

MCA

A POSITIVE FORCE
FOR THE ECONOMY

The New Norm

Retail



December 2009

RETAIL

As part of the **New Norm Series**, which looks at what the business landscape will look like after the recession, the Management Consultancies Association (MCA) has surveyed its member companies, whose clients include 90 of the FTSE 100, with a particular expertise in the retail sector. This report looks at the state of the retail sector today, and in the future, and how businesses can prepare to thrive in the upturn.

Key findings

- 80% of consultants believe retailers have responded “quite successfully” to the recession, although only 5% think they have been “very successful”.
- 46% believe that UK retailers are either “very well” or “quite well” positioned to take advantage of the recovery, relative to those in other European countries.
- 40% of consultants rate innovation as the most important strategy for retailers, ahead of online sales (33%), and keeping costs low and overseas sourcing (20% each).
- 70% of retailers are primarily focused on keeping costs under control. Innovation levels are low with only 29% of organisations actively exploiting the opportunities the recession has presented.
- Value/low price retailers will continue to gain market share and consumers will continue to be concerned about paying off their old debts rather than taking on new ones.
- Large retailers such as supermarket chains are likely to seize the opportunity to move into new product areas.
- High streets will change forever, as many smaller chains and boutiques have failed during the recession. Only those with the most specialist offerings and clearest consumer propositions will survive.
- Consumers, wanting to socialise as well as shop, will be more likely to travel to large shopping centres, however it is unclear whether this will increase their spending habits.

“Consumer confidence is rising and there’s a sense that there is some spending out there to be fought over... But 2010 has many uncertainties, including on jobs, taxes and government spending. They could well undermine the extra willingness to shop we’ve seen from customers recently¹.”

Richard Lim, British Retail Consortium

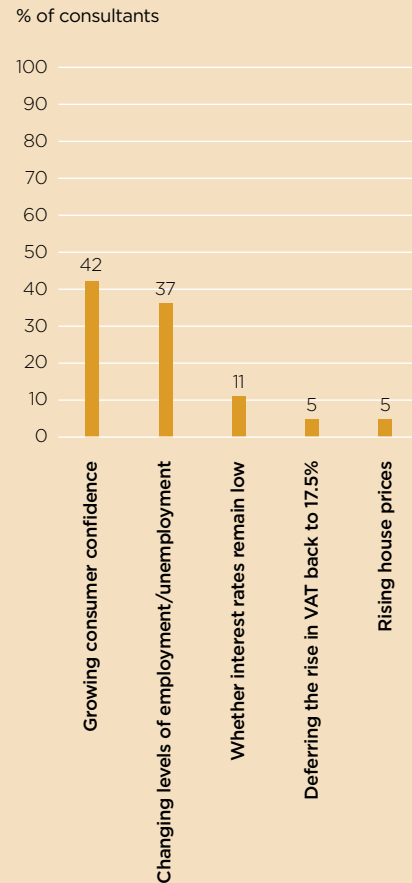
An MCA survey² of consultancies who work with most top 50 retailers and FTSE 100 companies has confirmed the uncertainty facing Britain’s retailers. Broadly speaking, consultants think the UK retail sector has weathered the economic storm reasonably well.

- Almost 80% of respondents said that retailers had responded “quite successfully”, although only 5% thought they had been “very successful”.
- 40% said the sector had responded better to this recession than to previous ones.
- 46% believed that UK retailers were either “very well” or “quite well” positioned to take advantage of the recovery, relative to those in other European countries.

However, consultants are very cautious about the prospects for a swift recovery: a third believe that further decline is likely, and the remaining two thirds think either that the sector is bumping along the bottom of the cycle or that the recovery is slender and slow. “Recent indicators do suggest that things are improving,” says Matt Crosby at Hay Group, “but some of the increase stems from government intervention and discounting. And if the government mistimes the schedule for paying back the public sector debt, there’s a risk of a double-dip recession. It’s hard to find signs of sustainable recovery.” At Deloitte, Richard Hyman thinks that the fact that the sector has borne up better than expected is a tribute to the strength of the UK’s expertise in this field: “Retailers have fought their corner well and proved themselves to be tactically smart.”

