+ in the UK population than 16-24 year olds, so the total spend is much greater; in clothing £6.7bn against

£6.1bn.” What’s more, ours is an ageing population which means that UK population over 65 will be 27% of total adult population by 2030 meaning this is clearly a hugely significant group for retailers.

In addition, James Knightley, Senior UK Economist, ING, noted that the ‘Silver Surfers’ are more likely to have kept their jobs during the downturn compared to UK youth unemployment which, even now, remains well above the national average (13.7% versus 5.1%). “Add to this, changes to age discrimination legislation which mean more over 65s are also exercising their right to maintain an income and continue working.”

This generation are also far more likely to enjoy generous final salary pension schemes when they retire. James Knightley added “retirees have benefitted from the government’s “triple lock”, resulting in real term increases in the state pension while those in work are only now starting to see incomes rising faster than the cost of living.”

As such, “structural issues in the economy mean that a substantial amount of the country’s wealth is concentrated among the older generation, particularly due to the rise in the value of their homes,” said Martin Newman, CEO, Practicology.

The Grey Pound is not just a bigger representation of the population in actual terms, Jonathan De Mello, Head of Retail Consultancy, Harper Dennis Hobbs, pointed out that “this generation has greater levels of disposable spend and certainly in the short term the ‘Greys’ represent the most considerable untapped opportunity – and retailers would do well to focus more product lines – and marketing – on them specifically.”

### **But what are the downsides?**

However, while there is a strong case not to ignore the ‘Grey-heads’ in the quest for retail growth, the RTT pointed out that there are some disadvantages in focussing too much on this demographic.

The main problem with going after the Silver Surfers; is not an issue of the amount of money they have to spend, but more what they are choosing to spend that money on. Dr Tim Denison, Director of Retail Intelligence, Ipsos Retail Performance, highlighted that “health products and home maintenance are the only two categories in which the senior consumer spends more per person than the average UK household,” which is not going to be a recipe for success for the majority of retailers.

Mike Watkins added that while older consumers may have a bit more cash at the moment, they are often less experimental and can be less open to innovation.

Martin Hayward also noted that “older customers do eventually stop spending and any retailer’s customer pot will be diminished if new younger customers aren’t brought in to replace them. This is currently under debate with Marks and Spencer’s clothing business which many believe to be focussed too much towards the older loyalists at the expense of younger customers who do tend to spend more on fashion.”

However, Maureen Hinton highlighted that targeting the Grey Pound, specifically in clothing is not that easy when you take into consideration the fact that there are essentially two distinct generations in this age group: “the post-war ‘Baby Boomers’ and their parents – and they have very different tastes and styles. The Baby Boomers have been avid consumers since the 1960s, unlike their parents who have a more austere attitude to spending, and therefore tailoring a proposition that satisfies both is a tough challenge.”

### **So how do retailers win and keep a share of the Grey Pound?**

Jonathan De Mello pointed out that “whilst traditional Millennial marketing might not resonate as strongly with the older generations, they certainly do not feel old, or want to be marketed or sold products in a way that makes them feel old...Greys are increasingly technology savvy with nearly 90% shopping online using a laptop, and

circa 50% owning and using a tablet for shopping online. Many are also on Facebook and other social media, so the perception that online media cannot reach them is a fallacy.”

### Millennials – what are the upsides?

So while there are pros and some cons to putting too much store on the Grey Pound, other RTT members considered the potential boon of focussing on growing share of Millennials spend to drive retail growth.

“Looking at the Millennials, they are having a profoundly disruptive influence on the retail industry,” said David McCorquodale. “The disruption is caused not only by their sheer spending power – they are the biggest generation in history – but also by the way they buy. Only 1% of them are influenced by advertising, but a third consult a blog or peer review before making a purchase.”

In sectors such as fashion and health & beauty, for example, Millennials spend more on themselves than the 65+s. Maureen Hinton pointed to GlobalData’s research “which shows 16-24years spend on average £826 per head per annum on clothes while the 65+s spend £565 per annum.”

Yet, according to Mike Watkins, “the most compelling reason for a retailer to capture the lifetime loyalty of Millennials is that in the next 10 to 20 years, female Millennials will become the driver of retail spend...even within consumer goods shopping, women account for 70% of spend and female Millennials will only become more important shoppers in terms of income available to spend. Female Millennials are increasingly promiscuous and they are found in increasing numbers in ‘price driven’ stores. However it’s not all about price as they are willing to pay for what they consider are essentials in their lives.”

Ultimately, retailers need to embrace Millennials in order to grow sales in the next two decades because if they choose not to, then they are at risk of losing the consumers of tomorrow.

### But what are the downsides?

In contrast, James Knightley pointed out that “much of the analysis regarding Millennials has focused on their struggles. Burdened by student debt, high housing rents and faced with a more challenging jobs market than many before them, they are less financially secure. Surveys suggest that they have less appetite for marriage and parenthood and are less inclined/able to make major purchases such as a home or a car.” Jonathan De Mello added that many Millennials have also had to rely on their parents (the Greys!) for financial support.

So does it really make sense for retailers to pin their hopes on this demographic in order to drive future growth? David McCorquodale highlighted that “Millennials can be volatile and are likely to shun brands with bad stories...[while] the Silver Surfers come from a generation that have loyalty, adapt slowly to change, like social interaction when shopping and perhaps are tolerable to a drop in standards.”

Yet Tim Denison commented that despite this, “it’s the fast-living, younger shoppers that retailers rely on to keep the tills ringing from the fashion stores through to the value chains. It’s why so much investment is being sunk into providing an omni-channel service that speaks to the digital native and meets their anywhere, anytime, anyhow shopping habits.”

“Millennials demand a seamless shopping experience, whether they interact with a retailer in a digital or physical sense,” according to Jonathan De Mello. “As a result, particularly in the fashion sector, brands have to constantly reinvent themselves in order to maintain growth – or risk falling by the wayside entirely...Nike (running clubs/Nike+), H&M (catwalk videos) and in the UK more recently Mamas & Papas (interactive touchscreens) are retailers actively targeting Millennials – all have sought to integrate digital into the shopping experience, and to ensure that visiting their stores is about more than just buying product.”

### So how do retailers win and keep a share of Millennial spend?

Key to this is the “sharing economy” which provides access to products and experiences without the burden of ownership. David McCorquodale highlighted that “Millennials are not necessarily consumers in the same way that their parents are. You only have to look at how they subscribe for music and books rather than buy – they will rent, not own; share, not hire.”

James Knightley added that “in terms of the Millennials’ retail experience, technology is a very important factor in how they shop. The use of price comparisons, the ability to get more product information and a greater focus on reviews means that they are more knowledgeable on products and arguably more demanding.” Therefore, to win with the Millennials, retailers need to use analytics tools to filter the information provided and the show that they are listening because Millennials ultimately feel loyal to a brand if they feel the brand is trying to give them something that adds value to them.

### Is it possible to win at both with both generations?

While there are ways of targeting consumers within different generations in order drive growth, the RTT also discussed whether it was possible to reach both Silver Surfers and Millennials.

The good news, according to Martin Newman, is what older customers want may well appeal to younger generations too, and vice versa. For example “new digital and mobile ways of allowing customers to buy from you, or interact with you, are likely to appeal to both ends of the spectrum. Retailers such as John Lewis and N Brown Group, who historically have had large older customer bases, are doing very well at selling via the web and mobile. This demonstrates that it’s not just the younger generation who benefit from the flexibility and choice that multichannel retail can deliver. “

### Does age determine spend?

Currently, there is much debate around whether demographic segmentation is in fact relevant anymore. When asked the question at the Retail Business Technology Expo conference last month Dr Nicola Millard, a consumer futurologist at BT, stated that age was now one of the worst means on which to differentiate consumer behaviour.

Martin Hayward added that “in today’s society, age, class, income and even gender are less indicative of behaviours and spending patterns than they have ever been. The old are trying to be young, the ‘poor’ aspire to designer lifestyles.”

As such, Tim Denison suggested that it is “physical and societal events during one’s formative years which create personal values that remain relatively stable through time and which shape our expectations, perspectives on living and behaviour.”

It is these commonalities and shared experiences within generations that are relevant to retail marketers and may help provide some insights into targeting consumers within different generations in order drive future growth.

### Conclusion

The RTT concluded that retail growth is not really going to come from focusing on winning share of spend in either the Grey Pound or the Millennials. David McCorquodale noted that “future retail success must lie in being able to adapt to the millennial way whilst making this change appear only an evolution, rather than revolution, to the Silver Surfers...Agility would appear to be the key as the demands of the Millennials change more regularly; and also transfer with ease to the Silver Surfer. This is the area where success can be won or lost.”

But what does future retail success look like? It depends whether you take a long or short term view on growth.

Maureen Hinton suggested that while knowing what drives the current Grey Pound is useful in the short term, in the long term this generation will be replaced. Therefore, “understanding Millennials with their digital lifestyles and new attitudes to spending will provide the key to retail spending over the longer term.”

Added to this, Tim Denison commented that while “Millennials may be entering their peak earning years, with GDP per capita growth on the decline and consumer spending slowing, they won’t be as rewarding and loyal a customer-base as their parents were at the same stage in their lives.” Therefore it may well be that it is the generation behind the Millennials with new demands and new traits that hold the key to future retail growth.

So does the question then become focused on Generation Z and maybe even the children of the Millennials, who will no doubt demand, shop, and spend in whole new ways? If this is the case, agility will be even more key and retail success will come from those retailers who adapt to thrive and remain relevant to their customers.



## Part II:

### In detail – Individual views of the KPMG/Ipsos Retail Think Tank members



**James Knightley**

Senior UK Economist, ING  
Outlook for 2017

The 'Grey Pound' is likely to be the more dominant driver for consumer spending in the near-term.

Developments during and after Global Financial Crisis suggest that the 'Grey Pound' is likely to be the more dominant driver for consumer spending in the near-term. Older people were more likely to have kept their jobs during the recession while even now UK youth unemployment remains well above the national average (13.7% versus 5.1%). Pensioners' incomes from savings may have deteriorated due to low interest rates, but asset prices have risen significantly and changes to pension legislation mean it is easier to access and spend lifetime savings for the over 55s. Furthermore, retirees have benefitted from the government's "triple lock", resulting in real term increases in the state pension while those in work are only now starting to see incomes rising faster than the cost of living. Add in the ageing of the UK's population – 35% of Britons will be over the age of 65 within 15 years – and this is clearly a hugely significant group for retailers to focus on.

In contrast, much of the analysis regarding Millennials has focused on their struggles. Burdened by student debt, high housing rents and faced with a more challenging jobs market than many before them, they are less financially secure. Surveys suggest that they have less appetite for marriage and parenthood and are less inclined/able to make major purchases such as a home or a car.

A key result of this is the development of the "sharing economy" which provides access to products and experiences without the burden of ownership. In terms of the Millennials' retail experience, technology is a very important factor in how they shop. The use of price comparisons, the ability to get more product information and a greater focus on reviews means that they are more knowledgeable on products and arguably more demanding.

That said, as the economy continues to strengthen, job opportunities will improve and with the number of 'Baby Boomers' retiring in the coming years set to increase, the potential for career progression and higher incomes will also naturally rise. As a result, a focus on using technology and social media to engage with these (potentially) wealthier consumers should be a priority.



