RETAIL FORECASTS REPORT 2023

WEATHERING THE STORM: HOW RETAIL BUSINESSES CAN FIND SUCCESS IN 2023

IDEAS | PEOPLE | TRUST

BDO

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RETAIL FORECASTS REPORT 2023

Reviewing the past 12 months, our Retail Forecasts Report analyses the previous trading year's activity and highlights key areas of focus for retailers as they enter 2023.

#BDORetailForecasts

AN INTRODUCTION FROM SOPHIE MICHAEL

HEAD OF RETAIL

As the threat of COVID-19 began to fade, we started 2022 with cautious optimism, with consumers looking forward to a year free of restrictions and relative stability in their shopping habits.

However, that optimism was not to last. A combination of geopolitical issues, supply shortages, and the Russia-Ukraine conflict have stoked inflation, placed strain on economies and severely dented consumer confidence.

Just as we saw in the 2008-2009 recession, value for money (not just price) has become ever more important for shoppers, and the pressure on mid-market retailers has become even more intense, as shoppers look to trade down. This shift in behaviour of buying cheaper branded goods as a way to save money is manifesting itself in almost every purchase, from essential groceries to bigger ticket items.

As we head into 2023, conditions are only expected to deteriorate even further, with falling consumer demand and increasing operating costs putting even more pressure on already squeezed profit margins. The weakening Pound has made imports and raw materials more expensive, while staff shortages are forcing businesses to increase wages, leaving retailers with little wiggle room to reduce prices further to entice shoppers.

In the coming months, retailers will be navigating their businesses through a period of continuing inflation; their focus will be on generating and protecting cash and working capital, while cutting costs wherever possible and streamlining their businesses to protect margins. These challenges will need to be balanced with a need to retain customers and aim to drive profitable growth. History has shown that those businesses that outperform during economic downturns tend to be the future outperformers for the longer term. So, whilst the current economic climate remains challenging, it does present opportunities for those that can weather the storm through having clear short and medium term forecasts to manage their businesses and keep their stakeholders close, whilst also reshaping their future and creating a sustainable business model.

UK RETAIL FORECASTS

This report will firstly further explore the macro issues that are now facing the UK. It will then highlight key ways in which consumers are changing their shopping behavior.

Finally, it will explore how retailers are adapting to achieve success in this continually challenging environment, ahead of what looks certain to be yet another turbulent year for retail.

MACRO ISSUE	CONSUMER RESPONSE	RETAILER RESPONSE
High and stubborn Inflation	Cutting back and trading down	Strengthening own brands, budget lines and loyalty schemes to discourage switching
Rising interest rates and spiralling inflation	Reduction in discretionary spend, particularly on bigger ticket items and homeware	Offering value ranges and products for shoppers
Emergence of Generation Z	Generation Z becoming significant consumers	Shifting marketing to appeal to Gen Z
Pressure on subscription-led business models	Prioritising which subscriptions to keep	Creating innovative subscription models and emphasizing the value of these models to retain loyalty
Post-pandemic channel re-balancing	Utilising omnichannel value and convenience	Diversifying to meet demands of omnichannel shoppers
ESG issues awareness and scrutiny	Increasing consumer demand for businesses to focus on ESG	Revamping operations and introducing new channels to meet ESG demands
Critical global importance of climate change	Shifting to value-led sustainability	Leverage the changes in consumer preferences and buying behaviours by responding to the demands of Gen Z particularly around the circular economy.

UK RETAIL FORECASTS

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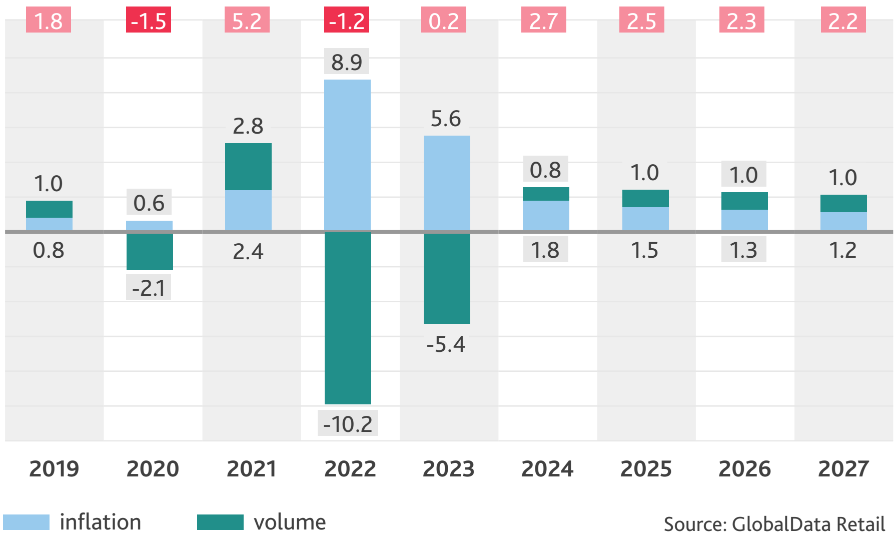
UK RETAIL MARKET GROWTH %



Source: GlobalData Retail

The optimism when entering 2022, amid easing COVID-19 restrictions, was quickly replaced by growing macroeconomic concerns. A combination of geopolitical issues, supply shortages and Russia's War on Ukraine has stoked inflation, placed strain on economies and had ramifications for businesses and consumers.