“But,” he warns, “many of the problems we anticipated in the retail sector in 2009 haven’t gone away. They’ve been postponed, not cancelled.” But these positive signs are having one beneficial effect: helping to improve consumer confidence. “Consumers have a sense that this is the bottom, that things aren’t going to get any worse,” comments Martin Fletcher at LCP Consulting. That is important because, alongside unemployment levels, consultants believe that consumer confidence will be critical in determining the strength and speed of recovery (Figure 1).

Figure 1 Which one factor will be most important in determining whether the retail sector recovers in the next year?



¹ 19 November 2009

² Management Consultancies Association survey of member firms, November 2009

“There are encouraging signs, but how long will the recovery take? Most retailers think the turnaround will continue but that there will be setbacks throughout 2010.”

Tony Nugent, HCL Axon

The key to responding to these challenging circumstances, consultants believe, has been innovation. 40% of consultants who responded to the survey rated this as the most important strategy for retailers, ahead of online sales (33%), and keeping costs low and overseas sourcing (20% each). For every Woolworths-like failure, there has been another retailer taking advantage of the recession, honing their value proposition to consumers. “These are now the retailers who, having invested time in thinking about their strategy, are now primed to grow quickly,” continues Martin Fletcher at LCP Consulting. “The key to success in the future will be for retailers to become demand, rather than supply, driven,” argues Richard Hyman at Deloitte. “Already we can see a difference between the retailers who are genuinely tuned into consumer behaviour, and the difference between them and less competitive companies will become clearer over the next year.”

However, the MCA survey suggests that innovative retailers are likely to be in the minority. According to the consultants surveyed, 70% of retailers are primarily focused on keeping costs under control (Figure 2). Indeed, innovation appears to be bottom of the list of priorities, with only 29% of organisations actively exploiting the opportunities the recession has presented.

“The Christmas period will be critical. There are a lot of investment decisions waiting for final approval at the moment, but no one’s going to sign anything off until they’ve seen the actual figures.”

Tony Nugent, HCL Axon

Although the main constraint has been cash-flow, there are other factors which have hampered UK retailers’ ability to innovate (Figure 3). The inability to be able to forecast sales with any degree of certainty and fluctuations in their supply chains have made it particularly hard for companies to invest. These conclusions contrast with those that previous MCA surveys have identified in other sectors. Elsewhere, the main barrier to innovation has been lack of leadership. Here, it appears that there are both ideas and the willingness to innovate at all levels in the organisation; what is lacking is cash and the ability to calculate what the return on investment will be.

Figure 2 What strategies are retailers using to position themselves for the recovery?

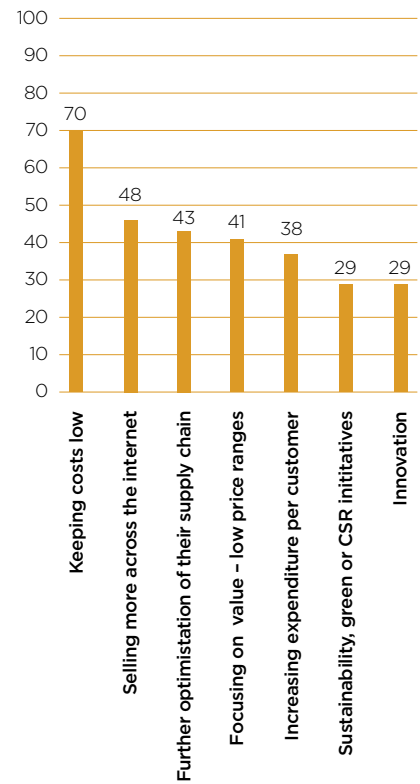
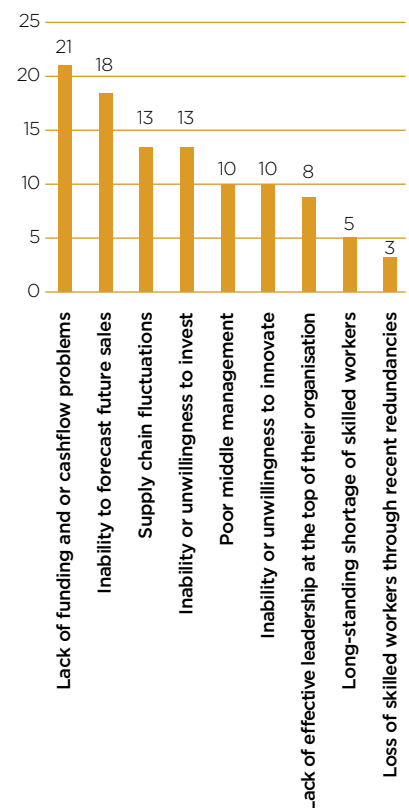


Figure 3 What are the key barriers for retailers in preparing for recovery?