**Dr Tim Denison**

Director of Retail Intelligence,  
Ipsos Retail Performance

The family-starting generation holds the key to retail success in the future, just as it has in the past.

There is much current debate around whether demographic segmentation is relevant anymore. When asked the question at the RBTE conference last month Dr Nicola Millard, a consumer futurologist at BT, stated that age was now one of the worst means on which to differentiate consumer behaviour. Seemingly this viewpoint is upheld by recent comments made by the outgoing head of music at BBC Radio 1, George Ergatoudis, stating that 60 year olds and 13 year olds share 40% of their playlists and taste in popular music.

The counter view that I sign up to is that physical and societal events during one's formative years creates personal values that remain relatively stable through time which shape our expectations, perspectives on living and behaviour. The belief is that the commonalities shared within an age cohort are far greater than the differences between cohorts. 'Baby Boomers', for example, reached their 20s in the 1970s when cars and overseas holidays first became affordable to the masses creating a car-borne, sun-seeking society, and a throwaway culture, where weekly trips to the supermarkets and sangrias on the Costa Del Sol became de rigour. Millennials, in marked contrast, grew up with terrorist attacks in the 2000s, such as 9/11 and the Bali bombing, and natural disasters, like the SARS epidemic and the Indian Ocean tsunami, shaping them to become security-conscious by nature and curious about greener living. Certainly retail marketers still find these characterisations relevant and useful for targeting their audiences.

Just as winning new business generates more excitement than retaining existing clients, so retailers tend to gravitate towards to targeting the younger generations.

But does it make good business to chase after the coat tails of today's youth? We are an ageing population, with more Baby Boomers than Millennials (22.8% vs 20.2%). The over 50s hold 80% of household assets, 60% of savings and 40% of disposable income. And don't fall into the trap that the elderly are more spend-thrift. They account for 47% of consumer spending (Saga, 2015).

On these grounds alone there is a strong case not to ignore the 'Grey-heads', who, incidentally, are often referred to, very tellingly, as citizens rather than consumers. The problem with going after the 'Silver Surfers' is what they spend their money on. Health products and home maintenance are the only two categories in which the senior consumer spends more per person than the average UK household. That's not a recipe for success to the majority of retailers.

It seems after all that it's the fast-living, younger shoppers that retailers rely on to keep the tills ringing from the fashion stores through to the value chains. It's why so much investment is being sunk into providing an omni-channel service that speaks to the digital native and meets their anywhere, anytime, anyhow shopping habits. The family-starting generation holds the key to retail success in the future, just as it has in the past. The Millennials may be entering their peak earning years, but with GDP per capita growth on the decline and consumer spending slowing, they won't be as rewarding and loyal a customer-base as their parents were at the same stage in their lives. The key may not open as rich a treasure trove as in the halcyon '90s, but it's the best one to possess.



David McCorquodale

Former UK Head of Retail,  
KPMG

To strive for success with the Millennials, retailers need to use analytics tools to filter the information provided and the show that they are listening.

Looking first at future retail success, I take this to mean a retailer that is relevant to its customers, selling goods that are appropriately priced and with growing sales and profitability. Intuition might tell me that with high student debt and house prices being out of reach for first time buyers, it would be unwise to seek success from the younger generation. Instead, it might be best to focus on the 'Grey Pound' who are living younger longer, are working harder, have the pensions to spend and who have adapted to technology. The 'Silver Surfers' come from a generation that have loyalty, adapt slowly to change, like social interaction when shopping and perhaps are tolerable to a drop in standards. Isn't the easier route to success staying relevant to this generation of 'Baby Boomers'? Perhaps, but success is not always achieved by taking the easier route.

Looking at the Millennials, they are having a profoundly disruptive influence on the retail industry. The disruption is caused not only by their sheer spending power – they are the biggest generation in history – but also by the way they buy. Only 1% of them are influenced by advertising, but a third consult a blog or peer review before making a purchase. They are so connected and give freely of information online. Millennials are not necessarily consumers in the same way that their parents are. You only have to look at how they subscribe for music and books rather than buy – they will rent, not own; share, not hire. On the flip side, Millennials can be volatile and are likely to shun brands with bad stories. It would only take one

calamity in the supply chain or a cyber attack that leaks shoppers' credit card details and trust could be lost.

Future retail success must lie in being able to adapt to the millennial way whilst making this change appear only an evolution, rather than revolution, to the Silver Surfers. To strive for success with the Millennials, retailers need to use analytics tools to filter the information provided and the show that they are listening. Millennials feel loyal to a brand if they feel the brand is trying to give them something that adds value to them – this may just be as simple as providing peer reviews in-store. Agility would appear to be the key as the demands of the Millennials change more regularly; and also transfer with ease to the Silver Surfer. This is the area where success can be won or lost.

My prediction, however, is that the generation behind the Millennials will have new demands and new traits. Will the next generation be so free with the information it puts online or be more guarded? If the latter, the drive for personalisation will become even harder. Will the next generation have greater demands on supply chains – perhaps even negating the need for a retailer at all, unless the retailer has its own product. People change, demands change and the successful retailer is the one who adapts to thrive and remain relevant to its customers.



Martin Hayward

Founder, Hayward  
Strategy and Futures

The answer for retailers  
is to focus more on  
need or desire than the  
demographics per se.

It's a long time since it's been possible to convincingly segment the population based on a single demographic distinction, and the current interest in age based cohorts is no exception to this.

In today's society, age, class, income and even gender are less indicative of behaviours and spending patterns than they have ever been. The old are trying to be young, the 'poor' aspire to designer lifestyles, and some are even choosing which gender they prefer.

That said, there are some age effects that cannot be ignored – older customers do eventually stop spending and any retailer's customer pot will be diminished if new younger customers aren't brought in to replace them. This is currently under debate with Marks and Spencer's clothing business which many believe to be focussed too much towards the older loyalists at the expense of younger customers who do tend to spend more on fashion.

However, it is some time since any retailer has managed to master the Herculean task of being able to attract all types of customer within one format. It could perhaps be argued that for a few years during its golden period, Tesco did manage this, attracting old and young, rich and poor, big shops and top-ups to its different formats and sub-brands but this time has passed as the grocery market becomes ever more segmented.

The other issue is who has the most to spend? Again it all depends... Millennials have enormous pressures to cope with student debts and housing inflation, but many still live with their parents to maintain their disposable income. The 'Greys' enjoy the benefits of housing stock and more generous pension arrangements but perhaps prefer to invest in lifestyle expenditure such as holidays and healthcare rather than goods.

To navigate these complexities, the answer for retailers is to focus more on need or desire rather than the demographics per se. With the possible exception of fashion, where product is arguably more age related than most categories, a good retail experience, a clear value proposition, and efficient logistics are all more important than how old the customers are.



Maureen Hinton

Group Research Director,  
GlobalData

The Baby Boomers have been avid consumers since the 1960s, unlike their parents who have a more austere attitude to spending, and therefore tailoring a proposition that satisfies both is a tough challenge.

So who holds the key to future retail success? The answer appears to be very obvious – the Millennials as they will be around for a lot longer than the grey pound who, because of the point in their lifecycle are on the verge of dying out.

But this assumes a retailer will follow a customer throughout their lifetime rather than target a particular age group. As we have seen with M&S this leads to terminal decline as their customer base literally starts to die off, while retailers such as River Island, or H&M, that continually keep adapting their proposition to match the current lifestyle and behaviours of their target customer group thrive.

So which of these should retailers be targeting? In a sector like clothing and health and beauty for instance the Millennials spend more on themselves than the 65+s. GlobalData's research shows 16-24years spend on average £826 per head per annum on clothes while the 65+s spend £565 per annum, so it would seem the Millennials are more attractive. However this does not take account of numbers – there are far more 65years in the population than 16-24years

so the total spend is much greater; £6.7bn against £6.1bn. So the Grey Pound is bigger in this case.

Yet targeting the Grey Pound in clothing is not that easy as there are two distinct generations in this age group – the post-war 'Baby Boomers' and their parents – and they have very different tastes and styles. The Baby Boomers have been avid consumers since the 1960s, unlike their parents who have a more austere attitude to spending, and therefore tailoring a proposition that satisfies both is a tough challenge.

Indeed these Baby Boomers are very similar to Millennials in that they have been the key drivers of past retail trends and Millennials are the key drivers of future trends. Understanding Millennials with their digital lifestyles and new attitudes to spending will provide the key to retail spending over the long term. Knowing what drives the current Grey Pound is useful in the short term, but not long term – they will be replaced.



Martin Newman

CEO, Practicology

The good news is, what older customers want may well appeal to younger generations too, and vice versa.

From a demographic point of view, Millennials outnumber those over 65, and will be consumers for many years longer. Data from the 2011 UK census showed 12.6m consumers between the ages of 15-29, while there were 10.4m aged 65 or over.

So it might seem obvious to focus heavily on what younger consumer audiences want, particularly if you assume that they are the driving force behind changes in consumer behaviour.

But life (and retail) is never that simple. For a start, structural issues in the economy mean that a substantial amount of the country's wealth is concentrated among the older generation, particularly due to the rise in the value of their homes. Middle-class 'Baby Boomers' are far more likely to enjoy generous final salary pension schemes than Millennials can expect to receive when they retire. And changes to age discrimination legislation mean more over 65s are exercising their right to maintain an income and continue working.

Meanwhile, Millennials must pay for university education, face relatively high rates of unemployment and housing costs eat a large proportion of their salary unless they continue to live in the family home (which increasing numbers are doing).

The good news is, what older customers want may well appeal to younger generations too, and vice versa. Data from Ofcom from 2015 on the use of technology by different age groups highlights how outdated perceptions are about the over 65s not being tech-savvy.

For example, tablet ownership among the over 55s has increased nine-fold in the past three years, and 37% now have access to a tablet. Meanwhile 48% over 55s own a laptop, and 32% a smartphone.

And broadband penetration among older consumers is quickly catching up younger generations too. Again, Ofcom's 2015 figures show 91% of 16-24 year olds have access to the internet at home, where as it is 75% among the 65-74 age group (but grew by eight percentage points between 2014 and 2015).

New digital and mobile ways of allowing customers to buy from you, or interact with you, are likely to appeal to both ends of the spectrum. Retailers such as John Lewis and N Brown Group, who historically have had large older customer bases, are doing very well at selling via the web and mobile. This demonstrates that it's not just the younger generation who benefit from the flexibility and choice that multichannel retail can deliver.



Mike Watkins

Head of Retailer and  
Business Insight,  
Nielsen UK

The most compelling reason for a retailer to capture the lifetime loyalty of Millennials however, is that in the next 10 to 20 years, female Millennials will become the driver of retail spend.

As a famous poet once wrote, 'the times, they are a changin` and the future success of many retail chains will require some different thinking around shopper behaviour.

Harnessing the spending power of the earned or inherited wealth (the 'Grey Pound') is one route to growth but in the digital age, understanding the motivations and engaging with Millennials has a deeper and longer term benefit.

Millennials are younger, more digitally inspired and are often female shoppers and will have a bigger influence on the future direction and strategy of brands and retailers. 'Grey' may have a bit more cash at the moment but they are often less experimental and can be less open to innovation.

