

COMMERCIAL BANKING

Business in Britain: Retail

A survey of key
sector opinions,
trends and insights.

September 2019

By the side of business



LLOYDS BANK

OUR CONTRIBUTORS



Scott Barton

Managing Director,
Head of Large Corporates,
Lloyds Bank Commercial Banking



Philipp Gutzwiller

Head of Retail,
Large Corporates,
Lloyds Bank Commercial Banking

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Welcome



Scott Barton

Managing Director,
Head of Large Corporates,
Lloyds Bank Commercial Banking

It might be an understatement to say that retailers have a lot on their plates at the moment.

In fact, there is perhaps no other major business sector in such a state of flux.

The industry is also exposed to considerable economic uncertainty, both domestic and international, which has potentially severe implications for businesses that are already seeing sales and margins put under pressure.

Failure to adapt to these new paradigms and capture the opportunities presented by technology can be fatal, and numerous stalwarts of the high street have now been consigned to history.

At the same time, nimble new contenders have muscled in to the market, creating a new generation of household retail names.

While declaring the death of the high street is premature – indeed we have seen plenty of

online brands open physical stores – it does seem that some of our town and city centres are struggling to adapt to the new retail environment.

In response to advances in technology, consumers are changing the way they shop to fit their lifestyle. As a bank, we will continue to support retailers in their transformation to this new paradigm, allowing them to remain competitive in the evolving market.

The retail sector remains vitally important to the UK economy. We're committed to understanding how the retail environment is evolving and are pleased to share our insights with you in this report.

It's designed to help inform our approach, while also providing fresh intelligence that can support strategic thinking in boardrooms across the country.

We hope you find it both informative and insightful.



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AT A GLANCE

71%

expect turnover to increase
over the next 5 years

86%

agree that the UK high street
is in crisis

51%

say it's time to reinvent the
in-store experience

Current environment and outlook



...potential threats to turnover growth range from the macroeconomic to sector- specific.



The UK retail sector is going through a prolonged period of upheaval, caused by a combination of changing consumer behaviour, digital disruption, macro uncertainty and new competitors.

Despite that, it remains the nation's largest private sector employer¹, supporting 2.9 million jobs, and accounting for a third of all consumer spending².

In order to capture a comprehensive overview of the industry, we spoke with corporate retailers in subsectors from grocery to clothing, and from department stores to convenience stores, all with turnovers of more than £50 million.

While close to two thirds (63%) said the majority of their sales were made in store, 37% said their sales were mostly online.

Of this diverse sample, 71% expected their turnover to increase in the next five years, by an average of 11%, with 9% forecasting no growth and 16% expecting turnover to decrease.

More than half (55%) forecast headcounts will grow over the same period, with a quarter (25%) planning to create more than 100 new jobs. Though roughly a fifth (21%) said their workforce would stay the same, a similar proportion (22%) said it would get smaller.

Eye for opportunity

Retail sales have been holding up during 2019, even as uncertainty weighed on consumers.

But retailers still have an eye for an opportunity and are pursuing a variety of routes to growth, led by applying new technologies to improve operations (15%), growing sales volumes (12%) and pursuing mergers and/or acquisitions (11%).

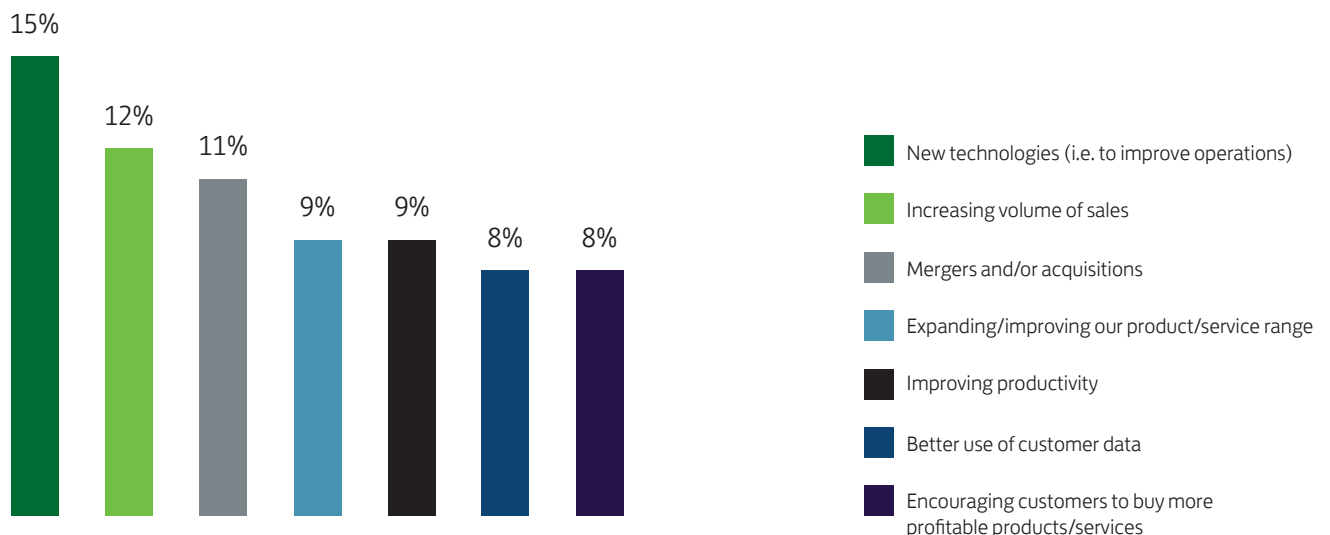
Other enterprising strategies include expanding and improving product ranges (9%), improving productivity (9%) and better use of customer data (8%).

