Health of UK retail will worsen to record levels

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Following its quarterly meeting in April 2012, the KPMG/Ipsos Retail Think Tank (http://www.retailthinktank.co.uk)(RTT) – a panel of retail industry commentators that provides authoritative and independent views on issues affecting the sector – is reporting an even bleaker outlook for UK retailers, with the health of the industry expected to worsen to record levels before any signs of recovery.

The RTT Retail Health Index is expected to fall to an all time low of 77 by the end of quarter two of 2012. This compares with 79 at the end of the first quarter and is five points lower than the level recorded during the depths of the original banking crisis and recession, in quarters two and three of 2009.

The deterioration in health in quarter one of 2012 was not as significant as the RTT had originally forecast, partly due to higher than anticipated demand and margins pressures easing. Costs again took their toll as retailers contended with an unexpected fuel crisis and higher energy prices, as well as ongoing investment in online and multi-channel infrastructure.

Most worrying, the state of health by the end of the second quarter of 2012 looks set to be the bleakest on record since the RTT Retail Health Index was established. The combined effect of increased energy costs, raised fuel prices and higher borrowing costs - among other economic and financial influences – is expected to further dampen consumer demand for in quarter two of 2012. Although inflation is on the decline, it is still above wage rises and many consumers are dipping into their savings to keep up with increasing pressures on their household budgets and disposable income. The majority view of RTT members is that retailers will struggle even further, although voting was split - reflecting the level of uncertainty that exists.

Although high profile events such as The Queen’s Diamond Jubilee celebrations and 2012 Games will inject a ‘feel good’ factor for some, underlying economic trends will have an increasingly detrimental impact on consumer confidence and spending, according to the RTT.

Helen Dickinson, Partner and Head of Retail, KPMG UK, said: “For several reasons, the first quarter of 2012 was not quite as dire as the RTT had originally forecast in December; demand for goods and services was slightly better than we had predicted and margins weren’t hit as badly. However, there will be a latent effect going into quarter two as the stark reality of the economy begins to take its toll on consumers in the coming months.”

Retail sales at the end of the first quarter were partly buoyed by the build up to Easter and the warmest March weather in the UK since 1997 and the sunniest on record since 1929. With spring in the air, consumers were naturally more inclined to venture out and spend their money on items such as new clothes and outdoor goods - particularly for the garden, DIY and other outdoor activities such as BBQs. This benefit will unwind in the next quarter.

In contrast, the colder and wetter weather in early April, leading up to the Easter bank holiday weekend, helped department store chain John Lewis to enjoy a “stunning” trading period as its customers chose to shop inside instead of shivering outside. The company reported especially high sales of electrical goods, including the latest iPad, as well as televisions, ahead of London and the south of England’s digital switchover.

The RTT noted that John Lewis is only one of a handful of UK retailers riding against the tide; many others are struggling to compete for business, resorting to heavy promotions, voucher schemes and discounting.

Dr Tim Denison, Director of Retail Intelligence at Ipsos Retail Performance, said: “Following unprecedented levels of promotions and discounts in quarter four of 2011 which had a severely detrimental impact on retailer margins, many businesses now recognise that this is not a sustainable strategy. Rather than continuing to discount and offer promotions to the same degree in 2012, manufacturers and retailers decided to back the strength of their brands. This is partly why margins have not been so badly affected as might have been the case if the levels of promotions and discounting that we saw in December had continued.”

Neil Saunders, Managing Director of Retail Analysts, Conlumino, added: “In quarter four of 2012 there was a lot of discounting going on ahead of the Christmas period. By comparison, the January sales were better planned and managed by retailers – there were still promotions happening, but nowhere near as heavy.”