Lifestyle preferences are much more important to Millennials. When they first become economically active they are digital and disloyal and these attitudes are carried forward as they start families and relocate from towns and cities to the rural suburbs. Customer service, ease of shop and modernity are values held in high importance with social shopping more in vogue than trips to the shops with the family on a Saturday morning. They are the truly connected consumer.

How they spend their disposable income is also different and experiences are much more important, which is good news for leisure retailers. Some of the neuroscience norms from Nielsen research support the view that many Millennial shoppers naturally (and often unconsciously) offset doing something good, with doing something bad. For example if they feel they have done some exercise, or eaten healthily they will unconsciously eat more snacks; if they have saved money on household goods

they will indulge in a spending spree at a fashion retailer. This is good news for any retailer with a customer proposition that is contemporary and classless.

The most compelling reason for a retailer to capture the lifetime loyalty of Millennials however, is that in the next 10 to 20 years, female Millennials will become the driver of retail spend.

Even within consumer goods (fmcg) shopping, women account for 70% of spend and female Millennials will become more important shoppers in terms of income available to spend. Female Millennials are increasingly promiscuous and they are found in increasing numbers in 'price driven' stores. However it's not all about price as they are willing to pay for what they consider are essentials in their lives. Diversity and inclusion are also on their shopping list.

Retailers will need to embrace the Millennials in order to grow sales in the next two decades. If they choose not to, then they are at risk of losing the consumers of tomorrow.



Jonathan De Mello

Head of Retail Consultancy,  
Harper Dennis Hobbs

Greys are increasingly  
technology savvy  
– nearly 90% shop  
online using a laptop,  
and circa 50% own  
and use a tablet for  
shopping online .

Marketers – and retailers – are obsessed with Millennials, but in my view it is the ‘Grey Pound’ that could potentially offer the most lucrative return on investment – at least in the short term.

There is much to commend the strategy of targeting Millennials, given their high propensity to spend on fashion, eating out and socialising generally – but they are equally a relatively elusive target group, given their relative brand promiscuity stemming from their desire to be different. As a result, particularly in the fashion sector, brands have to constantly reinvent themselves in order to maintain growth – or risk falling by the wayside entirely. Celebrity/designer collaborations have proved successful in this regard – witness the frenzy that was H&M Oxford Street following their Balmain collaboration, for example. Nike (running clubs/Nike+), H&M (catwalk videos) and in the UK more recently Mamas & Papas (interactive touchscreens) are retailers actively targeting Millennials – all have sought to integrate digital into the shopping experience, and to ensure that visiting their stores is about more than just buying product. Millennials demand a seamless shopping experience, whether they interact with a retailer in a digital or physical sense.

The oft-ignored Grey Pound however, in my opinion represents an area of significant untapped potential for retailers. In fact, despite the lack of focus and attention on this group, Saga research has found that those over 50 hold 68% of all UK household wealth (£7.8 trillion). Perhaps even more surprising to some – given Millennials’ high propensity to eat out – is the fact that – according to QikServe – over 65’s spend more on restaurants than any other age group – £556 per head on average.

Many current retirees have large pensions, and no mortgages. In addition to this, they typically have income from other investments

(shares, property etc). This is in contrast to younger Millennials, where many have had to rely on their parents (the g’Greys!) for financial support. Older Millennials are still struggling to buy properties, or are in the midst of having children – which substantially reduces their available spend; at least on the flamboyant, glitzy products that are traditionally being targeted at Millennials. Fundamentally, Greys have greater levels of disposable spend, and the main point is that – whilst traditional Millennial marketing might not resonate as strongly with them – they certainly do not feel old, or want to be marketed or sold products in a way that makes them feel old. Greys are increasingly technology savvy – nearly 90% shop online using a laptop, and circa 50% own and use a tablet for shopping online. Many are also on Facebook and other social media. The perception that online media cannot reach them is a fallacy.

Long term, it is hard to argue against the Millennials as a principal target group for retailers, but in the short term the Greys represent the most considerable untapped opportunity – and retailers would do well to focus more product lines – and marketing – on them specifically. Holland & Barrett, Hotter Shoes and Le Bistrot Pierre.



## The short and medium - term impact of Brexit on the retail sector

- In the immediate aftermath of the Brexit vote, political uncertainty had led to a dampening of consumer confidence
- In the medium-term, as currency hedging unwinds, the cost of goods purchased overseas will effectively become more expensive. The debate for retailers will then be whether to increase prices or absorb the loss into margins
- In the long-term, key considerations will be: the retail sector's reliance on non-UK workers; trade deals, and the potential positive opportunities for retailers

4 August 2016

### Introduction

Following the UK's decision to leave the EU, British retailers and consumers undoubtedly face an unprecedented situation, one filled with uncertainty.

Looking back to the day of the result itself (Friday 24 June 2016), in many ways the Brexit result was met with disbelief – not least of all by the retail industry. Martin Hayward, Founder of Hayward Strategy and Futures, noted that the combined might of the research industry failed to anticipate or predict the majority view of the British population, illustrating the level of surprise.

James Knightley, Senior UK Economist at ING, noted that the overwhelming majority of surveys had suggested that British businesses had wanted the UK to stay a member of the EU. However, David McCorquodale, Head of Retail at KPMG, noted that many retail CEOs, particularly from the large national chains, had been careful not to take sides for fear of alienating their

brand in such a divisive landscape. 'After all retail, like democracy, is controlled by the people', he added.

Surprise aside and with the result of the EU referendum now unquestionable, what does this momentous decision mean for retail?

The KPMG /IPSOS Retail Think Tank (RTT) met in July (Tuesday 12 July) to discuss the short and medium-term effects of Brexit on the Retail sector. Given the magnitude and unprecedented nature of Brexit, a number of considerations came to light but common themes arose.

In the short-term, key themes discussed by the RTT included: a weaker pound, fragile consumer confidence and political uncertainty. Meanwhile, in the more medium-term, the prospect of higher tariffs with trade restrictions; a more limited labour supply, and how retailers could benefit from positive opportunities in light of Brexit, were on the minds of the RTT members.

### Immediate and short-term impact:

In the immediate aftermath of the Brexit vote, the RTT widely recognised that uncertainty – particularly political uncertainty – has led to a dampening of consumer confidence, the driver of the retail sector's fortunes.

Mike Watkins, Head of Retailer and Business Insight for Nielsen UK, stressed that the psychology of the consumer was critical, and collectively the RTT members agreed that this uncertainty wasn't likely to be viewed favourably by consumers. For continued retail growth, consumers either need to 'feel' or 'be' better off, but in the face of this uncertainty this is unlikely, Mike Watkins added.

While future retail consumption may waiver, several members of the RTT suggested that in the short-term pre-planned purchases, like holidays for example, were unlikely to change as consumers have already made the commitment.

For retailers on the other hand, this political uncertainty was of equal concern, as Maureen Hinton at GlobalData added: "not only is it a drag on consumer confidence but also it prevents retailers making concrete business plans. Until they know how the UK government intends to tackle the issues around the exit from the EU, there is little retailers can do apart from consider every eventuality."

Dr Tim Denison, Director of Retail Intelligence at IPSOS Retail Performance, suggested that the: "...sharp shock being felt following the Brexit decision [was] political rather than economic; [with] the fundamentals of the latter remain[ing] solid." However, Nick Bubb, Retail Consultant, noted that: "the share prices of general retailers slumped in the immediate aftermath of the shock Brexit vote, as the City moved quickly and brutally to [factor in] a future UK recession and sustained sterling weakness."

According to Jonathan De Mello, Head of Retail Consultancy at Harper Dennis Hobbs, retail real estate experienced a similar fate. He highlighted that the relatively illiquid nature of commercial real estate resulted in such funds coming under considerable pressure to

be sold (both high street and mall), at a level significantly below their recent valuations. Concerns over whether this trend would extend to residential property was also flagged by other members.

There was general consensus among the RTT that some specific retail industries were likely to be more affected by the vote to leave than others in the short-term. Nick Bubb flagged that the share prices of 'big ticket' related companies, those related to the housing market (like furniture retailers), as well as motor retailers, had been particularly hard hit post Brexit. "On the basis of historical precedents...this is where consumers will rein in their spending first, in response to heightened uncertainty and worsening outlook for jobs and house prices", he said.

Martin Newman, CEO at Practicology, reinforced this theme noting that fashion was already on sale prior to Brexit, but the move towards promotional activity now appears to have spread to most of the high street. "Fashion retailers are most at risk due to the fact that they buy most of their goods overseas and pay in dollars, meaning they will be significantly impacted by increased import costs due to the rapidly falling value of the pound", he added.

While specific retailers may have experienced the immediate impact of Brexit more than others, it was widely suggested that in the short-term there are all sorts of reasons why consumers could simply keep on spending. Nevertheless, Dr Tim Denison flagged the need for timely promotions to encourage consumers to ride out the uncertainty.

### Medium-term impact:

As briefly eluded to, less favourable exchange rates for British retailers were a consideration for the RTT. James Sawley, Head of Retail & Leisure at HSBC noted that: "general retailers have a significant requirement for Dollars either directly or indirectly via wholesalers and distributors further down the supply chain."

While the retail industry may not consider this an immediate worry, as most retailers hedge their currency exposure (typically between 9 to 18 months), the cost of goods purchased overseas will effectively become more

expensive as hedging unwinds. (Though this is of course based on the assumption sterling continues to be devalued.)

As a result, the RTT agreed that some of the burden created by less favourable exchange rates may eventually need to be shared with consumers by way of increased prices. However, the debate then moves to whether this is possible in a price conscious, competitive environment, or whether retailers may have to absorb the loss into margins. For smaller retailers, who are unlikely to have hedged against such a scenario, this burden will be particularly hard to bare.

Whilst hedging for less favourable exchange rates may assist in delaying price rises 9 – 18 months, Maureen Hinton suggested that: “we are likely to see some rises in food [prices] before then, as the cost of ingredients increases for food manufacture. However, price competition among major supermarkets will dampen [such price rises].”

Following on from the latter point, Nick Bubb suggested that: “this is not such a bad scenario for the beleaguered food retail industry, which is currently bedevilled by food price deflation, but has historically enjoyed periods of food inflation. However, the concern is that the rise of the discounters and the surplus superstore capacity in the market, as online grocery shopping and convenience store shopping gain ever more traction, is causing deep-seated structural change in the industry.”

With respect to margins, several members of the RTT highlighted that the combination of higher import costs due to the decline in the value of the sterling, coupled with the implementation of the National Living Wage, would result in increased cost pressure on retailers. Jonathan De Mello noted that this could result in domestic retailers halting or slowing expansion within the UK, however other members of the RTT suggested that pressure on margins could provide a catalyst for accelerated efficiencies within the retail sector.

### Looking ahead:

As noted by many members of the RTT, what we are witnessing in the immediate aftermath of the vote comes ahead of the UK having even triggered Article 50. Details of our exit will only become clearer following negotiations and as one RTT member suggested, it is yet to be determined ‘whether the UK can achieve an amicable divorce from the EU’.

With this in mind, the timescales relating to Brexit were considered to be as uncertain as the outcome of negotiations themselves, however the medium-term could be considered to denote the period between the end of this year and the point at which negotiations have completed, while the long-term refers to the period beyond.