The Russia-Ukraine conflict is pushing up the price of energy, wheat, and other consumables; Russia and Ukraine are the source of one-third of all the wheat consumed in the world, and a very minimal amount is currently being exported. In addition, increased gas prices mean that everything along the supply chain is more expensive, and closed airspace over Russia, and inaccessible ports, are leading to an increase in lead times. This has resulted in increased food prices for consumers.

The rising price of essentials, such as food and fuel, has created a cost-of-living crisis for UK consumers, with inflation reaching 11.1% in October 2022. The Bank of England has raised interest rates to 3.0% in an attempt to stabilise the economy, with possible further rises expected, making mortgages and other borrowing more expensive. This, together with the increased tax burden announced by the Chancellor in the Autumn Statement, is putting further pressure on already squeezed household budgets.

Consumers are cutting back on retail spend, particularly for non-essential categories such as clothing and homeware; GlobalData's UK retail forecasts shows the retail market declined 1.2% in 2022 from 2021, with volumes plummeting 10.2%. Moreover, while the overall market is set to return to slight growth in 2023, this will again be driven by inflation, with volumes therefore remaining negative.

A lack of confidence from international investors in the UK economy has led to the Pound weakening drastically, which has had multiple negative impacts for UK businesses, with imports becoming significantly more expensive.

UK RETAIL FORECASTS

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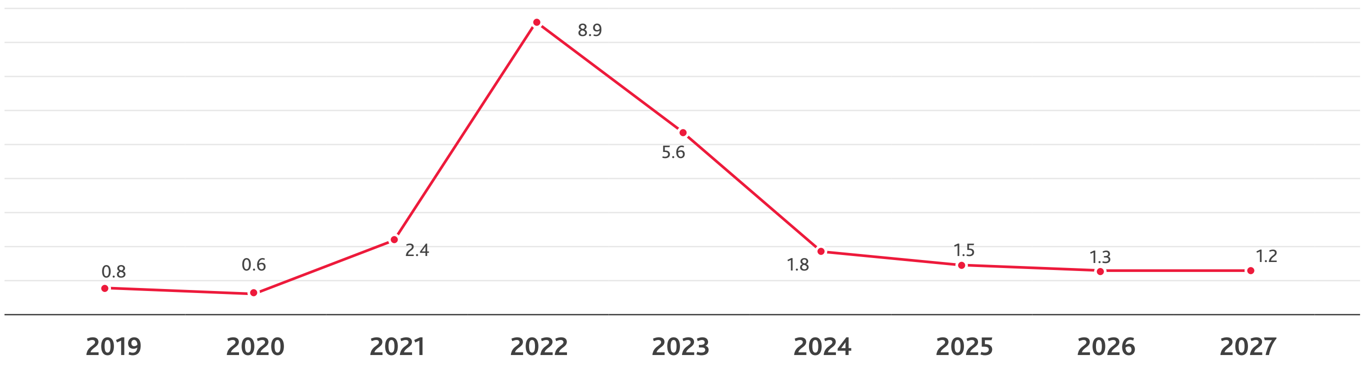
INFLATION IN THE UK RETAIL MARKET %



Source: GlobalData Retail.

China's continued zero COVID-19 policies are also causing supply chain issues, as whole cities are still being locked down. During this time, no travel is allowed in or out of the city and in most cases, people are not allowed to leave their homes, meaning all production is ceased. This is occurring across the country and no location is out of reach, as even Shanghai endured a 70-day lockdown in the first half of 2022, which caused major disruption for global trade, as Shanghai is a central point for a vast international supply chain.

Finally, border delays – a by-product of Brexit – are causing a major slowdown in transporting products between the UK and the EU. Since the UK left the customs union, there has been a more bureaucratic system in place and, as a result, the process is now far lengthier than it once was. At points, the congestion has been so severe that sections of the M20 motorway have had to be shut to hold waiting lorries. As well as the border delays, another result of Brexit has been staff shortages in the UK. These shortages have come mostly in haulage, warehousing and logistics, as one million people left the UK at the end of 2020. With a limited supply of workers, retailers have had to raise wages to compete for logistics workers, such as HGV drivers, increasing their overall cost base in 2021 and beyond.

All of these factors have created the perfect storm for retail businesses, with reduced consumer spending and increased costs putting significant pressure on profit margins. Retailers must however, continue to leverage any opportunities, and as we saw post referendum, the weaker Pound does conversely result in UK exports increasing and makes the UK retail market more attractive for the overseas shopper.

REDUCE COSTS TO IMPROVE SQUEEZED MARGINS

It will be essential for retailers to trim costs and become more streamlined in the coming months, to protect profit margins as consumers cut back spending and costs continue to rise.

Retailers will no doubt be focusing on reducing cash tied up in stock levels and considering where reductions can be made in payroll costs in terms of headcount. Moreover, due to the increase in energy prices and the weakness of the pound, businesses will potentially have to look for suppliers closer to home, as imports are now more expensive.