Retailers are also looking to new markets overseas, with Eastern Europe (55%) and Western Europe (43%) being flagged as the territories with the greatest potential for the future.

This comes despite the UK's anticipated departure from the European Union and likely reflects Europe's geographical proximity to the UK and the logistical networks linking the UK with the continent.

But British retailers are looking further afield for growth, too, principally to North America (38%), China (31%) and Central and South America (31%).

What do you see as the main opportunities to grow your turnover in the future?



1. <https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/datasets/employmentbyindustryemp13>

2. <https://www.retailerconomics.co.uk/library-retail-stats-and-facts/employmentbyindustryemp13>

Hazards and headwinds

The last year has seen a number of high-profile retail failures, demonstrating the challenging environment all too clearly. Declining footfall, nimble online competitors, raising rates and rents and a weakening economy are considered by many to be the main culprits.

We also asked retailers about threats to turnover growth, ranging from macroeconomic to sector-specific issues.

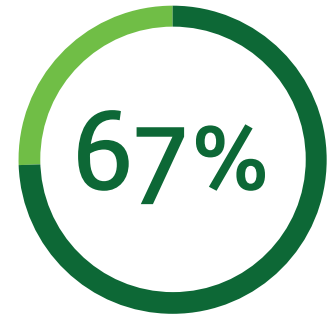
Weak economic growth in the UK came out as the primary concern, flagged as a threat by 44%.

This should not come as a surprise, given current Office for Budget Responsibility (OBR) forecasts of just 1.2% GDP growth in 2019 – the

lowest since the recession 10 years ago – rising to 1.4% in 2020 and 1.6% a year thereafter³.

The forecast of modest economic growth is only shared by 30% of respondents to our BIB research, while a similar proportion (29%) are expecting no growth and 38% are forecasting a contraction.

The second biggest threat to turnover increase was said to be the impact of the UK leaving the EU (38%). Many retailers have already reported the negative impact of Brexit uncertainty on their sales, particularly of big ticket items.



expect the economy to contract or stall in the next 12 months

Cashing out

Cash isn't dead yet, but could its demise be getting closer?

Processing cash is a time-consuming and increasingly costly business. Therefore the appeal of cashless retail is easy to understand.

There are other benefits too: with no cash on the premises, insurance premiums and security costs can fall, and contactless and card paying customers can be served more quickly.

All of which helps explain why a fifth (20%) of non-online-only retailers told us they would no longer accept coins of less than £1 in value in 12 months' time, with the same proportion going further and refusing any cash payments at all.

When asked to consider a five-year timeframe, almost a quarter (23%) said they would decline cash payments, with one in nine (11%) forecasting they would no longer

have any checkouts.

The use of cash is certainly in decline – debit cards overtook cash as the most frequently used payment method in 2017⁴.

However, it's important that the disappearance of cash doesn't negatively impact customers who rely on it. For example, those on low incomes or living in rural communities where alternative payment methods are affected by poor connectivity. In addition, the elderly and those with physical or mental health problems are also deemed to be vulnerable in a cashless society.

Suggestions have included introducing regulation or measures to ensure changes to the cash infrastructure to lower the cost and improve the convenience of handling cash for retailers.

3. <https://obr.uk/the-chairmans-presentation-on-our-latest-economic-and-fiscal-forecast-2/>
4. <https://www.bankofengland.co.uk/knowledgebank/will-cash-die-out>

Stocking up

The main impact of the UK's exit from the EU has so far been uncertainty.

Though just 11% of our survey sample said most of their sales were to customers outside the UK, overseas sales make up a significant proportion of revenues for many and have been boosted in recent years by the relative weakness of the pound.

But going forward UK retailers face the possibility of difficulties employing EU migrants due to new limits on freedom of movement, higher costs due to increased tariffs, compliance issues and disruption to supply chains.

As a result of this, more than half (56%) said that they had asked businesses in their supply chain to stockpile either finished products, semi-finished products or raw materials in the last year, while two in five (39%) said they anticipated doing so in the year ahead.

Among these firms, 81% said uncertainty surrounding the UK's future trading relationship with the EU was triggering this decision.

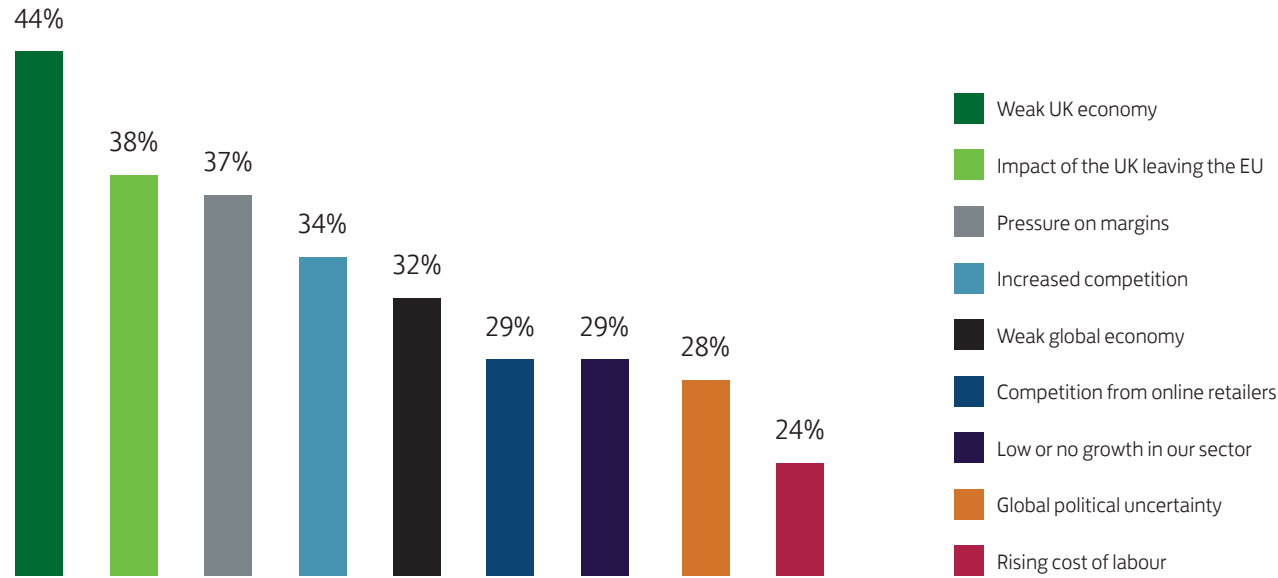
While stockpiling can help mitigate the risk of supply chain disruption, it is an expensive strategy that increases the amount of working capital required in a business, impacting access to capital and the bottom line.