A key long-run consideration identified by the RTT was the retail sector’s reliance on non-UK workers. As there will be two year consultation following the activation of Article 50, nothing is yet set in stone. However, the RTT agreed that growth in the retail sector was not dependent on cheap labour, and there was widespread agreement that it was unlikely migration would be stopped completely, but rather restrained if anything. However, it was noted that retail had fished in the wider European market for specialists in data, analytics and digital, and should restrictions be applied, the talent pool would be smaller for these specialisms.

Trade deals are naturally another key consideration, though David McCorquodale highlighted that he’d find it hard to believe that the UK would simply “pull up the drawbridge to trade or that our farmers [would] not be supported to produce our food.” He commented: “consumers will still want to shop and retailers will still excel in meeting demand. Already, low growth, increased costs, changing technologies, productivity and efficiency have all been driving and influencing retail strategy, and this is likely to accelerate over the next few years.”

However, Maureen Hinton noted: “while the UK can gain from freer access to global markets, until these deals have been established, UK retail is set for a period of volatility.”

Despite this, the RTT members veered away from focusing exclusively on a negative outlook, suggesting that Brexit could open up positive opportunities for retailers. Mike Watkins proposed that this was a time for retailers to ‘adapt or die’, noting that shopping behaviour has already changed. James Sawley highlighted that: “with cost pressures mounting in areas such as staffing, transport and energy costs, businesses have tough decisions to make which effect both customers and shareholders. [However,] retailers with healthy balance sheets and healthy margins can afford to play the wait and see game, keeping prices the same in order to protect or gain market share”.

Furthermore, Martin Hayward pointed out that the vote to leave could increase the importance of provenance and “the opportunity, and legal permission, to promote locally sourced goods over imports, adding extra impact to an already important trend in food and general retailing”.

Martin Newman added that: “there is potential for retailers to see a spike in demand online from international customers who seek to take advantage of the weak pound.” UK luxury was identified as a key sector likely to benefit from this, and the RTT noted that the “British” brand also exports well.

Nevertheless, a view shared by the RTT members was that British consumers will continue to shop and that there will be naturally be winning and losing retailers as the Brexit landscape begins to take shape. This process will take time, but as Martin Hayward stressed, details of the UK exit: “... will be slow to emerge and probably less dramatic than we have been led to believe in the heat of Project Fear”.

## Part II:

### In detail – Individual views of the KPMG/Ipsos Retail Think Tank members



**James Knightley**

Senior UK Economist, ING  
Outlook for 2017

There are signs of stress in commercial real estate already and the sense of caution may spread to residential property.

In the near-term Brexit is unlikely be too damaging for consumer spending. Unemployment is low, wages have been rising in real terms and the sun is finally shining. It will be a different story in coming months.

Surveys had suggested that an overwhelming majority of British businesses had wanted the UK to stay a member of the EU. We had already seen hiring and investment spending slow in the lead up to the referendum. Now that Brexit is confirmed there are concerns that we could see expansion plans cut with businesses taking a more pessimistic view on the new environment.

For the retail sector, the plunge in sterling is bad news. While most companies will have implemented some currency hedging, the cost of imported goods will rise substantially at a time when increases in the living wage are adding to business costs. We have already seen petrol prices rise because of sterling's plunge and we are likely to see this trend intensify. This will erode household spending power, while also pushing up retailers' distribution costs.

People who rely on income from savings are also going to suffer given the Bank of England has made it clear they will be cutting interest rates and are likely to implement additional QE.

There are signs of stress in commercial real estate already and the sense of caution may spread to residential property. Given this is viewed as a key barometer of the health of the UK we are concerned about the implications for sentiment and activity – and this is all happening before the UK has triggered Article 50 to start the two year countdown on the UK exiting the EU.

In terms of the negotiations, the key question will be whether the UK can achieve an amicable divorce from the EU, which will limit the economic pain, or whether it will break down in acrimony. If it is the latter, a toxic political environment could lead to protracted negotiations, resulting in significant economic distress for the UK and Europe more broadly. Foreign investors are also likely to take a dim view of putting money to work in the UK given the uncertainty over its future relationship with the EU. We will also have to wait and see if the Scottish nationalist movement launches a renewed push for independence. In this environment, a UK recession will be difficult to avoid.



Dr Tim Denison

Director of Retail Intelligence,  
Ipsos Retail Performance

Beyond the short term,  
the weakened pound  
will inevitably mean that  
the cost of imported  
goods will rise.

Keep calm and carry on shopping! That is my short term message to the UK consumer. The sharp shock being felt following the Brexit decision is politic rather than economic; the fundamentals of the latter remain solid. Employment is at its highest rate since such records began in 1991, wage growth has sat above inflation for 17 months and consumer confidence over their personal finances, major purchase spending and future savings plans are planted firmly in positive territory. It is only consumer confidence over the future state of the economy that is tumbling. So from a demand perspective it should remain business as usual in the short term for shoppers.

Retail sales could, in fact, be boosted in the summer months while existing retailer hedging arrangements remain in place, if they can successfully message shoppers to 'buy now while prices are low'. Early days admittedly, but our Retail Traffic Index figures show no dramatic year-on-year change pre- and post- the vote. In the week following the 23rd, UK retail footfall was down 2.2% on the corresponding week of 2015, compared to a deficit of 1.7% over the previous 4 weeks.

Beyond the short term, the weakened pound will inevitably mean that the cost of imported goods will rise. Some of that burden will be shared with consumers. More emphasis

will be given to UK sourcing to reduce exposure to currency weakness and volatility. Higher retail prices at the pumps and in the shops, a jump in inflation, potential delays in public spending programmes and private grandiose schemes such as HS2 reducing job security, will all threaten demand in the near term, tempered by the proven resilience of consumers.

We should acknowledge that retailers have come a lot way since the 2008 crash. They have become more nimble and responsive as businesses to downturns in demand. The likes of production runs and lease commitments are shorter. Nevertheless Brexit will undo some of the efficiencies gained from the 'four freedoms' and create a new raft of challenges for them. Logistics and distribution is an obvious area for change and added complexity; so too internet selling and fulfilment to EU customers, currently standing at 64% of online sales exports. To meet such challenges, retailers would do well to put productivity at the top of their agenda, reassessing the contribution of all input costs against sales. Just when we thought retailing couldn't become more interesting, it suddenly has done.



David McCorquodale

Former UK Head of Retail,  
KPMG

Consumer confidence, the driver of the sector's fortunes, has dampened somewhat in the immediate aftermath of the vote. The words and actions of our politicians may revive this but we first need the political seas to calm.

The British people have voted to leave the European Union, so politicians and civil servants now have to negotiate the best possible terms for the whole country and attempt to reunite what is currently a divided public. This will take time, but meanwhile retailers – who are driven by daily demand, seasonal purchasing or even peak Christmas ordering – must deal with whatever consequences arise.

To scope out the risks and opportunities we have been advising clients to consider the next two weeks, two months and two years – using this 2:2:2 model to assess the immediate, short and medium-term outlook for their business.

In the immediate / shorter-term, key considerations for retailers are customers, currency and consumer confidence. Customers are the voters and many retail CEOs, particularly for the large national chains, have been careful not to 'take sides' in public pronouncements for fear of alienating their brand. After all retail, as in democracy, is controlled by the people.

Currency presents another challenge, with the pound having weakened after the vote. While this is not an immediate worry for retailers as most hedge their currency exposure, the cost of goods purchases overseas will effectively become more expensive as hedging unwinds – unless, of course, the pound strengthens. For retailers the crucial decision will be whether to increase prices in this price conscious, competitive environment, or to absorb the loss into their margin. Those with significant overseas revenues will benefit in this case.

Consumer confidence, the driver of the sector's fortunes, has dampened somewhat in the immediate aftermath of the vote.

The words and actions of our politicians may revive this but we first need the political seas to calm. In the short term, retailers will want confidence to improve before the golden quarter of Christmas but they will move into profit protection mode if this is not the case – impacting investment and employment.

Looking to the medium term, there is less clarity, as we need to see what trade deals are negotiated. I can't believe we'll pull up the drawbridge to trade or that our farmers will not be supported to produce our food. Consumers will still want to shop and retailers will still excel in meeting demand. Already low growth, increased costs, changing technologies, productivity and efficiency have all been driving and influencing retail strategy, and this is likely to accelerate over the next few years. Employers may also have to look at a more domestic labour force to meet peaks in demand.

Should we have a period of sustained weak currency, overseas investors may feel that our companies are 'cheap' and may swoop to acquire, which would be rather ironic given the referendum result was more a drive for British sovereignty.

Nevertheless, I feel that strong, well-financed retailers will see the current uncertainty as an opportunity to take market share. Many did this in the aftermath of the global financial crisis and, with growth rates remaining low, there will be casualties amongst those who don't adapt and invest.

Change and uncertainty are feared by some but are viewed as an opportunity for the brave, and the brave have probably already started executing on their plans so the others will need to be fleet of foot in catching up.



Martin Hayward

Founder – Hayward Strategy  
and Futures

As long as Britain has been characterised as a nation of shop keepers, consumers have had an eye for a bargain.

For all of us in retail who are forever trying to better understand and anticipate the needs of our customers, there are some interesting side lessons to be drawn from the recent referendum.

Firstly, it's not unfair to say that total reliance on sophisticated and expensive market research can be misleading. For the second time in just over a year, the combined might of the research industry has failed to anticipate or predict the majority view of the British population. The circumstances around polling political views are acknowledgeably complex, but we should all understand that sometimes our customers don't necessarily share their real and deepest feelings through survey research and we should always combine survey findings with equal measures of intuition, behavioural observation and experimentation. This particular writer did just that and won a few quid at the bookies on the referendum result.

The results also serve to reinforce the large divergences in the lifestyles and outlook of different parts of the country. London is undoubtedly an international City, but it is surrounded by more parochial regions focussed more on retaining their own identity. This has implications for staffing, product mix and brand positioning.

The effects of the vote on the retail sector will take time to play out as we are looking at a likely two year transition process to Brexit.

Stocks and the pound are flailing around in the immediate uncertainty but we can make a few early inferences:

- Provenance will be even more important – the opportunity, and legal permission, to promote locally sourced goods over imports adds extra impact to an already important trend in food and general retailing.
- Local recruitment and staff training may become more important as migration is controlled.
- Greater competition for staff may in turn increase wages, and prices, but this will then stimulate sales elsewhere and allow government support for the low paid to be invested more productively.
- As ever, a weaker pound will enhance international sales, whilst a stronger pound will reduce import prices. With the Euro less than robust itself, it is a brave forecaster who can predict which way this will ultimately go.

However, in the face of all the upcoming uncertainty, we can be confident that the British consumer will continue to shop, continue to buy French wines and German cars and the country's manufacturers will sell British goods abroad. There will be winners and losers to different degrees, but until negotiations to leave are progressed they will be slow to emerge and probably a lot less dramatic than we have been led to believe in the heat of Project Fear.



Maureen Hinton

Group Research Director,  
GlobalData

In the short term though, it is political uncertainty that is a major factor for retailers.

There are five major factors affecting retail as a result of Brexit; in the short term a weaker pound; fragile consumer confidence; and political uncertainty; while in the longer term; the prospect of higher tariffs with trade restrictions; plus a far more limited labour supply.