The need for reducing costs is evident across the whole of retail with widescale store closures, staff restructuring and revised future growth plans. ASOS has recently announced job cuts of 100 of its employees to reduce costs. This comes a week after reporting it is operating at a loss of nearly £10 million in its year to the end of August. In the Homeware category, Wilko has recently brought in measures to reduce costs in order to cope with the cost-of-living crisis. Inflation has been a key area of concern and it has deferred payments to suppliers to protect its constrained cash flow. Wilko has also changed its minimum term for committing to paying suppliers, increasing it to 60 days. Having already closed 15 stores this month, Wilko is exploring alternative options to minimise margin erosion.

M&S has recently unveiled plans to close 67 stores in the next five years. The move will save substantial costs and the focus is on shutting stores with the lowest productivity. This comes after similar moves from other retailers such as John Lewis & Partners, which closed 16 stores during the pandemic in order to reduce costs and pivot towards an online consumer base. In 2021, JLP cut 1,000 management roles, in addition to 1,465 roles due to store closures.

Given the tightening of the consumer purse, it is no surprise that big ticket furniture retailers are particularly struggling, with little sign of improvement in future forecasts for the short to medium term. Made.com's gross sales fell by 19% to £174m for the first six months of 2022. After having gone public in June 2021 with a value of £775m, Made.com has now collapsed into administration, and has been bought by NEXT for only £3.4m. Made.com has been caught in a pincer movement as furniture shoppers returned to stores following last year's lockdown and as consumer confidence cratered as the cost-of-living rose. Many shoppers are simply unable to make larger purchases and its core customer base of young professionals are now focusing more on leisure and experiences.

DFS saw pre-tax profits drop by 43% to £58.5m in the year to the end of June 2022 due to supply chain issues, double-digit cost inflation on raw materials, and recruitment issues. The final quarter of the year was particularly challenging, with consumer demand slumping and orders falling below pre-pandemic levels. The furniture specialist has a pessimistic outlook for the coming months, presenting three scenarios for the current year, ranging from a 5% to a 15% decline in like-for-like orders on FY2019. The consistency of poor results across the industry shows an overarching reduction in consumer demand. Without the sales to rely on, retailers will have to explore methods of cost reduction and prepare for ongoing tight margins.

THE CONSUMER CONTEXT

Discretionary income has fallen due to rising energy bills, hefty increases in the prices of fuel, food and other essentials, and rising interest rates squeezing household budgets. As a result, many consumers are drastically reducing spend on non-essential products, particularly on homewares and bigger ticket items, as noted earlier, as well as cutting back on leisure activities.

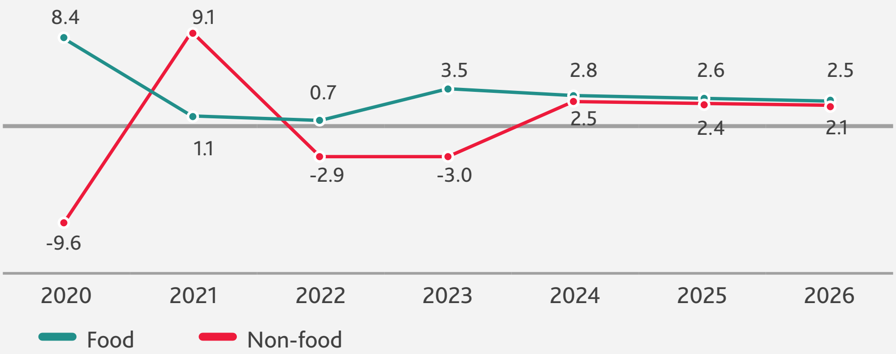
While the government has put in place a number of provisions to mitigate the impact of inflation, including fuel subsidies along with a since dialed-back commitment to place a cap on energy prices, the impact of the cost-of-living crisis on retail is still significant for consumers and will deteriorate further as a consequence of the Autumn Statement announcements.

For many low-income households, discretionary income has fallen to zero, and for many more, spending on non-essentials now requires a much higher level of consideration. Consequently, spending on non-food is set to have declined 2.9% in 2022 and will drop a further 3.0% in 2023. Just as we saw in the 2008-2009 recession, value for money (not just price) has become ever more important for shoppers, and the pressure on mid-market retailers finding an attractive differentiation will only intensify, as shoppers look to trade down.

