Retail health flattens despite positive signs of economic recovery

Submitted by: 2thefore
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Economic confidence rising but continuing lack of disposable income will temper shopper spending

• The health of UK retail remained static in Quarter 4 of 2013, as a slight increase in demand - assisted by a very late spending surge in the festive period - was offset by margin factors.

• Gross margins again came under pressure as retailers felt the need to run more planned and unplanned promotions.

• Cost factors over the quarter were again largely neutral and are likely to remain neutral in Q1 of 2014.

• The health of UK retail is expected to remain flat in Q1, despite further signs of economic recovery and improved consumer confidence.

Following its quarterly meeting in January, the KPMG/Ipsos Retail Think Tank (RTT (http://www.retailthinktank.co.uk)) reports that the health of UK retail has been largely flat over the past three months, representing a disappointing performance for the sector, given that the previous quarter (Q3) had shown some signs of improvement. As a consequence, the RTT's Retail Health Index remains at 79 points and is expected to be the same come the end of Q1.

Of the three key drivers of retail health – demand, margin and cost - demand was slightly up in Q4, helped by a late surge in shopping in December. However, the benefits were offset by a squeeze on margins as retailers again felt intense pressure to discount with both planned and unplanned sales promotions. Cost factors over the period were considered largely neutral, as they had been in Q3.

Notably, online sales were high in December, the busiest month for most retailers in the quarter, as Internet purchasing once again proved popular among consumers happier to shop from their tablets, smartphones and PCs. Overall, footfall was up like-for-like in December but only marginally compared to last year. The retailers faring best of all appear to be those with carefully planned and complementary 'multichannel' offerings.

The RTT acknowledged there had been intense competition in food retailing in Q4, especially towards the end of the quarter. Discounters Lidl and Aldi successfully battled to secure their own record slices of market share as some consumers continue to exercise caution with their household budgets.   Other food retailers had mixed fortunes, serving to emphasise that more online and more convenience store shopping continue to pose challenges for supermarkets, especially Morrisons which has the lowest online presence of all the major food retailers. With Waitrose and M&S Food at the high end also enjoying a successful quarter, the middle ground, featuring major food chains such as Asda and Tesco, was the area most intensely squeezed. Going forward, this opens up the potential for a greater negative impact on retail health if one or more of the 'losers' in the food sector, such as Tesco or Morrisons, reverts to a price war to counter discounters.

In non-food retailing, demand and margins were a mixed bag across sub-sets of the retail sector. Despite fashion sales eventually picking up in December, clothing purchases throughout the majority of the quarter were dampened by the prominence of seasonally mild temperatures across the UK. By comparison, electrical and electronic goods, including tablets, smartphones and games consoles, were once again ‘big ticket’ items at the top of many a Christmas wish list.

Going into 2014, there are signs that UK retail could pick up, given that there is a more positive outlook to the UK economy, consumer confidence is increasing and a growing housing market is likely to have a positive impact on retail. However, although employment figures are improving and people are feeling more secure about the futures, major wage increases are unlikely, disposable income will be tight and demand will remain tempered as a consequence. Furthermore, despite the UK having the potential to become the fastest growing European economy in 2014, the RTT cautions that the retail sector will remain vulnerable to wider economic shocks that impact consumer confidence or income levels.

Going into the next quarter, the RTT forecasts that the health of the retail sector will continue to remain level, with a slight increase in demand offset by flat margins and neutral costs

Quotes from RTT members

Dr Tim Denison, Head of Retail Intelligence at Ipsos Retail Performance, said: "The retail sector starts 2014 in a far better place than it was in a year ago. Demand in particular has strengthened as a result of growing consumer confidence, employment and job security, though margins remain under pressure from the need to discount. In truth, the final quarter of the year failed to match the heights of the summer, underlining the fragility of the recovery. It culminated in a Christmas of consumer convenience, when people shopped at a time to suit them and a channel dependent on their location at the time, whether at home, at work, or out and about. The winners were those that offered a seamless multichannel operation and those that didn't panic and discount too early or too heavily.”