The sharp drop in the value of the pound against the USD will increase supply chain costs as UK retail is so dependent on imports, most of which are bought in USD. Consumers have enjoyed next to no inflation, or even deflation, over the past couple of years, but retailers will be forced to pass on price rises to mitigate the impact of even higher costs on already squeezed margins.

Because so many retailers have hedged their currency until Spring 2017 these price rises are unlikely to have a significant impact until late Q2 2017, though we are likely to see some rises in food before then as the costs of ingredients increase for food manufacturers. However price competition among the major supermarkets will dampen these.

More immediately is weaker consumer confidence. This fell amid concerns about how Brexit will affect employment and

incomes. The UK population has become well used to austerity since the recession and will retain the same habits, but will be more wary again of making big financial commitments, such as buying houses, until they have more confidence in their own personal economic prospects. This will hit the sale of big ticket items in the home related market, which had only just begun to recover from the recession.

In the short term though, it is political uncertainty that is a major factor for retailers. Not only is it a drag on consumer confidence but also it prevents retailers making concrete business plans. Until they know how the UK government intends to tackle the issues around the exit from the EU there is little retailers can do apart from consider every eventuality. Higher tariffs and greater trade restrictions with the EU will impose more costs and curtail growth opportunities, while limiting free movement of labour will reduce a valuable resource for both retailers and their UK suppliers. While the UK can gain from freer access to global markets, until these deals have been established UK retail is set for a period of volatility.



Martin Newman

CEO, Practicology

Depending upon how much consumer confidence and demand are affected, over the medium term, this could also lead to redundancies and store closures.

In the short term, while the two main political parties scramble to find leadership and a plan for next steps, the consumer is waiting for the dust to settle and weighing up the potential consequences to them of Brexit. This is highly likely to affect consumer confidence in the domestic market and therefore suppress demand.

We've already seen examples of where Brexit is having a negative impact on sales performance. Fashion was already on sale but post-Brexit its spread to most of the high street.

Fashion retailers are most at risk due to the fact that they buy most of their goods overseas and pay in dollars, meaning they will be significantly impacted by increased import costs due to the rapidly falling value of the pound.

Although some retailers will have hedging in place, the currency hit will affect many smaller retailers and also some larger ones such as Sports Direct, which warned the stock market within hours of Brexit that profitability will be impacted due to currency volatility.

However, there is also the potential for retailers to see a spike in demand online from international customers who seek to take advantage of the weak pound.

Luxury is the one sector likely to benefit most from this, albeit this will have margin implications.

The concern over the implications of Brexit are likely to lead to the short-term reluctance among retailers to make significant capital investments, and may also lead to a slowdown in hiring.

The projects requiring significant investment that could be affected in the short term include:

- Large investment in IT and systems
- The roll out of new stores
- Store improvement or upgrade programmes
- Large business transformation projects
- Marketing activity
- Head office investment

Depending upon how much consumer confidence and demand are affected, over the medium term, this could also lead to redundancies and store closures.

The potential suppression of demand in the domestic market could lead to retailers driving their internationalisation strategies (Online and offline). Retailers may view the (potential) stability of other markets as being more attractive for growth opportunities. However, Brexit may well have a significant impact upon the EU economy as a whole; and therefore may also be a driver for retailers to pursue opportunities in AsiaPac, North America and other geographies.

The UK is also likely to be viewed less favourably as a potential regional base by international retailers. Therefore, brands such as Alibaba who set up their International HQ in the UK, may in future decide that being located within an EU member state is preferable.

In the longer-term, the threat of trade tariffs with EU countries is another concern retailers will need to address.



Mike Watkins

Head of Retailer and  
Business Insight,  
Nielsen UK

Big changes to the  
broad customer  
proposition should only  
be necessary for the  
minority of retailers as it's  
adapt or die!

Like the industry as a whole, consumers are in a state of shock at the moment following the result of the referendum. So it's of no surprise that we are seeing (and will continue to see) dramatic swings in consumer confidence, as sentiment is shaped by what shoppers are absorbing from the media.

At times of uncertainty, consumers look to home and family for support networks, which means that in the short term (the next 6 to 9 months) retailers will need to reinforce and message that they are 'here to help', be it good prices, customer service or the feel good of the overall shopping experience.

Empathy will go a long way to re building consumer confidence and helping spending intentions albeit this will be more of challenge in non-food than in food retail. In the short term we can expect shoppers to look to save more or pay off debts rather than increase discretionary spend and this could have a ripple effect on many retailers.

What retailers also need to reflect upon is that the top consumer concerns have been for some while, job security and the economy as well as terrorism, immigration (Nielsen Consumer Confidence Survey 2016). This shows that consumers still recall the economic pain and changes that had to be made in household expenditure in recent years, even if many households are now financially better off than at the height of the last recession, helped by low mortgage rates, falling energy and fuel prices and 3 years of price deflation in retail.

In the medium term (12 to 24 months) and as the impact of any change to monetary and fiscal policy becomes clear and are felt

by shoppers – and assuming some course correction – retailers will need to accelerate changes strategies already in place.

These need to include simplification, address overcapacity as the result of multi-channel shifts in spend, better analytics, innovation in service and product that gives real benefits, and of course, continually revisit what 'value for money' means for loyal shoppers (those who are advocates, shop most often and spend the most money).

For Supermarket shoppers we can expect renewed interest in seeking out cheaper brands (or brands at lower prices) and the safe haven of good value private label. Expect a continuation of wasting less (fresh) food and no return to larder stocking. Savings on 'core' groceries will allow spending to be maintained on added value, indulgent and affordable treats, goods and services.

Big changes to the broad customer proposition should only be necessary for the minority of retailers as it's adapt or die! Shopping behaviour has already changed and the expected implications of Brexit such as an increase in some retail prices and a more cautious consumer will simply reinforce a mind-set that is already in place. Nielsen research shows that 20% of shoppers claim not to have any spare cash but this also means that 80% do, so even if the retail pie does not grow as fast, gaining a bigger slice would seem to be an attractive strategy.



Jonathan De Mello

Head of Retail Consultancy,  
Harper Dennis Hobbs

Should a soft landing fail to happen, retail in the UK will be a less exciting place, as domestic retailers halt or slow expansion within the UK in order to necessarily focus on considerable cost pressures derived from a combination of higher import costs due to the decline in the value of sterling, and the national 'living wage

Brexit has already had a considerable and immediate impact on retail real estate in the UK, given the recent suspension of UK property fund redemptions due to exceptional liquidity pressures – including Aberdeen, Henderson, Columbia Threadneedle, Canada Life, Standard Life, Aviva and M&G, with more suspensions to inevitably follow. As a result of the relatively illiquid nature of commercial real estate, these funds are under considerable pressure to sell assets (both high street and mall) at a level significantly below their recent valuations. In terms of what would essentially be a forced sale, it would be 'non-core' assets in secondary retail centres that would be sold off first – as investor perception, correctly, would be that such centres are most at risk from dampening retail occupier demand.

This would be quite a profound setback for such centres, some of which are still – even now – recovering from the recession in 2008 – with high levels of vacancy and retail business failure. Whilst a combination of the internet/multi-channel retail – in addition to the recession – was the cause of the decline of these centres then, there is less light at the end of the tunnel for these centres this time, unless a 'soft landing' deal can be negotiated with the EU, whereby Britain trades within a wider free-trade 'European Economic Area.' This looks quite far away from happening currently however, given the 'quickie divorce' rhetoric emanating from some quarters of the EU.

Should a soft landing fail to happen, retail in the UK will be a less exciting place, as domestic retailers halt or slow expansion within the UK in order to necessarily focus on considerable cost pressures derived from a combination of higher import costs due to the decline in the value of sterling, and the national 'living wage.'

International retailers will similarly seek to reduce their exposure to the UK, and the UK's status as the principal foothold for

US brands seeking to enter the European marketplace will be threatened given the UK would be subject to standard EU barriers to trade. The government has tried to pre-empt any reduction of FDI into the UK through a planned reduction in corporation tax (already lower than EU peers such as Germany, France and Italy) to 'below 15%.'

It will be interesting to see how the government plan to finance this however, as if the plan is to do so with income tax/VAT rises, then this would impact already fragile consumer demand. Brexit would make Paris – London's only major competitor from a retail perspective – more attractive; albeit London, particularly when Crossrail is up and running, will still be considerably ahead from a retail spend perspective. However, whilst retailer demand will remain strong – and likely be consolidated in – the UK's principal retail centres (such as major cities and large out of town malls) secondary retail centres will clearly not be so lucky. In such centres tenants will seek to negotiate rental discounts/exit on lease expiry and landlords will be forced to reduce rents in order to maintain occupancy levels. Property investors with considerable exposure to secondary centres had better pray for a soft landing, or – even better – a second referendum!



Nick Bubb

Retail Consultant

Cutting prices should be unnecessary if consumers are feeling better off, but for cyclical and structural reasons retailers are still under pressure to offer deals and promotions.

The share prices of General Retailers slumped in the immediate aftermath of the shock Brexit vote, as the City moved quickly and brutally to discount a future UK recession and sustained sterling weakness.

This is, of course, what the stockmarket does, ie one of its functions is to discount future events and share prices in the General Retail sector have been telling us that the probable outlook for sales and profit margins is distinctly poor, in the light of the "Brexit" vote on June 23rd.

Where the balance of short-term and medium-term lies is unclear: if the normal time horizon in the City is about 6 months out then the scenario being discounted is a poor Christmas, although the underlying concern is about the outlook for 2017, as the weakness of sterling will then start to feed into higher import prices, other things being equal.

Ironically, this is not such a bad scenario for the beleaguered Food Retail sector, which is currently bedevilled by food price deflation, but has historically enjoyed periods of food price inflation. However, the concern is that the rise of the discounters and the surplus superstore capacity in the market, as Online grocery shopping and convenience store shopping gain ever more traction, is causing deep-seated structural change in the industry. And investors are nervous that Asda will set off a renewed price war to stop its persistent loss of market share, so the share prices of Food Retailers have not been completely immune to the recent uncertainties.

However, the share prices of the "big ticket", housing market related companies (like Furniture retailers), as well as Motor retailers, have been hit particularly hard since Brexit, as the City thinks, on the basis of historical precedents, that this area is where consumers will rein in their spending first, in response to heightened uncertainty and a worsening outlook for jobs and house prices.

Needless to say, there is not much evidence for this yet, but the City has chosen to shrug off any reassuring noises. This Topps Tiles reported on July 6th that the previous quarter's trading had been reassuringly strong (despite the recent impact of Euro 2016 on the attentions of many of its core customers) and yet it still saw its share price fall even further last week...In much the same way, Seb James, the CEO of Dixons Carphone, said on June 29th that UK sales had been up since the Brexit vote, but his share price has still been savaged.

Of course, in the very short term, there are all sorts of reasons why consumers can seem to be keeping on spending, with the weather often the driving factor and the fact is that the recent cloudy and cool weather has been quite helpful to "indoor" retailers of homewares, furnishings and appliances etc (in contrast to the unhelpfully hot weather that we enjoyed a year ago, which meant the comps for post-Brexit sales have been relatively soft for such retailers).

Thus, there was no sign of a Brexit slump at the great Retail bellwether John Lewis in w/e July 2nd, with gross sales up by 2.1% (broadly flat on a LFL basis), but trading was helped by the cool weather and the earlier start to Clearance this year, so we will have to wait to see an underlying trend emerge here.