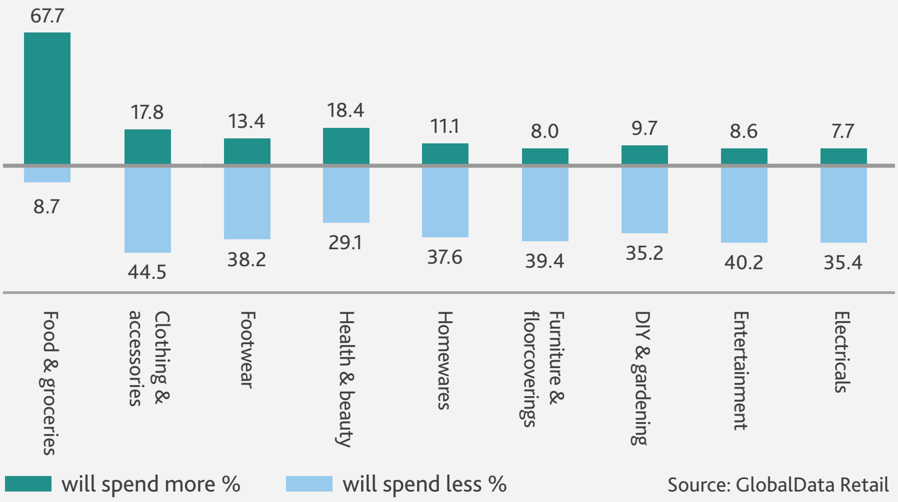
More affluent households have so far been somewhat insulated from the cost-of-living increases, having been more likely to have benefited financially from aspects such as working from home over the last two years, and having built up savings in lieu of being able to take foreign holidays during the pandemic. However, even this group is now coming under increasing pressure, especially as a result of rising mortgage rates.

GlobalData research shows that, overall, consumers are preparing to reduce their spending over the next six months. Food & groceries is the only category where consumers expect to spend more, with 67.7% of people planning for this, as they anticipate ongoing inflation will drive price further upwards and therefore demanding a greater share of the purse. Conversely, 44.5% of consumers plan to spend less on clothing and accessories, making it the worst affected category within retail, as shoppers seek out less essential areas of their spending to cut back on.

GROWTH IN FOOD VS. NON-FOOD



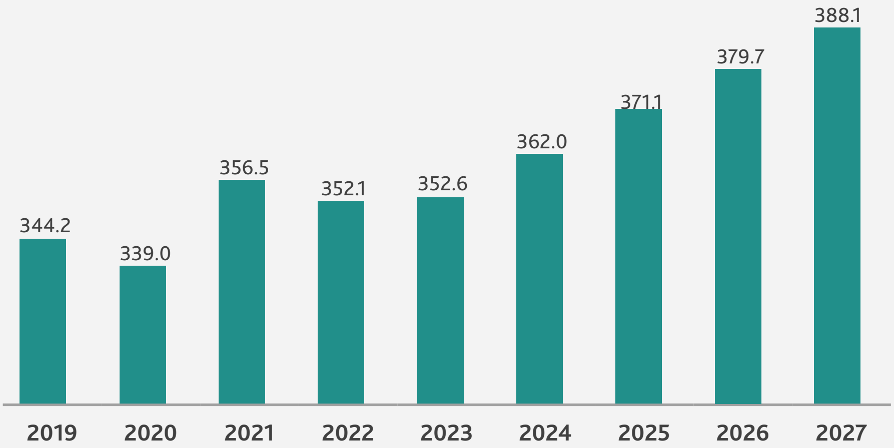
HOW WILL YOUR HOUSEHOLD BEHAVE IN TERMS OF RETAIL SPEND IN THE NEXT SIX MONTHS? (%)



Source: GlobalData Retail

UK RETAIL PERFORMANCE AND FORECASTS

UK RETAIL MARKET SIZE (£BN)



Source: GlobalData Retail

CATEGORY	2021 % GROWTH	2022 % GROWTH	2023 % GROWTH
Total retail	+5.2	-1.2	+0.2
Health & Beauty	+3.8	+2.1	-1.0
Electricals	+6.9	-15.6	-2.1
Food & Grocery	+1.1	+0.7	+3.5
Clothing & Footwear	+14.3	+6.1	-3.9
Homewares	+6.4	-2.8	-2.5
Furniture & Floorcoverings	+11.7	-1.4	-1.7
DIY & Gardening	+8.9	-10.3	-1.2
Other*	+8.1	-6.1	-4.1

Source: GlobalData Retail. *Other includes a range of products, such as Toys & Games, Jewellery, Sports Equipment, Entertainment and Books.

WITH CONSUMERS' DISCRETIONARY INCOMES DECREASING, RETAILERS ARE SUBSEQUENTLY EXPERIENCING A FALL IN DEMAND.

With fewer people partaking in shopping as a pastime, due to a lack of discretionary income, the most affected retail sector in 2023 will be Clothing & Footwear. Food & Grocery will buck the trend of decreasing spend, but, while this is expected given the essential nature of the sector, and the impact of price rises, shoppers are making significant changes to their behaviour, and more actively looking to trade down. In response, grocers are expanding their basic ranges, in a bid to entice consumers to trade down within their stores, rather than turning to competitors, but many will need to do more to convince shoppers from switching to the discounters.

In the past, retailers have been able to use sales and promotions to entice spend, but many consumers are now cutting back more aggressively. With consumers being less responsive to sales events, as has been reported by retailers such as Dunelm in its September interim results, it is becoming more important for retailers to use cost-saving measures (such as streamlining their supply chains) and careful cashflow management to ride out this challenging period.

Predicting consumer preferences has never been more important in committing cash to inventory holding, and it's more critical than ever that retailers understand their target customer and offer the product range and service that will generate sales.