As such, we'd expect to see firms reduce their inventories rather rapidly once they have more clarity about future trading conditions.

However, this could damage profits later down the line as retailers reduce prices in their hurry to sell off excess stock.



What do you see as the main threats to your turnover growth?



Bricks & Mortar

Every time another retailer fails, we read a raft of articles forecasting the death of the high street.

It is a phrase so well worn that it has become a cliché, but like so many overused expressions, it is rooted in an element of truth. The growing momentum behind the idea of an online sales tax in exchange for reduced business rates is the latest attempt to re-balance the playing field.

At the time of writing, almost one in six retail units lie empty⁵ and the number of high-profile retail and hospitality failures continues to increase.

Even in this context, it is perhaps surprising that a landslide 86% of the retailers we surveyed agreed that the UK high street is in crisis.

The reasons behind this are well understood. Three quarters (75%) agree that there has been a shift in the way shoppers use physical stores, where they will research in-store but continue their purchase online.

Almost two thirds (64%) say that shifting consumer habits are putting their business model under pressure.

Overcoming a crisis

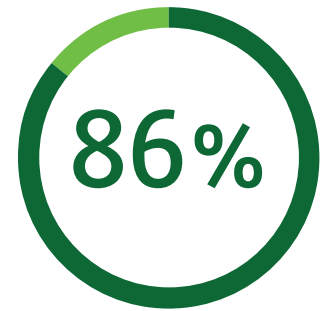
If the high street is in crisis as many retailers believe, how can this be overcome?

Some of the solutions suggested by respondents in this report displayed an admirable entrepreneurial streak, others focused on a desire for external support.

While 51% said it was incumbent on retailers to reinvent the in-store experience, 45% said retailers needed to find better ways to combine online and physical retailing and 35% said retailers could make better use of partners, like cafés or other customer-focused services in store.

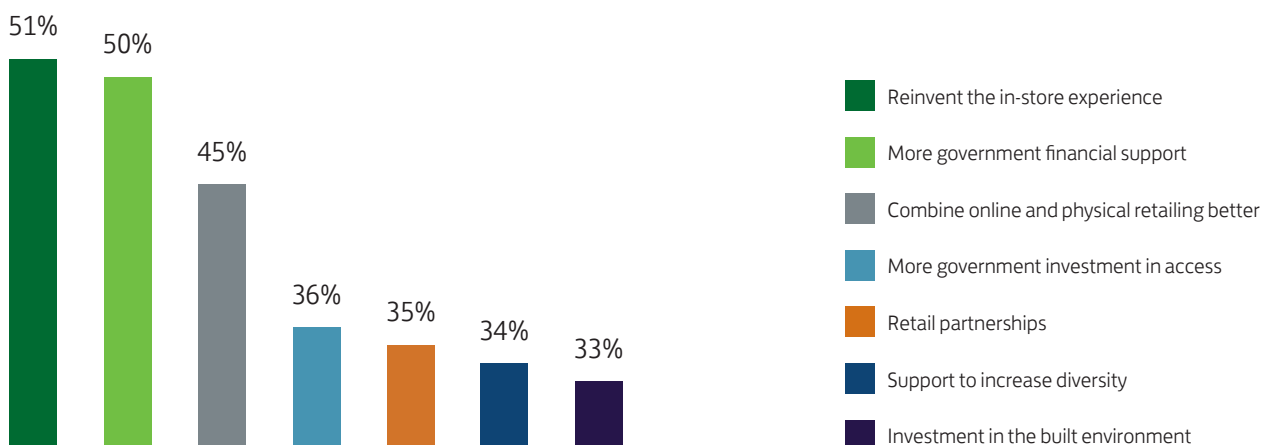
At the same time, half (50%) called for more financial support from government, for example through reduced business rates, with over a third (36%) arguing for greater investment in access routes like public transport or parking, and a similar number (34%) suggesting support such as incentives for specialist retailers or leisure businesses to increase diversity in town centres.

While support for retailers is always welcome, the most successful efforts to revitalise town centres across the country – such as by hosting events to drive footfall – have often resulted from private enterprises and local authorities working together to the same ends.



agree with the statement
“The UK high street is in crisis”

What do you think is needed for the high street to avoid crisis?



5. <https://www.rli.uk.com/16-of-retail-units-are-currently-empty-across-the-uk/>

Cutting costs

Of course, one of the first reactions to financial pressure is to reduce outgoings. One of the key areas of focus when reducing costs is to re-negotiate rent, an area where we have recently seen significant downward pressure.

It's one of the biggest overheads faced by bricks-and-mortar retailers, with many facing onerous legacy leases and upward only rent reviews.