Independent Retail Analyst, Nick Bubb, said: “March was boosted by various seasonal and calendar factors, notably the earlier fall of Mother’s Day and the fine weather, but these have reversed in April. Fashion and food retailers who expected the exceptionally warm and sunny weather of last April to be repeated have been sorely disappointed by this month’s cool and wet conditions. And though the current miserable weather is more helpful to “indoor” or household goods retailers, with TV sales the current boom area in London, this will simply bring forward sales from the rest of the year and take spending power away from other areas. Overall, Q1 wasn’t as bad as feared for the High Street, but Q2 seems likely to revert to type.”

Against this backdrop of continued uncertainty and one or two exceptional circumstances that occasionally help to boost retail trade, such as warm weather, it appears that the main issue facing UK retailers in quarter two of 2012 are underlying economic and financial pressures.

Vicky Redwood, Chief UK Economist at Capital Economics, said: “Although it hasn’t hit home yet, there will be a delayed reaction by consumers to the rise in all-time-high petrol prices. Furthermore, real pay is dropping sharply, borrowing costs are rising and the only modest recovery that we have seen is due to consumers delving into their existing savings. Individuals and families are also seeing other cuts in their income as benefits are cut and certain tax credits are removed.”

Helen Dickinson of KPMG added: “It would be fair to say that, for as long as they could, consumers have ignored some of these economic pressures, but they are not going away and if anything are becoming worse.”

This picture of consumer realisation that economic factors are biting even harder is supported by the findings of a recent ‘consumer confidence’ survey conducted by Conlumino.

“What we found is that over 60% of consumers expect to cut back on their retail spending and a further 15% said they are planning to cut back as much as possible,” said Neil Saunders. “Only a very small percentage said they were planning on spending more.”

Varying changes in retailers fortunes are also impacting the retail property sector, with new, and more modern retail space rendering older and outdated retail property derelict.

“Despite the gloom, demand for space in Central London remains exceptionally strong,” said Mark Teale of CB Richard Ellis.. Vacancy levels in the prime pitches of many major locations are dwindling too. The release of new chain branch data for Great Britain shows that – despite the seemingly endless trickle of administrations – the aggregate number of retail, catering and leisure branches continues to grow. The only sector where chain branch levels continue to fall is in services. But however well chain operators might be performing, stock obsolescence remains a serious problem. We are moving back to the traditional default position of UK supply: a chronic shortage of primary space and an equally chronic oversupply of obsolete space that nobody wants.”

The RTT noted that the ‘losers and closers’ are the independents who simply cannot compete and are going out of business. The trend is particularly acute among operators whose services are increasingly available electronically, such as those offered by financial services operators, The Post Office, travel agencies, video stores etc. On the retail side, music, video and books have been hit.

Mark Teale added: “Private equity debt problems, more than market conditions generally (or the Internet), continue to play a prominent role in UK retail administrations. The trickle of administrations is continuing to cede market share to stronger players: the reason trading performance is so mixed. There are winners as well as losers from the administration process. Outside the grocery field, expansion activity remains sluggish and looks set to remain so until economic conditions improve. The Internet is meanwhile beginning to have something of a ‘clutching-for-straws’ feel about it. The cost to retailers of acquiring sales from the internet, to make-up catchment market share losses where chains are contracting in size, looks set to prove a great deal more than many currently think.”

Casting a positive light across an otherwise bleak picture for UK retailers, Richard Lowe, Head of Retail & Wholesale Barclays Corporate, said: “A lot of retailers do still believe there are costs savings to be made, especially if they are able to adapt their business models. The world of online shopping has created international outlets for UK retailers, with several performing very well in overseas markets. In certain cases, where retailers have been able to spread their wings, they have managed to support their UK operations during difficult times.”

Summarising the RTT’s April discussion, Helen Dickinson of KPMG, said: “What we expected to happen to the health of the UK retail sector in the first quarter looks to have been delayed until the second. The underlying economic and financial trends are pointing in the wrong direction for retailers, many of whom are struggling to generate sales, protect their margins and control their costs. The retail sector is undergoing structural change as our desire to consume ever increasing volumes of goods diminishes and technological advances continue to change the way we shop. Future increases in selling prices are not an option for retailers to use to help them respond to these changes and maintain sales growth. Maintaining and improving profitability is a goal which is becoming harder and harder for retailers to achieve and hence the state of health will continue on a downward trajectory for the foreseeable future."