UK RETAIL PERFORMANCE AND FORECASTS

CONTINUED

2022

CLOTHING & FOOTWEAR

The Clothing & Footware market is set to have **grown 6.1%** in 2022, largely driven by inflationary price increases, and a resurgence in demand in the first half of the year, with Q1 up on weak lockdown comparatives and consumers buying holidaywear and occasionwear in the summer. In contrast, shoppers were forced to cut back on purchases in H2, as a result of the challenging macroeconomic environment, leaving spend for the full year 7.4% behind pre-pandemic levels and volumes down 1.0% year-on-year. While online penetration dropped 8.1ppts in 2022, it will remain 8.1ppts above 2019 levels, at 38.4%, since consumers have now become more accustomed to shopping online, after stores were closed during the pandemic, and apparel retailers are continuing to invest in optimising their online propositions. 2023 will be a more challenging year as consumers experience a greater level of financial strain; the Clothing and Footwear category is expected to contract by 3.9%, with volumes down by more than 10.0%.

2022

DIY & GARDENING

The DIY and Gardening category was one of the worst-performing Home categories in 2022, **declining 10.4%**, as it came up against very strong comparatives. Momentum in home improvement has waned as consumers have less disposable income amid the cost-of-living crisis – and therefore DIY retailers are having to rely on strong trade sales to sustain profits.

2022

HEALTH & BEAUTY

The Health & Beauty market reached £22.9bn in 2022, with **growth driven by rising prices**. Major FMCG companies, such as Unilever and P&G, have announced price rises to protect profits, as the cost of raw materials like palm oil and coconut oil has soared, alongside other supply chain costs. The essential nature of some subsectors, such as babycare, bathroom toiletries and paper products has helped protect the sector as shoppers cut back on items they can do without. Although some consumers feel compelled to buy into cosmetics and fragrance subsectors to replace items needed as social occasions return, alongside working in offices and holidays, others have been accustomed to wearing less make-up and it is expected that they will cut back on beauty purchases rather than trading down.

2022

HOME (HOMEWARES, FURNITURE, FLOORCOVERINGS)

The Homewares category **declined 2.8%** in 2022, despite a strong Q1, for the same reasons that afflict the DIY sector. The Furniture & Floorcoverings category performed better than both Homewares and DIY & Gardening in 2022, declining just 1.4%, supported by a reasonable Q1 from retailers including DFS, Sofology and ScS, and greater resilience from Tapi in the flooring market. However, the outlook for this category is bleak, with consumers already starting to cut back on big-ticket spend. DFS has presented three scenarios for its current financial year (to June 2023), ranging from a 5% to a 15% decline in like-for-like orders on FY2019.

UK RETAIL PERFORMANCE AND FORECASTS

CONTINUED

ELECTRICALS

2022

The Electricals category **declined in 2022**, after a strong performance in 2021, driven by a squeeze on discretionary spend limiting consumers' willingness to invest in big ticket electrical items, such as televisions and computing equipment. Those that are buying electricals are increasingly seeking the lowest prices - the electricals market is deflationary as retailers discount products to win shoppers and help sell through stock.

FOOD & GROCERY

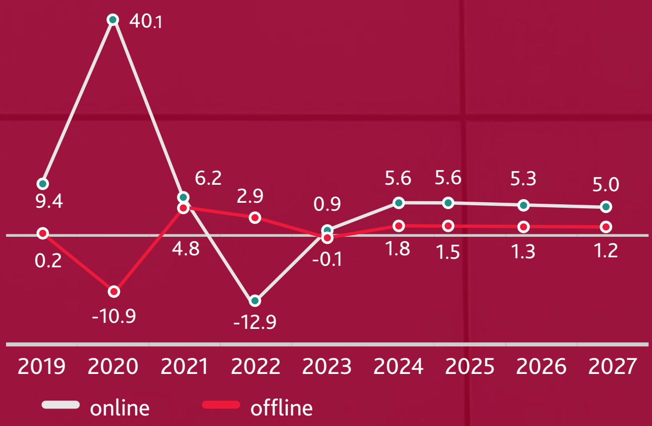
2022

Expenditure on Food & Grocery **increased marginally in 2022**. Inflation peaked in H2, boosting sector revenues and returning it to positive territory – helping to offset the severe 11% fall in volumes. Suppliers and retailers continue to be forced to pass higher costs onto the consumer as the price of raw ingredients, materials, packaging and labour all increase – as well as oil and fuel. Oilseed and wheat prices will be closely monitored as the crisis in Ukraine continues and the halting of exports from both there and Russia will hit the cost and availability of goods, especially in the savoury snacks, bakery and cereals categories. Consumers continue to cut back, trade down and switch grocers, forcing players to review and improve price match and price locking campaigns and loyalty schemes to retain shopper loyalty and footfall levels. For the grocers, eroded margins and profitability will take time to rebuild.

RETAIL CHANNELS

2022

Spend through online channels fell back in 2022, following two years of significant growth, as people stayed home during COVID-19. Despite this decline, online penetration remains much higher than pre-COVID levels as consumers have become accustomed to the convenience that online offers and as retailers benefit from improvements to their websites and fulfilment options. Online penetration was 23.2% in 2022, down 3.1ppts on 2021, but up 4.9ppts on 2019. The reduction in online spending also demonstrates the overall reduction in consumer discretionary spend.