More than half (55%) said they had taken steps to reduce the cost of their retail estate, primarily by seeking to renegotiate rents with landlords (43%).

Of those who had tried this approach, 72% said they had found landlords were sympathetic to their circumstances and were willing to negotiate, while 28% had not.

Other cost reduction measures included reducing maintenance spend (39%), closing stores (34%), relocating (31%) and entering CVAs (19%), the form of insolvency procedure where firms can restructure their debts, including closing underperforming stores and renegotiating rents, while continuing to trade.

But others had sought more creative solutions to boost profitability, by improving store layouts (39%) and opening partnerships or concessions in stores (25%).

Offering loss leaders is another well-established strategy for driving footfall, which half of our survey (49%) said they employed, rising to 62% in the grocery sector.

Retailers do this predominantly through daily, weekly or monthly promotions (67%) or a permanent selection of sale products (61%).

However, two thirds (65%) of all those currently offering loss leaders said they planned to stop in the next year.

Click-and-collect

More and more retailers are now offering click-and-collect services, often for free.

It is perhaps telling that retailers reported click-and-collect is now their most important driver of footfall (44%), above in-store promotions (40%).

While to some this might suggest that consumers have fallen out of love with the in-store shopping experience, the reality is likely to be more nuanced.

Click-and-collect has advantages for customers and stores alike; delivering to a single site rather than people's homes makes the logistics simpler and cheaper, so it's often offered free of charge.

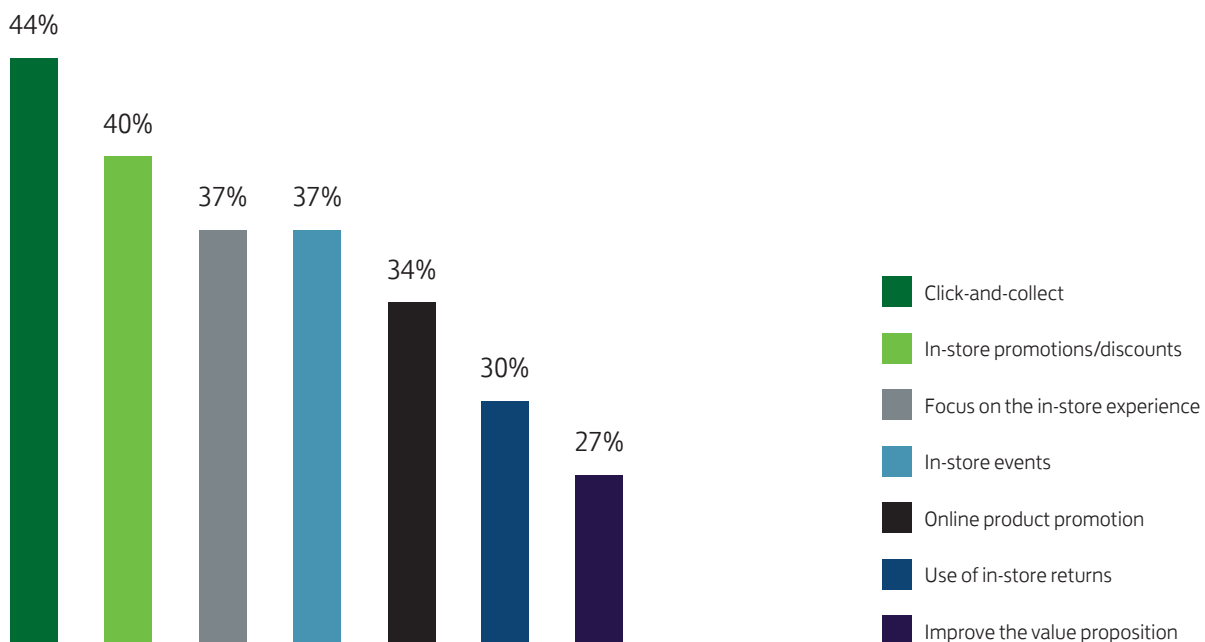
The footfall generated by people collecting or returning orders drives in-store sales too.

One study estimates that up to 70% of click-and-collect customers make impulse purchases in store⁶.

In the modern retail environment, it is critical for retailers to seamlessly link their in-store and online offers if they are to make the purchasing experience as frictionless as possible and achieve long-term customer loyalty.

It's heartening to see that, 61% of retailers told us while they plan to have fewer stores they will integrate their online operation to complement the physical experience.

What are the most important factors in attracting footfall into stores?



6. <https://www.bbc.co.uk/news/business-46960792>

Focus on experience

With consumers choosing to invest in experiences over products, retailers need to respond.

We recognise that retailers are exploring new ways to revitalise in-store sales to capture the evolving shopping habits of their customers.

Three quarters (75%) say there's been a shift in the way shoppers use physical stores, where they will research in-store but continue their purchasing online.

Half (51%) say they believe it's time to reinvent the in-store experience altogether.

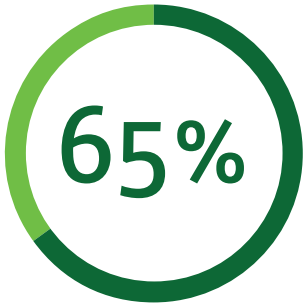
It's an ambitious aim, but it does seem that stores will have to redefine their offer in order to compete with, or complement, mobile and online ecommerce.

Increasingly, retailers seem convinced that the answer lies in providing an experience.

When we asked retailers how they were planning to create more footfall in their stores in the coming year, the top answer was through a focus on the in-store customer experience (39%).

