UK retail prospects for 2019: The struggle will intensify regardless of Brexit

December 2018

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

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

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

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

Looking ahead to 2019

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Ends

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

KPMG/Ipsos Retail Think Tank

James Knightley, ING Chief International Economist:

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

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

Recent scenario analysis produced by the Bank of England also talked of a deep recession, surging unemployment and collapsing asset prices in such a situation. However, there is little appetite for such an extreme form of Brexit within the House of Commons, aside from a handful of Brexit "purists". Moreover, recent parliamentary votes and proposed amendments suggest a "softer" form of Brexit remains the most likely outcome. Indeed, there is growing talk of a "Norway plus" model, which would leave things relatively unchanged (Customs Union + single market, but without any say on the rules) while betting markets continue to see the odds of a second referendum slashed – 18 months ago it was priced at 20/1, today it is as low as 6/5.

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

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

Dr Tim Denison, Director of Retail Intelligence – Ipsos Retail Performance:

2018 was always going to be another tough year for retailing and brutal to those retailers that failed to be agile and responsive to the market dynamics– and so it transpired. Retail footfall is projected to have fallen by 8% on 2017 by the end of the year, its steepest decline this century. Announcements of CVAs, store closure programmes and swathes of job losses littered the headlines and UK high streets. Retailers and reputations, built up over decades, were brought down in mere months. For many others though, the hardship of working through business transformation programmes should help them savour success again in the future. These times are like no other in the history of retailing especially with Brexit now looming larger than Trump, but I will leave other, more notary RTT Members, to pick their way through the implications of that modern-day version of "no man's land".

Technology continues to play a significant role in the future direction that retailing is taking. Three streams, in particular, are worthy of a call out. AI and machine learning are beginning to deliver results in supply chain efficiency and inventory management, much needed in the omni-channel world. They are also producing direct benefits to shoppers, for example by offering personalised discounts on items bought regularly. Scan-and-go and checkout-free facilities are also making headway and stand every chance of hitting mainstream retailing in 2019, thanks to the omnipotence of mobile technology and payment apps. Finally, voice-recognition technology shows every sign of replacing the popularity of text-tapping. Over 1 in 5 households in the UK now have a smart speaker and seem open to the idea of using it to shop.

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

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

Paul Martin, UK Head of Retail – KPMG:

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

It's all too easy to focus only on the negatives but we should remember that the UK retail sector is a £360bn economy which, whilst changing, is likely to have grown by approximately 2% in 2018.

Growth in 2019 is likely to be similar, but the main caveat to short-term growth is the political landscape. A no-deal Brexit will significantly dent the growth potential of certain parts of UK retail, including increased shop-floor prices for the consumer, reduced profitability for the retailer and accelerated distress for those businesses particularly exposed.
It is too easy though to point the finger at Brexit as the singular cause of all the woes in the industry. There is in fact a much wider array of forces at play currently. These forces have been gathering momentum for a number of years and are by no means new, albeit 2018 did see many of them connect to create a toxic cocktail.

There are six main forces to highlight:

- Macro-economic and geopolitical challenges
- Regulatory and compliance-related initiatives and costs
- Structural changes to the sector, including changing consumption behaviour
- The over-supply of physical stores
- High levels of legacy debt (financial, IT infrastructure investment and changes to the ways of working)
- Lack of leadership talent to deliver change

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

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

1. **Growth** has to remain a firm agenda topic for retail businesses, whether that takes the form of M&A, product and/or service innovation or perhaps through partnerships, which is increasingly the case these days. M&A should not only take the form of defensive consolidation, businesses increasingly need to 'care and dare' and think outside of the box.
2. **Cost & efficiency:** Most retail businesses continue to carry excess costs, so exploring ways to become even more cost focussed in the future is crucial. Many cost optimisation initiatives have not delivered the expected results in the long-term, but this shouldn't deter retailers from revisiting their approach. At the same time, becoming more efficient is also paramount – increasing productivity and using cognitive and physical automation will undoubtedly divide the winners from the losers.
3. **Customer:** Those businesses that know who their customers are, and why they choose to visit and interact with them, hold the recipe for success. The days of being product-centric or having great store locations are over – it is no longer good enough. Winning access to the consumer's wallet is only going to become more competitive, especially if the economic backdrop deteriorates. As such, establishing a customer centric culture (this doesn't mean adapting everything for the customer at any cost), as well as engaging and rewarding a retailer's workforce, will go hand-in-hand.
4. **People:** The word 'transformation' is certainly overused, but the concept is here stay. Many successful organisations consider themselves to already be in a permanent state of transformation. Historically many transformation projects have focussed on IT architecture, processes and organisational structures, but often these have forgotten the most important ingredient which is the workforce behind these tasks and procedures. It is evident that customer behaviours have changed over the last 20 years, but so too have the behaviours of

a retailer's employees. With this in mind, without taking employees on this journey of change, success is unlikely.