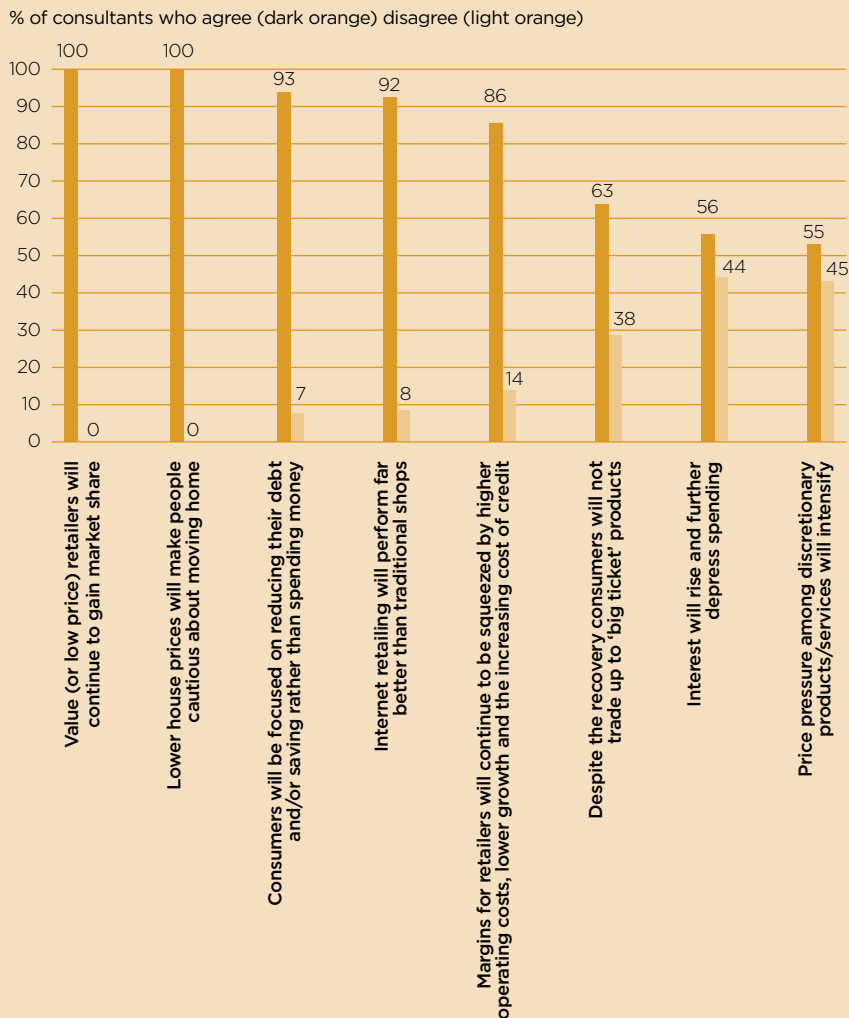


“If you didn’t have a particularly big and well-managed business, the recession has simply found you out.”

Antony Rawlins, Xantus Consulting

What does all this say about the post-recession retail environment? Not surprisingly, the MCA survey suggests that value/low price retailers will continue to gain market share and that consumers will continue to be concerned about paying off their old debts rather than taking on new ones (Figure 4). However, it also indicates the extent to which the recession has made internet shopping far more important.

Figure 4 Features in the post-recession retail environment



“Retailers will have to start looking beyond conventional ideas of service. Customers want solutions, not products, and the successful retailers of the future will understand they have to anticipate customer needs, not just react to them.”