Ironically, the weather shift against last year has hurt John Lewis's sister company, Waitrose, which saw sales c5% down LFL in w/e July 2nd, impacted by a tough comp (good picnic and barbecue business on the back of the sunny weather a year ago, plus the "Pick Your Own Offers" launch hype) and the cooler weather this year.

Another weekly sales survey is that produced by the accountants BDO for small and medium-sized non-food retailers and w/e July 3rd was actually not great, with overall Store LFL sales down by 1%, but this survey is nearly always gloomy, partly because it excludes Online sales...

In much the same way, the various High Street footfall surveys have been negative post-Brexit, as Dave Forsey, the MD of Sports Direct, pointed out on July 7th, but footfall figures have consistently been negative, partly because of Online sales growth...so this doesn't tell us that much.

Talking of Sports Direct, however, moves the subject onto the impact of the post-Brexit slump in sterling on the dollar-based Overseas sourcing of Fashion retailers, because Sports Direct is the most exposed to this, having had to confess that it had no hedging in place for this sort of eventuality... If sterling stays at around \$1.30, the impact on Sports Direct's gross margins next year will be material, assuming it is unable to pass higher prices on to the consumer.

It would have been helpful if Sports Direct had tried to quantify this downside risk to gross margins with its final results, but for the time being it is hiding under the "too soon to tell" mantra.

The definitive word on the subject of Overseas sourcing margins and the impact of the weakness in sterling for Fashion retailers will doubtless come from Simon Wolfson, the highly-regarded CEO of Next, in the Next Q2 trading update scheduled for August 3rd.

Around that time in early August, we will also get an early view of how "white van man" is reacting to the change in the climate in the building trade post-Brexit, with the Travis Perkins interims on August 2nd likely to provide an important barometer of this side of the trade.

Unfortunately, it is clear that the feeble UK economic recovery has been slowing anyway in recent months and, given the general shock to consumer confidence from the Brexit vote and the negative impact on the London jobs and housing market in particular, it is not surprising the City moved so quickly to price in the risk of a recession and sustained sterling weakness (although it has also recognised the benefit on FX translation to retailers with significant Overseas earnings).

Markets can over-shoot in both directions and some of the recent share price falls were overdone, but the direction of travel for the domestic economy is clear, with the Bank of England's latest monetary policy easing likely to be increasingly ineffective.



James Sawley

Head of Retail & Leisure,  
HSBC

Retailers will be working closely with their banking partners to ensure they are receiving sufficient support throughout this period of turbulence.

The votes are in and Britain is out. The reaction of the equity and credit markets confirm how investors perceive the short and medium term risks, and they are concerned. Immediate attention has turned to USD exposure and the outlook for Cable.

General retailers have a significant requirement for Dollars either directly or indirectly via wholesalers and distributors further down the supply chain. Companies are typically hedged between 9 and 18 months out, so are covered for two to three seasons. This is therefore a strategic challenge for the second half of 2017 onwards. While all retailers are in the same boat, some will be able to weather the stormy seas better than others.

Consequently I expect to see a range of approaches to how imported inflation is dealt with.

Retailers selling price inelastic products such as food or low ticket items, and those with a category leading value proposition or significant brand equity, will be able to flex prices with minimal impact on volumes, protecting gross margins and net income.

But for many operating in the more discretionary end of the wallet, a strategic decision will have to be taken on pricing. With cost pressures also mounting in areas such as staffing, transport and energy costs, businesses have tough decisions to make which effect both customers and shareholders. Retailers with healthy balance sheets and healthy margins can afford to play the wait and see game, keeping prices the same in order to protect or gain market share. Following a sustained period of strong consumer fundamentals, UK retail generally finds itself benefitting from a strong capital base, thereby giving many businesses the option of riding out a few years of uncertainty.

Retailers will be working closely with their banking partners to ensure they are receiving sufficient support throughout this period of turbulence. Immediate priorities will include supply chain security and mitigating any further volatility in Sterling. While the outlook is currently one of uncertainty, our respective industries are adept to dealing with significant change and will remain fundamental to the prosperity of the UK economy.

HOME CINEMA





## Consumer confidence

can it be accurately measured and does it drive consumer spending?

- Consumer confidence indices never tell the whole story, but they do provide insight into shoppers' mind-set, particularly when viewed as a trend over time
- There is a strong correlation between consumer confidence and consumer spending, however shock events like the Brexit vote can result in divergence between the two data sets
- Consumer confidence indices should be used in conjunction with other measures to get the most useful and accurate insight

November 2016

### Introduction

Consumer confidence indicators have long been used to gauge household spending intentions and retail sales, with the measures pivoting around the general theory that changes in consumer confidence are typically followed by corresponding changes in consumer spending. As Dr Tim Denison, Director of Retail Intelligence at Ipsos Retail Performance, summarised, the theory suggests that: "...if a consumer is more confident about the economic outlook and their personal circumstances, they will be inclined to spend more."

When the KPMG/Ipsos Retail Think Tank (RTT) met in October, the members agreed that consumer confidence measures do provide key insight into likely patterns of spending. Jonathan De Mello, Head of Retail Consultancy at Harper Dennis Hobbs, highlighted the impact consumer spending has on the economy, whilst James Sawley, Head of Retail & Leisure at HSBC, reinforced this further by flagging that the consumer has been the driving force behind the UK's recent economic recovery.

However, as the UK assesses the impact of the EU referendum result on the economy, many members of the RTT noted that, more recently, there has been little to no correlation between the indicators and actual retail sales. Martin Newman, CEO of Practicology, highlighted that news headlines such as "Consumer confidence slows as job security fears surface" and "Consumer confidence up in September as shoppers shrug off Brexit fears," which have been reported within days of each other, seem to call into question the accuracy or interpretation of these measures.

With consumer confidence increasingly in the spotlight, the RTT explored whether it can in fact be accurately measured and whether it in fact acts as a driver to consumer spending.

### Can it be accurately measured?

David McCorquodale, Partner at KPMG, highlighted that “measuring consumer confidence is an attempt to evaluate consumer mind-set and is not something that can be compared across other measures at an absolute level.” He added that “...what, when, how and in what context you ask [questions] will affect the absolute levels reported.” Martin Hayward, Founder of Hayward Strategy and Futures, also stressed that there is “no such thing as the average shopper”. He noted that: “the unique demography [of shoppers] and the nature of goods sold means that there may be significant variances to the norm that can render the indicator of overall confidence less valid”.

The fundamental flaws of polling were also raised as a shortcoming of consumer confidence surveys. Maureen Hinton at GlobalData suggested that: “As we have seen with election polls, it’s hard to get an accurate picture of intended behaviour with surveys, and an isolated score can lead to false assumptions.”

As a result, a number of the RTT noted that individual scores are far less relevant and, as Maureen Hinton highlighted, “a time series [which] does supply a trend...[and] can be used to measure the direction of confidence and the impact it will have on spending” is far more insightful.

Going a step further, David McCorquodale provided some suggestions as to how the accuracy of the trend can be improved. He stressed that a representative sample, the frequency of the questioning and clear instruction on where on a scale to answer, all play vital role. If questioning is consistent, sent at the same time every period and weighted to match national representation for age, gender, socio-economic background and other factors, then a more accurate picture could be obtained.

James Knightley, Senior Economist at ING, pointed out that consumer surveys tend to ask questions relating to consumer perceptions after events have already taken place. As such, he stressed that economists consider consumer confidence indices to be ‘lagging indicators’ that in themselves do not provide new information, but rather reaffirm assumptions that have already been made. Dr Tim Denison also questioned “how relevant exactly are reflections of the past on future consumption prospects.” He stated that: “...we live in a ‘here and now’ world where 12 months yonder has increasingly less meaning or relevance to the way we live.” This suggests such indices are a helpful summary of the past but less accurate in providing an indication of how consumers might act in the future.

Keeping with the ‘here and now’, many of the RTT members also stressed the power the media has in shaping the outlook of consumers, perhaps skewing the actual levels of confidence consumers feel versus what they act upon. Nick Bubb, Retail Consultant, stated that if you: “ask the typical consumer what the general economic outlook is... they will repeat back what they’ve just heard in the media.” He added that: “what [consumers] say and what they do are very different”.

James Sawley, however, firmly believed that consumer confidence can be accurately measured, with research organisations having honed their methodologies over time to be more accurate. Like many of the RTT members, he pointed to the measure’s long-term positive correlation with retail sales, which – as David McCorquodale and Maureen Hinton suggested – paints a more accurate ‘picture’ of the direction of travel, whilst the individual scores themselves are less reliable and should be interpreted with caution.

## Does it drive consumer spending?

Whilst many of the RTT members referred to the long-standing correlation between consumer confidence and spending over time, they also noted divergence between the data sets following shock events. Dr Tim Denison, along with other RTT members, pointed to the months that followed the Brexit vote as a prime example of this. As James Knightley stated: “Consumer and business confidence plunged in the wake of the referendum result, yet the economy performed fairly well”. In fact – as Martin Newman noted – many retailers reported that their sales have not been negatively impacted by the Brexit vote as yet. But why?

As highlighted when exploring the accuracy of consumer confidence measures, Mike Watkins, Head of Retailer and Business Insight at Neilsen UK, suggested that there can be a delay in the effect diminishing consumer confidence has on actual consumer spend. He pointed to research describing “...a six to nine months lag after a change in sentiment to a change in spend.” However local market conditions such as price competition or personal circumstances such as job security can have a bigger impact on how much and when consumers decide to shop. James Knightley further added that: “Swift government action... can [also] swiftly nullify immediate consumer reactions.”

Maureen Hinton also pointed out that while consumers may come to believe the economy overall is worsening, until it impacts them at an individual level they will continue to spend as normal. As an example, Martin Newman illustrated that for a home owner, rising property prices may lead to a more positive sentiment in general, with their spending positively impacted as a result. However, the opposite is true for someone saving for their first home – if house prices are rising it directly diminishes their disposable income because they would need to save more.

That said, Maureen Hinton also flagged that a continuous stream of bad news is likely to make consumers more cautious, with the result being self-fulfilling. This crucially links back to the issue of media reporting on consumer confidence and indirectly influencing the consumer mind-set when hitting the shops.

Separately, James Sawley highlighted that certain categories of goods are likely to perform better than others in a period of low consumer confidence. Whilst luxury and big-ticket items would likely experience a decline in such an environment, retailers: “...operating as ‘value leaders’ [would be] likely to see an uplift in sales as consumers trade down”. While this might be the case for domestic consumers, James Knightley argued that: “consumer confidence can’t take account of everything to do with consumer spending”, as an example he pointed to the recent boom in tourism as overseas visitors take advantage of the weaker pound. This therefore suggests that indicators should not be used to project consumer trends uniformly.

Finally, David McCorquodale shed more light on what wavering consumer confidence may mean for retailers themselves. He suggested that: “low consumer confidence affects markets as a whole and makes it tougher for specialists to prosper. Generalists win by skimming more markets and persuading those already in store to buy, whereas specialist operating in non-essential categories are easily avoided by cash strapped customers.” To curb diminishing sales, and perhaps even delay or negate the negative impact on consumer spending, he highlighted techniques used by retailers to cement purchase decisions, including free longer guarantees and even celebrity endorsement.