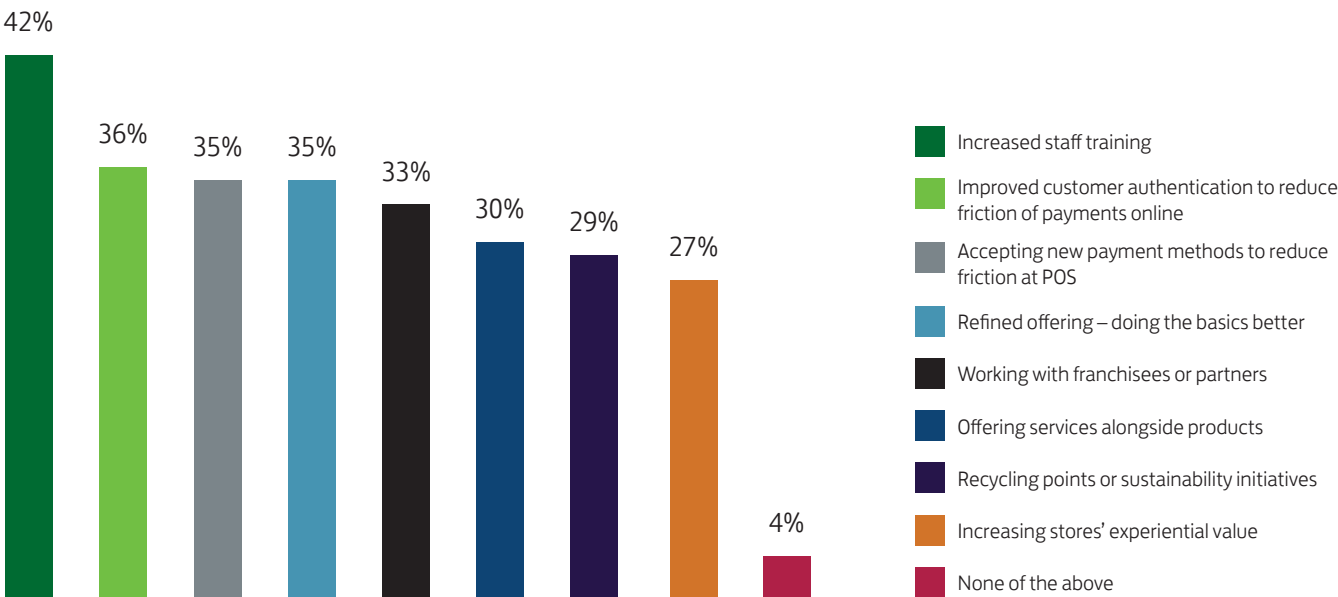


It seems it's no longer enough for customers to walk into a store, choose a product off the shelf, pay for it and leave, when they could instead do this from the comfort of their sofa at a time of their choice.



believe that, in the future, the main purpose of stores may be to offer consumers meaningful experiences rather than sell products

In which of the following areas have you invested to improve the customer experience in the last year?



It seems it's no longer enough for customers to walk into a store, choose a product off the shelf, pay for it and leave, when they could instead do this from the comfort of their sofa at a time of their choice.

Rather, they are looking for a more immersive encounter that adds value to their shopping experience.

So, we are seeing sports stores offering yoga classes, fashion retailers installing smart mirrors and employing style consultants. We further see increased use of technology on the shop floor, be it to let customers browse a broader range online or to seek product reviews, to take payment or to handle returns.

Retailers seem to be confident in this strategy.

Two thirds (65%) told this report that, in the future, the main purpose of a store may be to offer consumers meaningful experiences rather than to sell products.

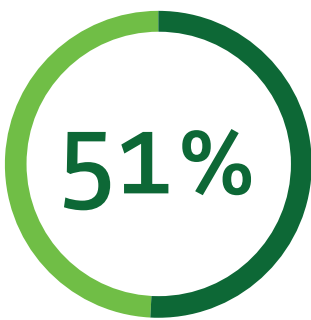
Enriched encounters

But what progress are retailers making towards providing an enriched retail experience?

Already, two thirds (66%) of the retailers we spoke to allow customers to view products in store for home delivery.

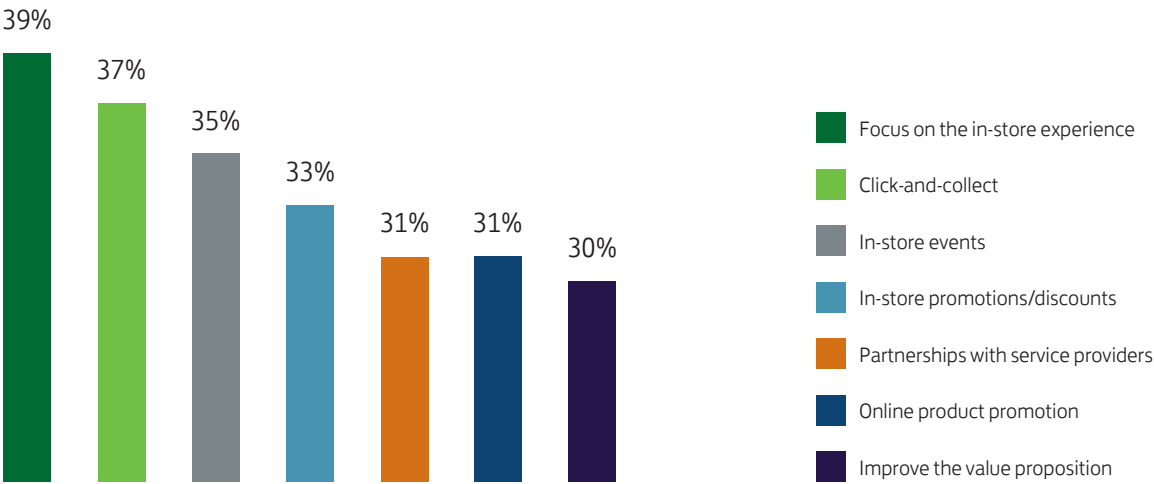
In addition, they have implemented a wide range of strategies to improve customer experience, including investing in staff training (42%), working with franchises or partners to attract customers and increase the amount of time they spend in store (33%), offering services (30%) and improving the experiential value of visiting stores (27%).