Philip Michell, Vertex

- **The big will get bigger:** Because those retailers with cash are better able to innovate, the big retailers will gain ground. This is particularly true, though not exclusively, of the large supermarket chains which are likely to seize the opportunity to move into new product areas. “These companies have demonstrated that they have a very good business model, consistently growing through the downturn,” Antony Rawlins at Xantus Consulting points out. “You only have to look at Wal-Mart to understand the extent to which they could still diversify, into homeware, leisure and electronic goods, for example. Perhaps we’ll even see supermarkets selling cars in the future.”
- **A growing shift to “social” shopping:** High streets will also change forever, as many smaller chains and boutiques will have failed during the recession. Only those with the most specialist offerings and clearest consumer propositions will survive. Consumers, wanting to socialise as well as shop, will be more likely to travel to Westfield-like centres or revitalised destination shopping locations in city centres. How much they spend there will be a different question altogether.
- **Multi-channel retailing will become a reality:** Sites such as eBay, which create a market in which individuals or micro businesses can trade, mean that a vast amount of “retailing” no longer appears in conventional statistics. “This is something that has been growing for the last ten years, but still represents a huge structural change in retailing,” says Mark Turner at LCP Consulting. The larger retail chains will, however, have to respond to the growing challenge of online retailing. Some analysts are forecasting that a quarter of all shopping could take place online within the next ten years, so traditional retailers need to become genuinely multi-channel.

“If you look at an average town, lots of people have gone out of business and shops have closed down. It’s a pretty bleak landscape and not a particularly enticing shopping experience. Major shopping centres have fared better and these are likely to become the main places where the social aspects of shopping take place.”

Mark Turner, LCP Consulting

“What we should be seeing is the re-invention of retail.”

Mark Turner, LCP Consulting

- Margins will be lower:** One of the underlying problems which has been exacerbated, but not caused by, the recession is excess capacity. Consumer demand has grown almost without pause for the last 40 years, growth that has been served both by new store openings and online sales. Moreover, internet capacity has continued to grow during the recession, driving up capacity further, even as demand falls. “This is at the heart of the structural change in this sector,” says Richard Hyman, “but most retailers have yet to adapt to the much lower return from capacity this will result in.”
- Quality of service will be the key differentiator:** At the same time, many bricks-and-mortar retailers will struggle with poor service. The remorseless focus on costs during the recession has resulted in widespread dissatisfaction and lack of engagement among shop-floor staff. “Hay Group’s The Loyalty Deficit is based on an independent study of frontline employees across both the private and public sectors. It shows that employee engagement levels stand significantly below normal levels - this will translate into a poor quality shopping experience, just at a time when the quality of service is going to be critical to keeping customers,” says Hay Group’s Matt Crosby. The rise of internet shopping poses an additional challenge: “Retailers will have to start thinking much harder about how they ensure their people embody their strategy,” Clare Martin at SFL points out. “They shouldn’t assume that the skills required in online shopping are the same as those needed in a traditional store. They need a totally different mindset.”
- Pent-up demand for internal change will peak in 2011:** As the MCA’s survey illustrates, one of the ramifications of the fierce cost control of the last two years has been low levels of investment in new initiatives. Past recessions suggest that this pressure cannot be maintained indefinitely: competitor moves, changes in technology and simple boredom among senior executives, will combine to create a wave of new initiatives. “But their nature will be different,” warns Tony Nugent at HCL Axon. “New technology, as a means of keeping costs low while increasing flexibility, will be crucial; payback periods will be shorter; more functions will be offshored.”
- Retailers will have to take responsibility for stimulating demand, not governments:** Retailers face the challenge of government intervention and the prospect of initiatives that a new government may introduce should they come to power. VAT and other tax increases will make it harder for retailers to get themselves back on to a sound financial footing. Moreover, whatever the result of next year’s General Election, it is clear that substantial cuts in public sector expenditure are necessary and these will have an effect on consumer expenditure. “Retailers will need to go back 20 years and try to stimulate demand by extending credit,” says Philip Michell at Vertex.

We are grateful to the following MCA member firms for their contribution to this report

- Boxwood
- Corpra
- Change Management Group
- Deloitte
- Hay Group
- HCL AXON
- IBM Goba! Business Services
- LCP Consulting
- SFL Ltd
- Vertex
- Xantus Consulting

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