## Conclusion

There was general consensus among the RTT members that consumer confidence indices are never going to tell the whole story. Confidence indicators do provide useful insights that can help reaffirm general assumptions but, as Jonathan De Mello surmised, given the fickle nature of human emotion, consumer confidence cannot be viewed in isolation and needs additional context to make it meaningful.

As raised by many of the RTT members, particular caution should be given to consumer confidence measures following ‘shock events’ such as the Brexit vote. Martin Newman flagged that given the unprecedented nature of EU referendum: “...consumers are likely to rely on gut feel [so, nothing] other than money through the tills and website checkouts [can] accurately measure [consumer spending]”.

The RTT also concluded that consumer confidence indicators and consumer spend are inextricably linked. Maureen Hinton described the spiral in which bad news leads to more cautious consumers and, “as consumer spending is a major contributor to GDP growth, so the economy contracts and consumers begin to see job losses, leading to further cutbacks” and effectively more bad news. This therefore suggests the confidence indicators do drive spending, but confidence is driven by the economy so the cycle becomes self-fulfilling.

## Part II:

### In detail – Individual views of the KPMG/Ipsos Retail Think Tank members



**James Knightley**

Senior UK Economist, ING  
Outlook for 2017

Consumer and business confidence plunged in the wake of the referendum result yet the economy has performed fairly well.

Confidence surveys tend to ask questions about incomes, employment prospects and inflation so responses typically reflect consumer perceptions of events that have already happened. This means that economists consider consumer confidence indices to be “lagging indicators”. It is not a piece of information that will provide something “new” that will lead us to significantly change a view on the outlook for the economy.

This is not to say they aren’t useful. They can help to determine whether assumptions we make are fair since over time consumer confidence surveys tend to have a reasonable correlation with consumer spending. It can also give us greater conviction that we are likely to see a pick-up (or a fall) in credit demand, increased demand for housing, which could boost construction and whether we are likely to see improving tax revenues from rising VAT receipts.

On the other hand, confidence surveys, like any form of polling, can send misleading signals. This most typically happens around shock events. For example, in the US there have been instances of sharp falls in consumer confidence yet consumer spending continues apace, such examples include the September 11 terrorist attacks,

Hurricanes Rita and Katrina and when we have seen sizeable falls in equity markets. Survey respondents may feel (at that particular time) that their job is at risk or that their incomes and wealth may fall, but until it actually happens they will continue with their daily lives. Swift government action can therefore quickly nullify immediate consumer reactions within surveys.

The UK has experienced something similar with the Brexit vote. Consumer and business confidence plunged in the wake of the referendum result yet the economy has performed fairly well. That is because consumer confidence can’t take account of everything to do with consumer spending – for example the boom in tourism numbers taking advantage of the weak pound.

I therefore take the view that consumer confidence surveys are never going to provide a truly accurate picture of what is going on, but they can provide some useful information. However, it needs to be interpreted with caution and is largely used to confirm assumptions already made. Moreover, it is of little use in determining changes in high frequency transactions, such as food.



**Dr Tim Denison**

Director of Retail Intelligence,  
Ipsos Retail Performance

Whilst consumer confidence surveys may have their weaknesses in indicating spending intentions, they are a convenient and popular way of bundling people's take on an array of general economic factors at the time, which under "situation normal" can provide useful insight.

Consumer confidence surveys have long been a staple indicator of household spending intentions and retail sales, loved by the media. The theory goes that if a consumer is more confident about the economic outlook and their personal financial circumstances they will be inclined to spend more. And the evidence is compelling. It does show that there is a strong long term association between consumer confidence and retail sales.

On further consideration it begs the question why. Most of the confidence metrics use a basket of questions to derive their headline scores. There is nothing inherently wrong in this. More questionable perhaps is that equal weighting is given to the state of the economy and personal finances over the past 12 months and to the year ahead. How relevant exactly are reflections of the past on future consumption prospects? Furthermore, we live in a 'here and now' world where 12 months yonder has increasingly less meaning or relevance to the way we live.

Recent months have shown that consumer confidence and retail sales can have little or no correlation, lagged or otherwise. The collapse of the GfK headline index to -12 in July following the Brexit vote bore no resemblance to the BRC-KPMG Retail Sales Monitor total

sales growth of 1.9% or the 0.3% decline in August. Significant "other" events often lead to a breakdown between the two data sets. In fact, studies have shown that one third of the movement in confidence is left unexplained by economic variables and that these non-economic factors don't impact spending.

So does measuring consumer confidence have a role to play? The argument above is that if we were to build a measure using a cocktail of the broad macroeconomic variables that are collected elsewhere, they would do a better job at predicting future retail sales. The problem, though, is that many of these official statistics are slow to be published, negating their worth as predictive measures. Whilst consumer confidence surveys may have their weaknesses in indicating spending intentions, they are a convenient and popular way of bundling people's take on an array of general economic factors at the time, which under "situation normal" can provide useful insight. The question left hanging is when can we say when is "situation normal" and when is it not.



David McCorquodale

Former UK Head of Retail,  
KPMG

Low consumer confidence affects the market as a whole and makes it tougher for specialists to prosper.

aluate consumer mind-set and is not something that can be compared across other measures at an absolute level. What, when, how and in what context you ask it will all affect absolute levels reported. The key is a nationally representative sample of consumers with a simple questions asked regularly, combined with clear guidance on how on the scale to answer. If the question is consistent, sent at the same time every week or month and responses are weighted to match national representation for age, gender, socio-economic and so on, then you can build up a picture. The score itself doesn't matter as we are looking at the trend – the extent to which it rises or falls.

This form of survey is used for measuring macro confidence – my belief that I can plan for the future without any concerns that things may become uncomfortable – and is more dependent on the overall economic environment. It can suffer significant short term swings caused by external factors, e.g. the vote on Brexit or even the performance of a national sports team. But over a longer period of time, it is a useful indicator.

In retail, margin tends to rise with confidence as much as the sales line as the retailer has to try less hard to move merchandise. With this, headline deals need to remain sharp to support the value proposition, but the inclination to trade up is much greater in positive times.

Low consumer confidence affects the market as a whole and makes it tougher for specialists to prosper. Generalists win by

skimming more markets and persuading those already in store to buy, whereas specialists operating in non-essential categories are easily avoided by cash strapped customers. Techniques to insure against 'buyer's remorse' – e.g. Argos' 16 day money back guarantee, free longer guarantees, celebrity endorsement – all help to cement the purchase decision by creating a set of attributes that feed the consumer narrative (i.e. what we tell ourselves as shoppers to justify our purchase – often played back to friends and family).

There is also micro confidence to consider – my belief that this brand will deliver on what I need and will be there tomorrow, and treat me fairly should things go wrong. Specific retailers will deliver consumer confidence, broadly irrelevant to the above factors, through being a trusted brand.

Today, many retailers are talking about the shift towards experience and away from product ownership. Therefore an increase in confidence does not necessarily translate into higher spend in stores but on leisure activities. This is especially acute in apparel.

Consumer spending is more driven by disposable income and personal choice than confidence measures. Retailers have to fight for that share of wallet but can run strategies to benefit from macro confidence as well as micro confidence.



Martin Hayward

Founder, Hayward  
Strategy and Futures

As with any form of  
insight of insight,  
it's always worth  
remembering that there  
is no such thing as an  
average shopper.

There is no doubt that consumer confidence indices are a useful indicator of overall propensity to spend as has been demonstrated by various analyses conducted by the European Central Bank amongst others. However, as with any summary indicator, they need to be viewed as a contextual indication rather than a specific prediction.

For individual retailers, the unique demography of their shopper base and the nature of the goods sold means that there may be significant variances to the norm that can render the indicator of overall confidence less valid. For instance, and perhaps counter intuitively, retailers with a low income profile may see little disruption to sales at times of low confidence as their shoppers are always living on a tight budget and have little discretionary spend in good times or bad. Conversely, higher income shoppers may be more sensitive to their overall confidence as they have more at risk in the future – the recent stumble in higher end property sales following Brexit may be a good example of this.

As with any form of insight of insight, it's always worth remembering that there is no such thing as an average shopper. Where possible, it is important to understand the needs, wants and motivations of your own specific customer base to assess how the general economic and confidence indicators are likely to affect your own sales. A good example here might be coffee – a

truly discretionary and expensive daily habit that in theory should be one of the first and easiest ways to control spending at times of low confidence. However, throughout the recent years of economic uncertainty, this sector has continued to grow because consumers have come to categorise this spend as an essential rather than a discretionary spend.

Understanding your own customers' sensitivity to confidence will also help to determine how marketing plans should be developed to preserve loyalty in difficult times. Useful questions for every retailer to consider include:

Do I have enough information about my own customers' sensitivity to economic confidence?

Can the goods on offer be positioned as essentials rather than luxuries, thereby protecting spend in times of uncertainty?

Can the loyalty program be used to encourage continuity of purchase through swings in confidence?

Do I understand what influences my customers' confidence – this is particularly important for younger generations where social networks are increasingly more influential than traditional media sources?



Maureen Hinton

Group Research Director,  
GlobalData

Can confidence be accurately measured? As we have seen with election polls, it is hard to get an accurate picture of intended behaviour with surveys

Does it drive consumer spending? We at GlobalData have been tracking consumer confidence on a monthly basis since 2012 and what is evident in our survey, as well as others, is that consumers may have little confidence in the future of the economy, and will say they intend to cut back on their spending over the next six months as a result, but they will continue to spend. They may believe the economy is worsening and jobs and incomes will be affected, but until there is a major financial crisis, such as the global banking crash, and they begin to see the impact in their personal lives, or those of friends and family, as happened during the recession, they will carry on as normal.

That said a continuous stream of bad news does mean consumers will start to be more cautious, and then it becomes self-fulfilling, particularly as consumer spending is a major contributor to GDP growth, so the economy contracts and consumers begin to see job losses, leading to further cutbacks. The so called 'Project Fear' of the remain campaign leading up to the EU referendum, that predicted a full blown recession with massive job losses if the UK voted to leave, led to

a significant drop in consumer confidence after the referendum, and consumers holding back on committing to big ticket spending. Yet there was a quick recovery in both confidence and spending when there was no immediate impact on people's lives and income. Confidence does drive spending, but confidence is driven by the economy.

Can confidence be accurately measured? As we have seen with election polls, it is hard to get an accurate picture of intended behaviour with surveys, and an isolated score can lead to false assumptions. However a time series does supply a trend and we can use it to measure the direction of confidence and the impact it will have on spending. But it needs to be set against other factors such as the economy, wages and the labour market to make meaningful assessments.

So in summary – consumer confidence is a driver of spending, but it should be used in tandem with other factors to provide a meaningful picture of future spending trends.



Martin Newman

CEO, Practicology

Looking at social media the day after the Brexit referendum, one could be forgiven for thinking the sky had fallen in.

Within three days in the past week, I've seen headlines saying "Consumer confidence slows as job security fears surface", "Consumer confidence up in September as shoppers shrug off Brexit fears" and "Brexit not deterring shoppers but household finances under pressure".

So it's clear that measures of consumer confidence can be interpreted in different ways at any point; even if the measurement accurately shows trends in consumer sentiment over time.