David McCorquodale, Head of Retail, KPMG UK, said: "2013 saw a comeback in consumer confidence. Sales this Christmas revealed the winners to be those retailers who have made significant investment in multichannel systems and operations during the downturn. Whilst family budgets will remain constrained until wage rate inflation overtakes cost inflation, there is time for retailers to catch up and invest as demand in Q1 2014 will remain muted. However, the meter is ticking and only those who prepare for growth will attain growth; others will slip into the 'zombie' category. I see a wave of retail IPOs bringing focus on the sector in early 2014 which will assist the barometer of consumer confidence and help lay the foundations for future recovery."

Nick Bubb, Retail Consultant to Zeus Capital, said: "Apart from just how late the final Christmas spending surge came, the big surprise of Q4 was how difficult a time the major food retailers had. As the dust settles on Christmas trading in food retailing, it look as if the accelerating channel shift to both more online shopping and more convenience store shopping is causing big problems for even the best equipped operators in the supermarket industry."

James Knightley, a senior global economist at ING, said: “Economists have been calling the turn in the UK economy some time now, but the hard pressed household sector has been slow to actually feel it. With unemployment falling rapidly and household wealth starting to rise as the property market heats-up and stock market continues to strengthen, there is now a growing sense that the economy is moving in the right direction. As such, consumers look set to loosen the purse strings a little more and with wage growth set to pick up through the year there is likely to be a little bit more money available to spend."

Neil Saunders, Managing Director of Retail Analysts, Conlumino, said: "The final quarter of the year showed some progress in growth terms, although probably not as much as retailers would have liked. However, the point is that retail is now firmly back in growth and that growth seems to be sustainable. But no-one should pretend that things are easy; retail remains crowded and competitive and this type of environment simulates discounting and potentially erodes margins."

Mark Teale, Head of Retail Research at CBRE said: "The smattering of early Christmas results point to a continuation of the squeezed household middle with only discounting, at one end, and luxury at the other bucking the trend. Improvements in economic optimism have yet to feed through into a significant sales upturn. Household spending in real terms remains 1.5% below Q4 2007 levels: some measure of the mountain still left to climb. There is London of course, which continues to glide effortlessly through the downturn on a wave of overseas money. Catering is on a roll too. So are discounters and luxury/aspirational players. No great surprise that JLP, Next, Waitrose and Sainsbury's are weathering the difficulties much better than M&S, Debenhams, Tesco and Morrisons. Internet-driven margin dilution meanwhile continues to exacerbate sector weakness and not just in grocery markets. Chain expansion activity, the real bellwether of sector health, remains stuck at a record low as a result. The opportunity to stimulate a widespread consumer feel-good factor in the run-up to the 2015 election looks to be slipping away. 2014 is shaping up to be more of the same."

Richard Lowe, Head of Retail & Wholesale at Barclays, said: "Consumer confidence improved in early 2013 and this continued through the summer, supported by the excellent weather, although consumers became more cautious during autumn. The Christmas season got off to a slow start, but ratcheted up during the final days before Christmas, as retailers pulled out all the stops with special promotions to draw shoppers into their stores. The food sector has had a particularly challenging Christmas trading period and there was a very mixed performance across the whole sector. Looking at the next quarter, it is likely shoppers will be keen to tighten their purse strings after the expense of the festive season, but retailers will be hoping that the improving UK economy will lead to increased confidence as the year progresses."

-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, Retail Consultant to Zeus Capital

Dr. Tim Denison, Ipsos Retail Performance
David McCorquodale, KPMG
Martin Hayward, HAYWARD Strategy and Futures
Neil Saunders, Conlumino
Richard Lowe, Barclays Retail & Wholesale Sectors
Mark Teale, CB Richard Ellis
James Knightley, ING

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.

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