It seems likely that we will see more retailers introducing innovations like interactive mirrors, mobile POS systems, virtual reality, augmented reality and automated checkouts, with more than three quarters (77%) saying they plan to integrate more technology in-store.



say retailers must reinvent the customer experience in stores

How do you plan to create more footfall in your store in the coming year?



Online & Social

Nine in ten UK adults are now online, rising to 99% of 16 to 34-year-olds⁷.

There can be little debate that the emergence of e-commerce represents the most fundamental change to the retail sector in many decades.

The internet is expected to account for more than half (53%) of all retail sales within 10 years, up from about a fifth at present⁸.

Though most retailers have moved to establish an online presence, many have struggled to compete with online-only e-tailers, given the disproportionate overhead costs of high-street retail.

One of the trickiest aspects to navigate has proved to be the generational differences—the way that young people shop is now very different to older generations, yet many retailers still have to support a variety of shopping habits.

Another differentiator is the relative user experience when shopping online. Consumers have become used to the 'best in class' experience by leading e-tailers and don't trade that for brand loyalty for traditional retailers.

Peer reviews are also influencing consumer decisions like never before.

But the ways that retailers have sought to respond to the rise of e-commerce has been diverse.

The e-commerce opportunity

A fifth (21%) of those we surveyed had abandoned their bricks-and-mortar stores over the last five years and transformed into online-only retailers.

Counter-intuitively, the same proportion had taken the opposite tack, focusing on their retail estate instead.

This likely reflects the grocery sector opening smaller format convenience stores, particularly in urban areas, though more innovative retailers selling high value goods are also seeking to offer improved customer experiences through smaller portfolios of fewer but better stores.

More than a third (37%) had moved towards using multiple channels for the first time, though half (51%) were further along their evolutionary journey, shifting from using multiple channels to focus on greater integration of those channels. Looking forward, a fifth (20%) said they would no longer have any physical stores in a year's time, presumably becoming pure-play online retailers. When asked to look ahead five years, 18% said they would no longer have any stores.

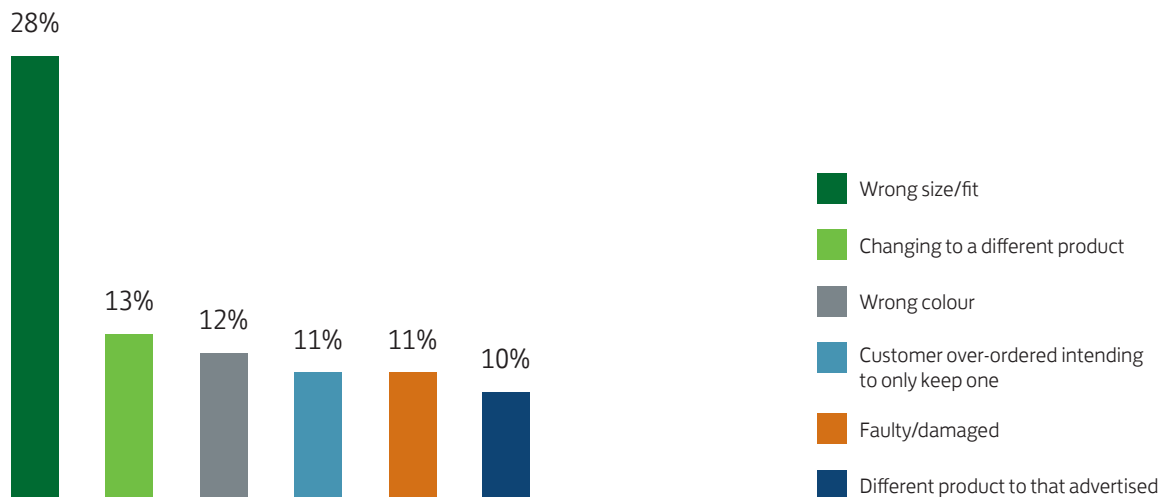


plan to delete their social media accounts in the next year



will no longer offer free delivery in a year's time

What is the main reason customers are returning items?



7. <https://www.ons.gov.uk/businessindustryandtrade/itandinternetindustry/bulletins/internetusers/2018>

8. <https://www.theguardian.com/business/2019/jul/09/half-of-uk-retail-sales-will-be-online-within-10-years-report-predicts>

And more than half (58%) plan to enter into partnerships with other retailers – either in distribution or fulfilment – to improve their service or reduce costs.

It seems more than likely we'll see a growing number of joint ventures like this, which can increase buying scale, grow revenues and bring greater brand awareness.

The social club

Social media isn't just about staying in touch any more.

Most recently, social media platforms have become central to online retail strategies, particularly for those targeting younger people, becoming sales channels as well as tools for marketing and customer service.

Social media platforms have been quick to introduce new e-commerce capabilities, and it seems that consumers are happy to engage.

More than three quarters (78%) of retailers told us that social media is an important tool to raise awareness of their brand and new products.

But less than half this number (34%) currently use insights gained from social media to inform their product development and/or marketing.

More than half (55%) said they planned to increase their social media budgets, specifically for managing customer service enquiries and marketing products.