On the 28th September, the press reported that the consumer confidence index compiled by YouGov and the Centre for Economics and Business Research had risen by one point in September, compared with August, but was still below pre-Brexit referendum levels. This was attributed specifically to concerns about future job security, rather than other aspects of consumer confidence.

Respondents are asked about their household financial situations, property prices, job security and business activity in the workplace.

And this highlights why it's hard to tie sentiment about macroeconomic indicators to consumer spending, where decisions are taken at the micro level. The relationship between the two is not always a neat one. For a home owner, property prices rising may lead to more positive sentiment in general and their spending

may be positively impacted as a result. For someone saving for their first home the opposite is true, and rising house prices may directly diminish their disposable income as they try to save more.

Looking at social media the day after the Brexit referendum, one could be forgiven for thinking the sky had fallen in. Equities and foreign exchange traders must certainly have thought so. Any measure of sentiment taken that day would surely have been significantly more negative than even a week before.

Yet since then many retailers have reported that their sales have not been negatively impacted by Brexit, and the Office for National Statistics agrees (through the British Retail Consortium disputes this).

To tie consumer sentiment directly to consumer spending assumes that consumers have all the information they need to assess how future macroeconomic conditions will personally impact them, and make rational decisions when they have that information. These are major assumptions.

As no country has ever left the EU, no one really knows how this will play out, and consumers are likely to rely on their gut feel. I'm not sure that anything other than money through the tills and website checkouts accurately measures that.



Mike Watkins

Head of Retailer and  
Business Insight,  
Nielsen UK

What is clear is that when shoppers are uncertain about the economic environment and also their own personal finances, we see more alignment of sentiment with spend.

With the UK leaving the European Union now a certainty, retailers are reframing strategies to take into consideration the uncertain macro-economic outlook. Whatever the terms of “exit” finally are and whenever implemented, this will precipitate a change to the business model of retailers.

However, equally `unknown` and a bigger challenge is how to predict the levels of consumer spend over the next 3 years.

One of the indicators is of course consumer confidence. The conventional thinking is that changes in confidence (sentiment) are a proxy to a changes in behaviour (consumer spend). This is not always the case.

Firstly, consumer sentiment is without doubt shaped by what is read, watched or followed in the media and much of this is external to the UK which is why short term trends are volatile. It is always better to look at confidence indicators over a quarter or preferably 6 month period.

Secondly, shaky confidence will be amplified by a weak economy, or as in the UK at the moment when the economic and political elite manage expectations downwards. This generally leads to a more cautious consumer who is less inclined to spend freely. Again the outcomes can be unpredictable but they are more indicative.

Research across the European CPG market by Nielsen suggests that whilst consumer confidence does indeed pilot demand there is typically a 6 to 9 months lag after a change in sentiment to a change in spend.

However it is local market conditions (such as price competition, retailer disruption, changes in property values) and personal circumstances (such as the job security, disposable income, changes in family and lifestyle) which have a bigger impact on how much and more importantly when, consumers spend.

For example, global consumer confidence has improved in 2016 helped by North America and Asia Pacific being more optimistic regions with LATAM impacted by regional economic crises.

In contrast, Europe still has the most pessimistic consumers despite having some of the largest economies in the world and some of the most affluent consumers (source: Nielsen).

In the UK, consumer confidence reached a 10 year high at the end of 2015 yet retail spend remains under pressure as consumers spend more on leisure and experience; spending which seems to be less linked to traditional interpretations of consumer confidence.

What is clear is that when shoppers are uncertain about the economic environment and also their own personal finances, we see more alignment of sentiment with spend. Having a better understanding of the `why` behind often opaque spending intentions, will help retailers to better predict future levels of consumer spend as the UK begins to uncouple from the European Union.



Jonathan De Mello

Head of Retail Consultancy,  
Harper Dennis Hobbs

There are flaws however in the quantification of consumer confidence; making it a less reliable mechanism for forecasting retail sales.

Consumer confidence can have a wide impact on the economy – for example low consumer confidence is cited as a primary cause of the 1990-1991 recession. Swings in consumer confidence are now closely monitored by economic forecasters due to the effect that public opinion has on retail sales. Retailers are already under pressure from rising costs; falling demand due to reduced consumer confidence would serve to reduce margins further.

The traditional composite indicator of consumer sentiment, operated by most governments and supra-national organisations, are Consumer Confidence Indicators (CCIs) – which are based on consumers' opinions of their current economic situation, their plans for major purchases and their own expectations for the immediate future. Other metrics of consumer confidence, such as Ipsos' Primary Consumer Sentiment Index (PCSI) provides insight into consumer opinion across different countries, standardising survey results and allowing for international consumer confidence comparisons.

Another popular measure of consumer confidence – the GFK Consumer Confidence Index – has risen in August after dropping by its fastest rate in 26 years in July following the Brexit vote. This consumer confidence uptick is principally driven by a combination of historically low interest rates and low unemployment – which the pro-Brexit press have been only too keen to highlight. However, it remains to be seen whether this happy consumer confidence 'halo' will last, when Article 50 is actually invoked.

There are flaws however in the quantification of consumer confidence; making it a less reliable mechanism for forecasting retail sales. The general public are often influenced by overly reactive news reports that exaggerate the impact supply-based economic issues (rising oil prices for example) have on the average consumer, causing drastic changes in economic confidence as misconceptions of the

influence on their future spending power spread. While this might trigger changes in spending habits in the short term, it may not necessarily impact their actual future spending power – while a survey respondent might claim to be dissatisfied with the state of the economy one day, their actual economic situation may not always reflect this, so it would be useful for a retailer to additionally consider quantitative indicators of economic strength (employment rates, average property prices, interest rates, personal savings rates etc..) alongside qualitative indicators such as CCIs.

From a property perspective, property values and rental levels can have a major impact on consumer confidence – as they act as a direct reflection of consumer demand and actual spending power. For consumers, house prices – and whether they are rising or falling – have a major influence on sense of personal wealth, and consequently propensity to spend rather than save. Reduced spending means falling retail sales which in turn impact owners of commercial property – as retailers seek to increase efficiencies through cost reduction. Seeking rent reductions and modifying rental payment terms – for example from quarterly to monthly – are mechanisms retailers have employed in the past. Where this has not worked, a number of retailers have gone down the CVA route – shedding loss making stores and holding on to the stores they really want to keep.

Keeping consumer sentiment in mind should be considered highly important due to its subsequent impact on spending habits, but measuring this using traditional consumer confidence indices creates issues of translating subjectivity into hard numbers. Due to the fickle nature of human emotion, consumer confidence cannot be viewed in isolation – rather, it should be viewed very much in the context of other, more quantitative, retail performance indicators.



Nick Bubb

Retail Consultant

Ask the typical consumer what the general economic outlook is and they will repeat back what they've just heard in the media

Much has been made of the slump in the Consumer Confidence surveys in July, shortly after the "Brexit vote" and the subsequent recovery in August and September, but this tells us very little about the actual state of consumer spending in the last quarter, let alone the likely outcome for the next quarter.

In the short term, much of discretionary consumer spending is driven by the weather. If it's seasonally warm, consumers will focus on picnics and barbecues and enjoying the parks and gardens and will not be interested in traipsing in the car to out-of-town stores to buy furnishings and furniture or in buying heavy coats and jackets and outerwear, unless big discounts are on offer.

As it happens, the post-Brexit period coincided with some aggressive sales on the high street in July, as well as a welcome shift to much warmer weather, after a cold spring, so it's not surprising that prompted consumers to spend a bit, even though the newspapers and TV news reports were warning of troubled times ahead.

And to the extent that "personal finances" were still supported by good jobs growth and wage rises at a time of low price inflation there was some logic in consumers being unphased by all the "gloom and doom" in the media after the Brexit vote.

Ask the typical consumer what the general economic outlook is and they will repeat back what they've just heard in the media... and probably be cautious, but what they say and what they do are very different things.

And although widely followed monthly consumer confidence surveys like GfK ask their panel of 2000 consumers (which is not a hugely representative number) other questions, there is considerable doubt about what these mean when interest rates are so low...

Is now a good time for major purchases? Maybe not if the economy is about to go into recession and the housing market is going to crash, but if interest rates are going to stay so low that credit is ultra-cheap then why not buy big ticket goods?

Is now a good time to save, rather than to spend? Well, maybe yes, if unemployment is going to rise and the housing market is going to crash, but what's the point of saving when there is no interest to be earned?

When interest rates are as abnormally low as they are, the market research companies need to find new tests of consumer confidence



James Sawley

Head of Retail & Leisure,  
HSBC

The consumer has  
been the driving  
force behind the UK's  
economic recovery

From a banker's perspective, I believe firmly that consumer confidence can be accurately measured. Organisations such as GfK have honed the methodology since the 1970s and consequently such indices have a positive correlation with retail sales.

Consumer confidence is a key driver of spending propensity and therefore is a fundamental indicator of the current and future prospects of the retail sector. As lenders, we keep a keen eye on this. Whilst consumer confidence is important we do not look at this in isolation when trying to forecast the performance of the sector. Data on employment, wages, inflation, the availability of consumer credit and, of course, house prices, all work in unison to help the credit markets shape lending and risk appetite.

As lenders we are cognisant of the fact that just because consumer confidence might be falling as a result of a multitude of external factors, this does not necessarily translate to worsening prospects for the sector in its entirety.

In times of deterioration in consumer confidence, certain categories are likely to outperform, such as 'affordable luxury' items like cosmetics and eating out, while those operating as 'value leaders' are likely to see an uplift in sales as consumers trade down.

The consumer has been the driving force behind the UK's economic recovery and therefore it is vital we keep the nation's shoppers upbeat and confident enough to head out and keep the tills ringing by spending their hard earned cash. With interest rates at rock bottom, the lending and investing community awaits possible news from next month's Autumn Statement to find out if the new government has a different view on the use of fiscal policy to reinvigorate lacklustre retail sales, giving consumers the confidence that they are prepared to act in uncertain economic times.



## Member contact details



### Paul Martin

UK Head of Retail  
KPMG LLP  
07551 152 088  
paul.martin@kpmg.co.uk



### Dr Tim Denison

Director of Retail Intelligence  
Ipsos Retail Performance  
01908 682700  
tim.denison@ipsos.com



### Martin Hayward

Hayward Strategy and Futures  
Founder  
07768 56764  
mrhayward@btinternet.com



### James Sawley

Head of Retail & Leisure  
HSBC  
03455 847 701 / 07584403342  
james.sawley@hsbcib.com

### Nick Bubb

Retail Consultant  
07980 676 601  
nickbubb12@gmail.com



### James Knightley

Senior Global Economist  
ING  
020 7767 6614 / 07870215408  
james.knightley@uk.ing.com



### Martin Newman

Executive Chairman  
Practicology  
07977 139056  
martin@practicology.com



### Mike Watkins

Head of Retailer and Business Insight  
Nielsen  
01865 732305 / 07885 226683  
mike.watkins@nielsen.com



### Maureen Hinton

Group Retail Research Director  
GlobalData  
02079 366891/07775573810  
maureen.hinton@globaldata.com

### Harper Dennis Hobbs

#### Jonathan De Mello

Head of Retail Consultancy  
Harper Dennis Hobbs  
020 7462 8703 / 07824143563  
jonathandemello@hdh.co.uk