5. **Brand & Reputation:** It's often cited that "a brand that is built over many years can be destroyed in minutes", and that is especially true today. Brand and reputational risk has become a top-3 CEO issue for many organisations. Retailers are facing a plethora of regulatory and compliance-related initiatives and they need to demonstrate how they are addressing these. Ignoring these can result in the most significant ramifications, whilst embracing and shaping these can deliver a completive advantage.

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

Martin Hayward, Founder – Hayward Strategy and Futures:

For those who seek uncertainty, challenge and change, 2019 will again be a great year to work in retail management as the industry continues to adapt to new technologies and consumer behaviours. In many ways though, the path to success is clearer now than it has been for some time as the industry, legislators and consumers begin to better understand the new landscape and look to integrate the strengths of traditional stores with the benefits of new distribution models.

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

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

- The real cost of delivery/ returns is now being better understood and will begin to influence charges and business models in favour of in-store shopping or click and collect models.
- A mass of legislation will begin to emerge that will address:
  - The tax avoidance that international internet based businesses have enjoyed for many years
  - The real cost of home delivery on urban congestion
  - The employment practices and costs of unregistered couriers
  - The unfair loading of business rates onto traditional retailers
- A renewed focus on the importance of local shopping for the quality of life and economic viability of smaller towns
- Consumers will begin to realise that home shopping is useful, but that it is sedentary and often less fun or inspiring than browsing in a real store (c.f. the resurgence of real books, live music, food markets) – there is a wonderful irony in the uptake of fitness tracking devices to encourage movement at the same time as a growth in devices that remove the need to move at all to change TV channel, turn on lights etc.

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

Maureen Hinton, GlobalData:

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

But even those that manage to survive are under immense pressure. Apart from the uncertainties of Brexit and fragile consumer confidence, the nature of demand has changed inexorably. Consumers want convenience and value and the UK is way ahead of any other country in its penetration of online shopping; 16% of total retail spending is already online, but in a sector such as electricals online is over half of total spending, while clothing and footwear is already over 20% and heading for 30% in the next five years. This has put vulnerable clothing retailers in this highly fragmented sector under even more pressure as the shift to online pureplays has diluted spend in physical retail.

There does remain a place for physical retail but the pace of change has outstripped retailers' capacity to resize their store portfolios. Stuck with rising costs, long leases and declining margins, many do not have the means to invest in their stores and product, and give consumers a reason to visit or spend, or to invest in technology to offer the seamless online experience pureplays deliver.
Despite Mike Ashley's comprehensive analysis for the Housing, Communities and Local Government Committee on the problems of the high street and how to fix it, the government is unlikely to do anything to help in 2019, (even if it really understood the problems) and even out the costs/taxes for physical and online businesses, it is too preoccupied with Brexit.

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

Walmart is obviously keen to leave the UK market, but Amazon is expanding and will be putting food incumbents under further pressure as it opens its Amazon Go stores. Consolidation seems inevitable in the food & grocery sector quite apart from the proposed Sainsburys/Asda deal.
Amazon could still make an acquisition or a strategic partnership, as could the Chinese, and use their tech capabilities to disrupt the market further. With such pressure on demand, and overcapacity in the retail industry, there is no room for new entrants unless they can offer something very different from that on offer from incumbents.

Martin Newman, CEO – Practicology:

Despite the challenges over the last couple of years, I believe that we have arrived at the perfect storm for retailers.
Consumer confidence is low. Lower than it's been for years. And consumer spend continues to edge away from 'buying stuff' and instead move towards 'having experiences'.
Although many retailers have made plans for Brexit, crucially some have not, and it continues to cast a shadow over the retail landscape.
Add to this the pressing requirement for retailers to become socially responsible. Consumers today are increasingly taking issue with single use and plastic packaging, demanding that retailers pay more than just lip service to their supply chain and how they look after their employees.
And of course, retailers are having to continually adapt their operating models to accommodate the demand from consumers to 'shop their way.' Customer expectations for their shopping experiences have largely been defined by the disruptive retail brands who have created new and more convenient ways for customers to buy and have their orders fulfilled.

Just as in 2018, retailers with the biggest challenge in the year ahead will be those stuck in the middle. Retailers with a homogenous product and price proposition or a lack of clarity over their value proposition, purpose and relevance are at risk. Especially as many also find themselves with too many under-performing stores in their portfolio. These brands need to re-think what their customer value proposition is, how they can maintain the relevance of their products and services and make plans for extending the lifetime value of customers to their business.