And while a quarter (26%) of firms expect greater engagement with customers through organic social media in the next year, we also saw a small reaction against social, which will be interesting to monitor going forward.

A fifth (22%) planned to cut their social media budgets and 2% planned to delete their accounts altogether.

Return to sender

One of online retail's greatest strengths is the hassle-free returns

The ability to return any item on a whim is also core to its appeal.

While this can drive sales – one survey found three quarters (78%) of UK shoppers said the option of free returns makes them buy more⁹ – returns do have a financial impact on retailers, acting as a drag on working capital, much like stockpiling does.

More than half (54%) of online retailers said the number of returns they received caused issues with working capital, with two thirds of them (65%) saying these issues were significant.

While 47% said fewer than a fifth of sales were returned, 14% reported that more than half of all items were sent back.

When we exclude grocery and convenience stores from our sample, an average 24% of all sales were returned.

To mitigate this, online retailers are encouraging customers to take returns to stores (40%), offering more personalised

products (36%), using data to give more accurate sizing advice (31%) and charging for returns (29%).

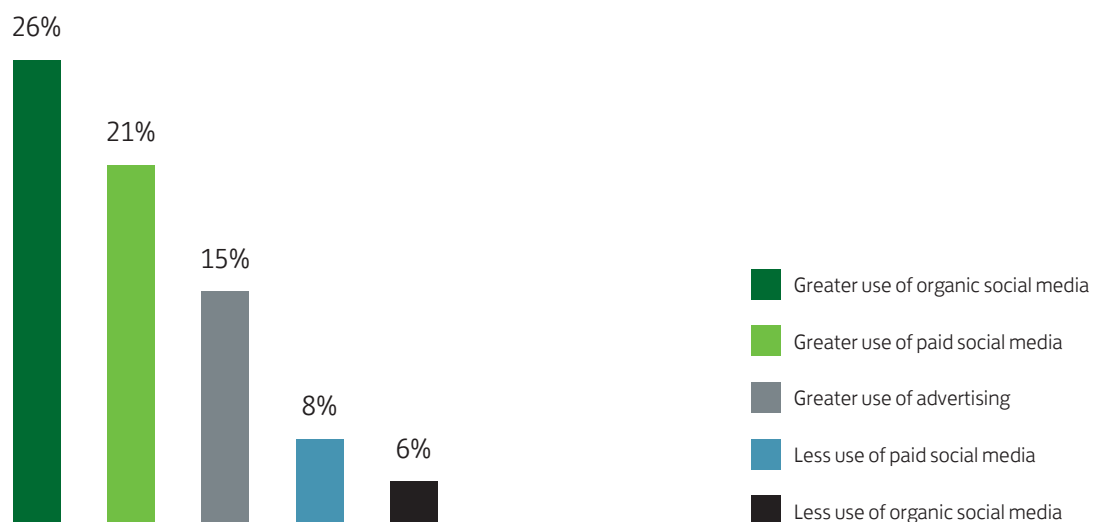
The main reason that customers are returning items, say those businesses we spoke to, is because they are the wrong size (28%) and this is an area where we believe technology can provide a solution.

Apps already exist that enable users to accurately measure their size by photographing their body.

We expect to see more examples of this kind of technology being integrated into e-commerce sites in the future.

Strikingly, 45% of respondents said a growing proportion of in-store sales are also being returned, suggesting the online shopping mindset is also transferring to the high street.

What is the main way you expect your engagement with customers to change in the next 12 months



9. <https://www.klarna.com/international/press/revolutionise-returns-78-of-shoppers-will-buy-more-in-the-long-run-if-a-retailer-has-free-returns/>

Data driven



Every online and in-store interaction leaves a trail that can help inform a retailer's strategy, bringing a greater understanding of existing customers' shopping habits and how to attract new consumers.



Data is perhaps the most valuable resource of the digital age.

Digital technology means retailers today know more about their customers than ever before.

Every online and in-store interaction leaves a trail that can help inform a retailer's strategy, bringing a greater understanding of existing customers' shopping habits and how to attract new consumers.

It means brands can give customers tailored recommendations based on their purchase history, creating a more personalised shopping experience.

It can inform store layout design to maximise sales and forecast what products to stock and when.

But applying big data effectively can be complex and expensive, requiring expertise and investment.

Increasingly, those brands that have access to big data and know how to use it have a real competitive advantage over their rivals.

Accordingly, it was no surprise to see that 93% of respondents already use data to inform their product development and/or marketing.

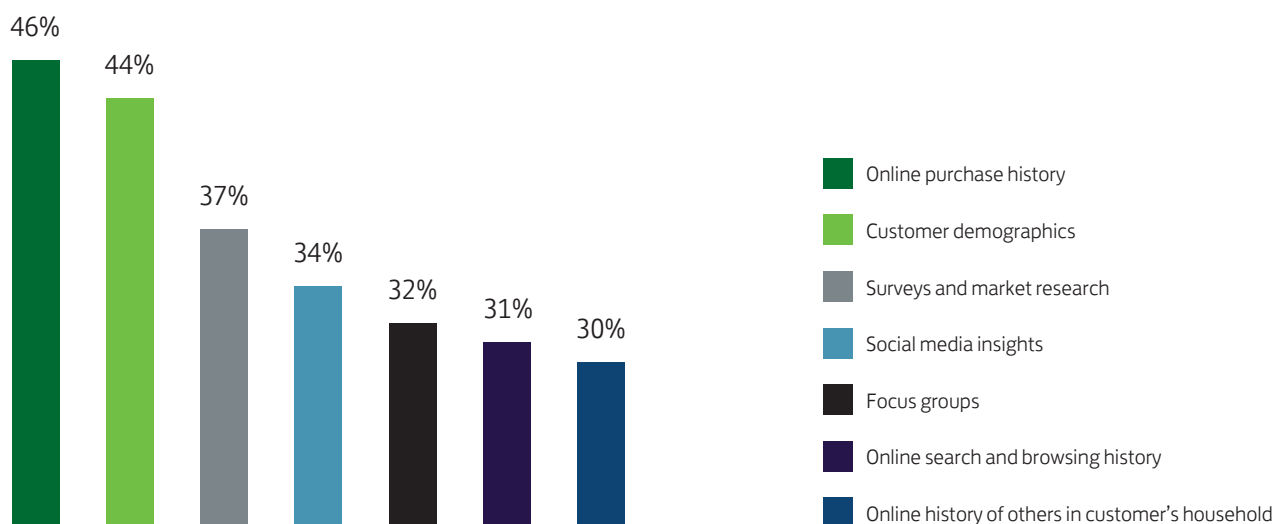
Likewise, three quarters (76%) use in-store analytics to help understand how customers engage with their products.