-Ends-

Note to Editors:

The RTT panellists rely on their depth of personal experience, sector knowledge and review an exhaustive bank of industry and government datasets including the following:

Members are:

Nick Bubb, Independent Retail Analyst
Dr. Tim Denison, Ipsos Retail Performance
Helen Dickinson, KPMG
Neil Saunders, Conlumino
Richard Lowe, Barclays Retail & Wholesale Sectors
Vicky Redwood, Capital Economics
Mark Teale, CB Richard Ellis

The intellectual property within the RTT is jointly owned by KPMG (www.kpmg.co.uk) and Ipsos Retail Performance. First mentions of the Retail Think Tank should be as follows: the KPMG/Ipsos Retail Think Tank. The abbreviations Retail Think Tank and RTT are acceptable thereafter.

The RTT was founded by KPMG and Ipsos Retail Performance (formerly Synovate) in February 2006. It now meets quarterly to provide authoritative 'thought leadership' on matters affecting the retail industry. All outputs are consensual and arrived at by simple majority vote and moderated discussion. Quotes are individually credited. The Retail Think Tank has been created because it is widely accepted that there are so many mixed messages from different data sources that it is difficult to establish with any certainty the true health and status of the sector. The aim of the RTT is to provide the authoritative, credible and most 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. Its executive members have been rigorously selected from non-aligned disciplines to highlight issues, propose solutions, learn from the past, signpost the road ahead and put retail into its rightful context within the British social/economic matrix.
Definitions: The RTT assesses the state of health of the UK retail sector by considering the factors that influence its three key drivers.

1. Demand - Demand for retail goods and services. From a retro-perspective, retail sales, volumes and prices are the primary indicators. When considering future prospects, economic factors such as interest rates, employment levels and house prices as well as others such as consumer confidence, footfall and preferences are used
2. Margin (Gross) - Sales less cost of sales; the buying margin less markdowns and shrinkage. Cost of

sales include product purchase costs, associated costs of indirect taxes and duty and discounts
3. Costs - All other costs associated with the retail operations, including freight and logistics, marketing, property and people

The Retail Health Index – how is it assessed?

Every quarter each member of the RTT makes quantitative assessments of the impact on retail health of demand, margins and costs for the quarter just completed and a forecast of the quarter ahead. These scores are submitted individually, collated and aggregated in time for the RTT's quarterly meeting.
The individual judgements on what to score are ultimately a combination of objective and subjective ones, drawing upon a wide range of hard datasets and softer qualitative material available to each member. The framework follows the example of The Bank of England Agents' scoring system on economic intelligence provided to the Monetary Policy Committee.

The aggregate scores are combined to form the Retail Health Index ('RHI') which is reviewed at that meeting and occasionally revised after debate if members feel it appropriate. The RHI tracks quarter on quarter changes in the health of the UK retail sector and as such provides a useful and unique measured indicator of retail health. The index 'base' of 100 was set on 1 April 2006. Each quarter, it assesses whether the state of health has improved or deteriorated since the previous quarter. An improvement will lead to a higher RHI score than that recorded in the previous quarter, and with a deterioration leading to a lower score. The larger the index movement, the more marked the shift in the state of health.

The RHI has two main benefits. Firstly, it aims to quantify the knowledge of the RTT members in a systematic way. Secondly, it assesses the overall state of health of the UK retail sector for which there is no official data.

For media enquiries please contact:
Glen Goldsmith, 2thefore
Tel: 01483 811234 / 07812 766338
Email: glen@2thefore.biz

Zoe Sheppard
PR Manager - South and Wales Region
KPMG LLP
Tel: +44 (0)117 905 4337
Mobile: +44 (0)7770 737 994
Email: zoe.sheppard@kpmg.co.uk