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

In 2019, I expect to see more third-party entities supporting high street retail, just like Visa and others have done in recent advertising campaigns. However, landlords need to re-think their approach to leases and provide the opportunity and flexibility for both artisan brands and pop ups to fill the empty spaces in high streets around the UK. Do this, and it will provide consumers with more reason to visit their local high street.
Last but not least, retailers would do well to remember that a customer is for life and not just for Christmas. It's never been more important to focus on customer lifetime value and how to drive engagement with customers. To achieve this, retailers need to become service providers, finding ways of making life easier for customers and in doing so, giving them more reasons to be loyal.

Mike Watkins, Head of Retailer and Business Insight – Nielsen UK:

The end of 2018 was a turning point in the fortunes of many food retailers.
After indulgences during the hottest summer in many decades and a brief uptick in expenditure very late in the festive season, shoppers hit a tipping point and finally started to hold back grocery household spend in Q4.

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

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

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

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

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

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

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

Nick Bubb, Retail Consultant:

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

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

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

But people still have to eat, so Food Retailers have some defensive strengths, in a sector with relatively low Online sales penetration, whereas the General Retailers are exposed to the vagaries of discretionary consumer spending and the pressures of greater pure play Online competition. And the quoted General Retail sector has had a very difficult year, with share prices on average over 20% down so far in 2018.

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

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

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

James Sawley, Head of Retail & Leisure at HSBC:

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

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

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

I must summarise in saying that the sector isn't all doom and gloom, there are shoots of growth and rays of sunshine out there. Value retailers are marching on with successful store openings, countering the wider sector trends. Online is still unparalleled in terms of growth and demand, trading without borders with the globe as their market place. The 'last man standing' retailers, i.e those left trading in categories in which disruption has almost been fully played out and are now reaping the rewards of fighting a hard battle. And lastly, retailers with the strongest brand value and identity, and in most cases having loyal followers, these are the types of retailers I expect will continue to perform well, winning market share in 2019.

Jonathan De Mello, Head of Retail Consultancy – Harper Dennis Hobbs:

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

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

The increased flexibility within property leases certainly helps retailers, but clearly does not deal with the other issues retailers face such as exorbitant business rates, and falling demand. Retailers entering CVA or administration prior to rent quarter day (in order to renege on property debts – among other debts) occurs more and more frequently these days – but landlords have arguably never been as pliable as they have been before as they know that – without their tenants – they themselves would face ruin. A lot of the over-rented stores retailers have in their portfolios are self-inflicted; down to over-aggressive expansion – typically driven by private equity ownership. This is particularly true in the casual dining market – where a prime West End unit would a couple of years ago have had 20+ bidders bidding aggressively for it. In this context, it is clear to see that the business failures we have seen in the casual dining sector in 2017 and 2018 were pretty much inevitable. From the viewpoint of landlords' willingness to do deals and retain tenants in their centres, Mike Ashley's stance against Intu – which would essentially be shooting both House of Fraser and Sports Direct in the foot if he pulled their stores out of all Intu schemes – is pure hyperbole in my opinion; designed to make a statement and pressure Intu into giving him the deal he actually wants. It is a bully boy tactic but one that is likely to work in Intu's case – given the state of their share price following the very public discussion around this issue, and John Whittaker's subsequent withdrawal of the acquisition of a controlling stake in Intu. While I don't see many – if any – retailers entering CVA prior to December 25th, Q1 2019 rent day (March 25th) will be an interesting one to watch, given likely poor Christmas trading for many physical retailers over Christmas – if early indications from Black Friday (and the huge amount of promotional activity seen in-store) are anything to go by. Having some certainty on Brexit either way is key right now for retailers – and the wider consumer – and the sooner the better.

Ends

Note to Editors:

The RTT panellists rely on their depth of personal experience and sector knowledge, and review a comprehensive bank of industry and government datasets. More in-depth comments from the individual RTT members on this white paper can be found at www.retailthinktank.co.uk/whitepapers.

Members of the RTT are:

• Nick Bubb – Independent Retail Analyst
• Dr. Tim Denison – Ipsos Retail Performance
• Jonathan De Mello – Harper Dennis Hobbs
• Martin Hayward – Hayward Strategy and Futures
• Maureen Hinton – GlobalData Retail
• James Knightley – ING
• Paul Martin – KPMG
• Martin Newman – The Customer First Group
• James Sawley - HSBC
• Mike Watkins – Nielsen

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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.

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