And two thirds (68%) say they use data to create a more personalised and targeted marketing strategy.

But, along with opportunity, access to data can also be a liability.

The penalties for compromising customers' data can be huge, both financially and reputationally.

Which data do you currently use to inform product development and/or marketing?



Online crime

Cybercrime is big business and it's continuing to grow in its scale and sophistication.

Reassuringly, four in five (79%) said the safe use and protection of customer data was a priority.

A third (33%) flagged cyberattacks as a threat and two thirds (65%) said they would be investing in cybersecurity to protect their business in the next year, with over a third (36%) saying improving cybersecurity was a priority.

That said, it is a worry that a quarter (24%) of those surveyed admitted they are not prepared for a cyberattack and a fifth (22%) said they were not investing to protect themselves.

Cybercriminals are becoming ever more adept at targeting vulnerabilities within organisations and the threat is constantly evolving.

This threat has never been more urgent and firms would be well advised to have cybersecurity at the front of their minds at all times.

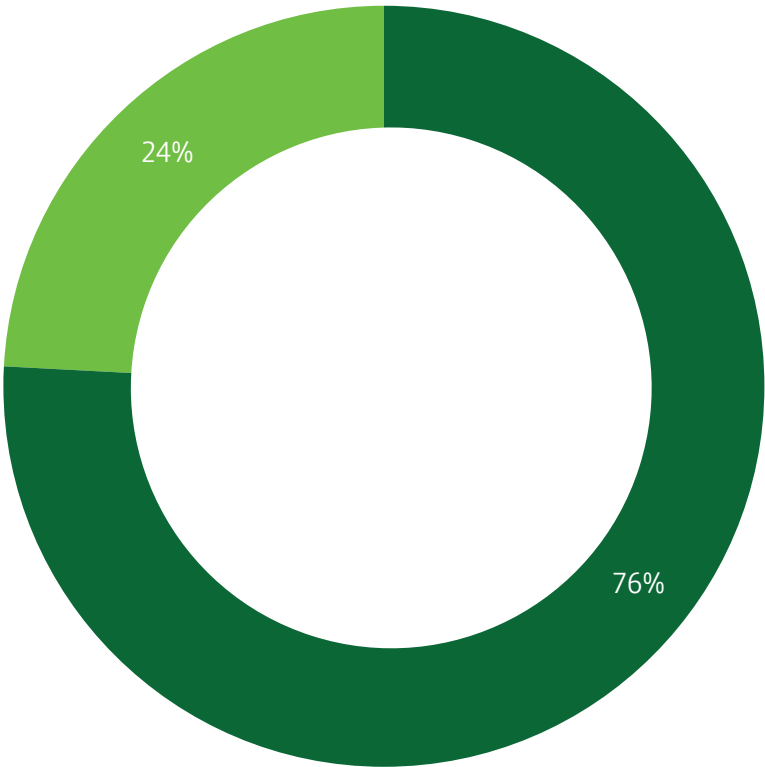


Cybercriminals are becoming ever more adept at targeting vulnerabilities within organisations and the threat is constantly evolving.



use data to inform product development and/or marketing

Is your business well prepared to defend itself and recover quickly from a cyberattack?



Yes
No

Closing statement



Philipp Gutzwiller

Head of Retail, Large Corporates,
Lloyds Bank Commercial Banking

From mail order to the department store and online shopping, the retail sector has re-invented itself many times over the years.

Over the last decade, digital disruption has fundamentally changed the shopping experience. More channels than ever are now available to inspire, sell and fulfil. This will award the agile and adaptive retailer who remains relevant to its core customer base.

However, the challenges it presents shouldn't be understated. But as Albert Einstein said: "In the middle of difficulty lies opportunity."

This report has found that UK retailers are adaptable, agile and ambitious, exploring every opportunity to survive and thrive in an industry that is finding its feet as it continues to be redefined.

There have been some high-profile failures, and no doubt there will be more, but emerging e-tail brands will fill their shoes.

The successful retailers of today already look very different than they did a decade ago.

Likewise, it is difficult to predict who the market leaders will be in 10 years' time, and how they will get there.

However, retailers who keep their customers in mind and are evolving with them will likely be the winners of the future.

Whatever happens, Lloyds Bank has been by the side of UK retailers for generations, and we are committed to continue supporting the sector.



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Methodology

To gather representative data, financial decision makers at a cross section of 200 retail businesses with an annual turnover of £50m+ were surveyed in England, Scotland, Wales and Northern Ireland. Online interviews were conducted by BVA BDRC via its business access panel. Fieldwork was conducted 26th June to 3rd July 2019.

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