UK RETAIL PERFORMANCE AND FORECASTS

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TRAVEL AND TOURISM

2022 has seen a resurgence in the UK Travel and Tourism industry due to the lifting of COVID-19 restrictions. According to the ONS, the UK had 2.7 million visitors in May this year compared to only 86,000 in May 2021. However, this was 21% lower than pre-COVID-19 levels, so there is still some way to go.

The weakening Pound has had a direct impact on the tourism industry. It has made travelling abroad more expensive for UK residents, at a time when many consumers are already having to cut back on non-essential spending. While some consumers will go on staycations instead, many will cut back on holidays altogether, due to high prices for petrol and trains. In addition to this, hospitality venues such as hotels are struggling with staffing issues and high running costs, which will result in room prices going up.

However, on a more positive note, visiting the UK is now more attractive for overseas consumers, with the weakening Pound making it comparatively cheaper to do so. This could increase both visitor numbers to the UK and the amount each visitor spends. This should help mitigate the impact of the government recently reversing its decision to offer tax-free shopping for non-UK visitors. 2023 will continue to see growth from the previous years, as COVID-related travel restrictions and concerns become more distant.

2022 CONSUMER CONFIDENCE INDEX

Consumer confidence is at a record low due to the ongoing cost of living crisis. GlobalData's future sentiment index reached -65.8 in October 22, a slight improvement on the -68.2 recorded in September, but still the second-lowest figure the index has seen since it was created in 2012. Excluding H2 2022, the lowest future sentiment on record is -55.6% in April 2020 as the COVID-19 pandemic took hold. Meanwhile, GFK reported that consumer confidence fell to a 40-year low in August 2022. The rapidly rising price of food, fuel and energy has left consumers with a negative outlook and is putting extra strain on budgets. The personal finances index dropped 13.4 points month-on-month in September; this financial uncertainty will continue in the coming months and result in reduced spending going into 2023. Within the specific measures that form consumer sentiment, the treats and luxuries index and the visiting shops index have been the key drivers of this negative consumer confidence figure. The treats and luxuries index fell by 9.1 points against August 2022, to -37.6, while the visiting shops index fell by 8.1 points on the previous month to -36.3. As the cost-of-living crisis worsens for many, consumers are choosing to spend less on items they view as luxuries to save this for essentials such as food & groceries.

The most negative consumer sentiment is in the economic outlook index at -74.1, closely followed by the retail spending index at -72.9. This is testament to the uncertainty felt by consumers in the current economic environment, particularly during winter, as bills for heating and lighting peak.

Pessimism in the UK market stretches to concerns over purchasing essential items. The consumer sentiment index shows the 18-34 age group dipped into the negative. This is due to the high inflation rates, which have pushed prices of essentials above the budget of many younger consumers especially.

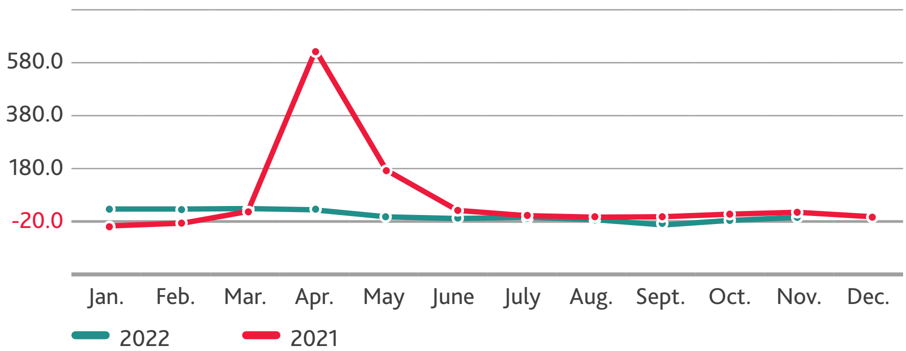
For those aged 55+, sentiment regarding the affordability of essential items is still far above younger shoppers. As older individuals usually have higher-paying jobs, pensions or savings to draw on, they are in a better position to face these difficult economic conditions. Nevertheless, this index dropped by over 20 points year-on-year in September among this age group, highlighting that even those that have typically been able to weather the increase in prices so far are beginning to feel the pinch.

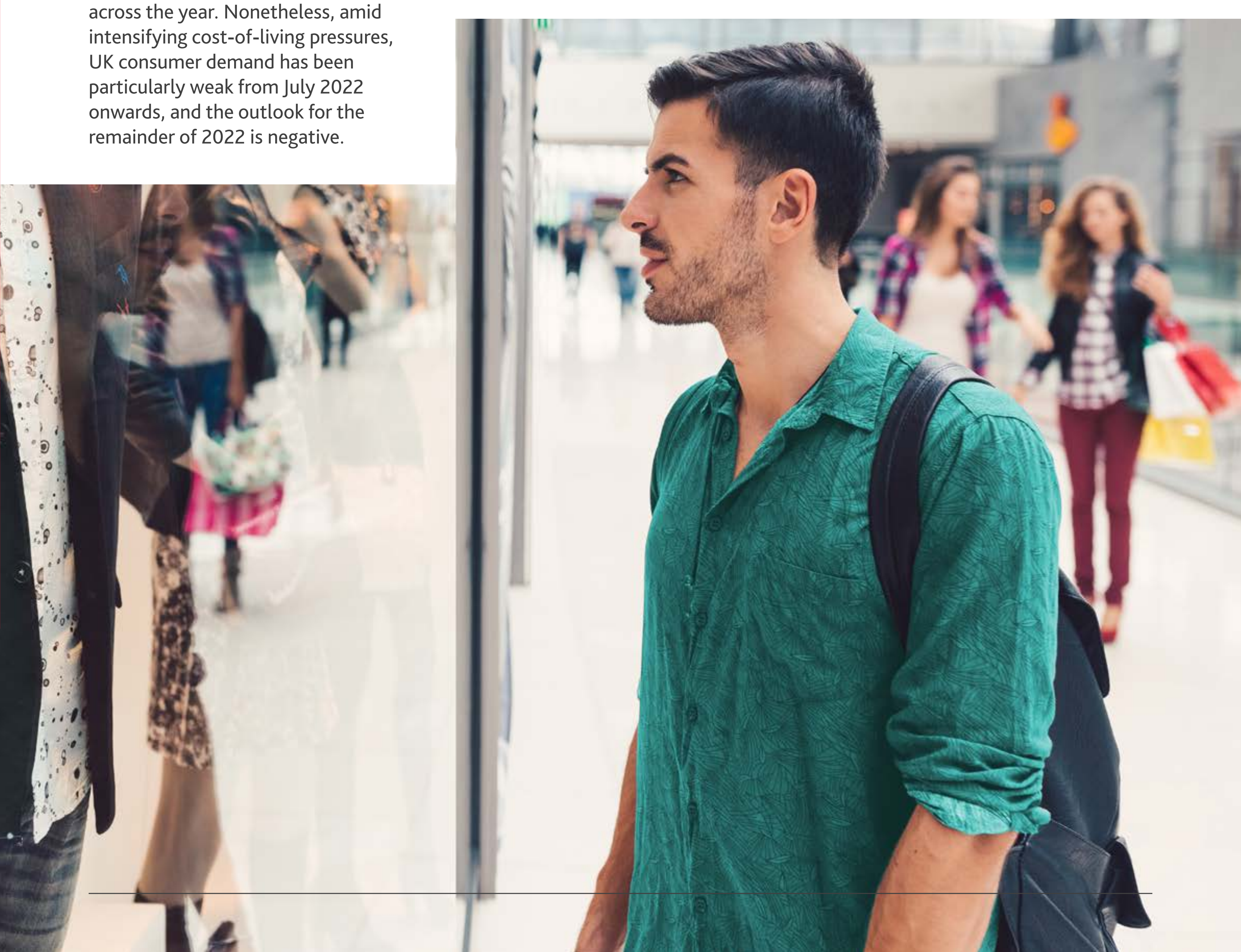
2022 HSST DATA AND COMMENTARY

According to BDO's High Street Sales Tracker (HSST), high street sales saw a year-on-year increase in January and February 2022, compared to a relatively poor period the previous year when non-essential stores were forced to close. The remainder of 2022 lags behind 2021, particularly compared to March-July 2021, which benefitted from being up against weak pandemic-driven comparatives.

A restriction-free 2022 has seen a more consistent spending pattern across the year. Nonetheless, amid intensifying cost-of-living pressures, UK consumer demand has been particularly weak from July 2022 onwards, and the outlook for the remainder of 2022 is negative.

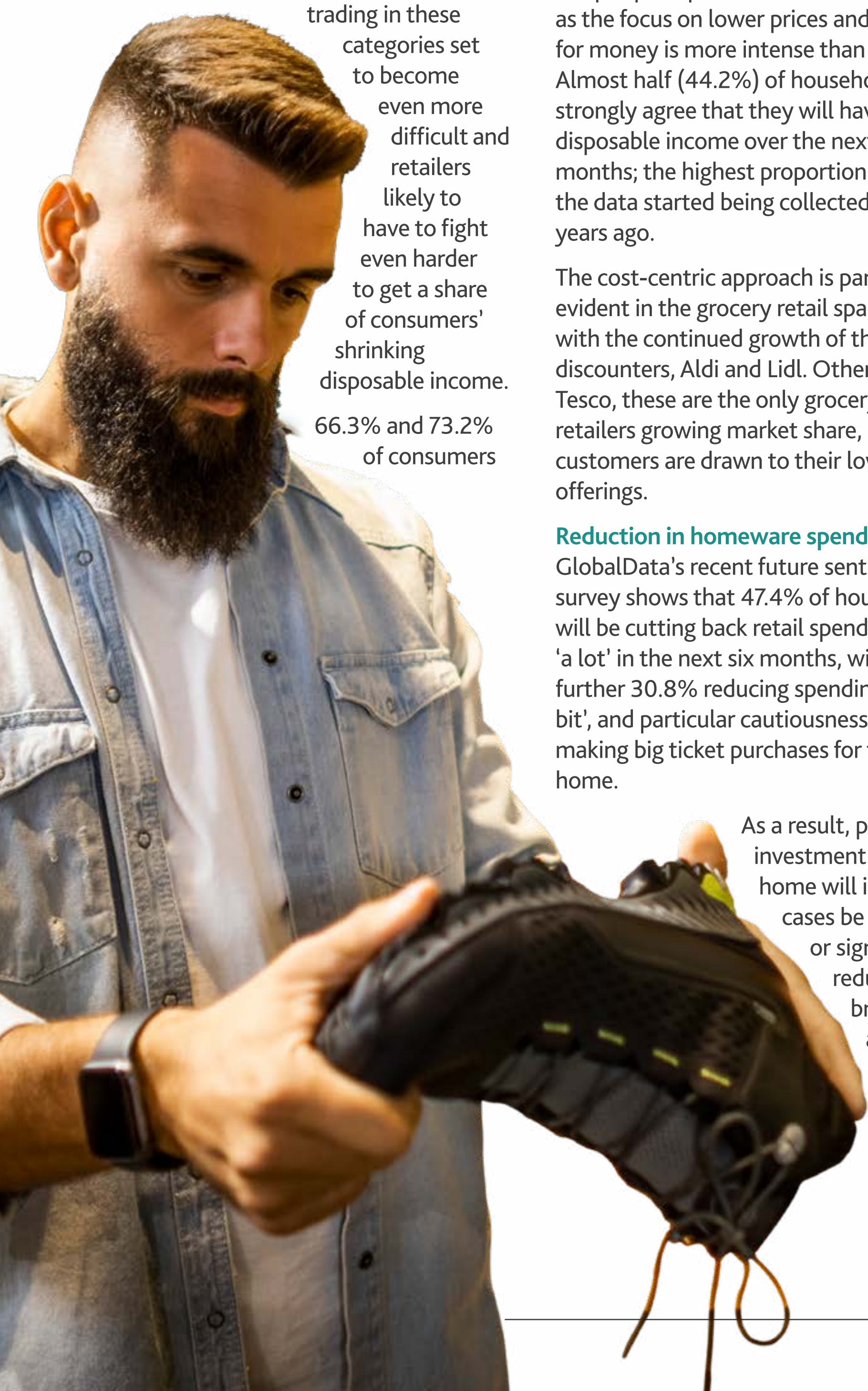
BDO HIGH STREET SALES TRACKER TOTAL LFLs 2021-2022





HOW CONSUMERS ARE RESPONDING TO NEVER-ENDING TURBULENCE

Cutting back and trading down. Consumers are increasingly cutting back their spending on more discretionary products, such as Clothing & Footwear, DIY & Gardening and Furniture & Floorcoverings, with trading in these categories set to become even more difficult and retailers likely to have to fight even harder to get a share of consumers' shrinking disposable income.



66.3% and 73.2% of consumers stated that they expect their shopping habits to change when purchasing non-essential goods and essential goods respectively, according to recent GlobalData consumer research. This has put price pressure on all retailers, as the focus on lower prices and value for money is more intense than ever. Almost half (44.2%) of households strongly agree that they will have less disposable income over the next six months; the highest proportion since the data started being collected six years ago.

The cost-centric approach is particularly evident in the grocery retail space with the continued growth of the discounters, Aldi and Lidl. Other than Tesco, these are the only grocery retailers growing market share, as new customers are drawn to their low-price offerings.

Reduction in homeware spend. GlobalData's recent future sentiment survey shows that 47.4% of households will be cutting back retail spending 'a lot' in the next six months, with a further 30.8% reducing spending 'a bit', and particular cautiousness around making big ticket purchases for the home.

As a result, planned investment into the home will in many cases be delayed or significantly reduced, bringing an end to the strong growth the home improvement market witnessed during the pandemic.

Generation Z becoming significant consumers. Generation Z are now an established consumer base who utilise digital technology for everyday activities, such as online shopping.

Social media sites, such as Instagram and TikTok, are popular among Gen Z for purchasing products with ease and convenience. These platforms provide simple steps to purchase products, like links in their Instagram bio or 'swipe up' links, whereby the consumer may be watching a video and simply has to swipe up on the screen to access the website to purchase the product. Gen Z customers are very responsive to current trends and retailers will need to remain vigilant and agile to recognise and adapt to shifts in consumer demand.

Generation Z are also driving curiosity in emerging technologies such as the Metaverse. This concept is still very much in its infancy, but may one day be a popular channel for purchasing physical and virtual products.

Prioritising which subscriptions to keep. The influence of the subscription segment has accelerated over the past couple of years, with a high proportion of UK shoppers spending more time at home, and the pandemic persuading home-bound UK shoppers to try new businesses based around paying recurring fees.

Subscription services vary from the widely known entertainment companies such as Netflix and Amazon Prime, to food, clothing and even

HOW CONSUMERS ARE RESPONDING TO NEVER-ENDING TURBULENCE

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gadget subscription services. However, with 53.4% of households now cutting back on leisure spending (according to a recent GlobalData survey), the future success of this model is in doubt, as shoppers are being forced to prioritise essential costs over nice-to-haves.

Utilising omnichannel value and convenience. As the market recovers from COVID-19, retailers are now starting to see a new normal in terms of channel buying habits and preferences, with many favouring a omnichannel approach, combining the convenience and choice of online with the value and experience of stores.

Fast fashion is a sector that has particularly felt the impact of the post-pandemic drop-off in online, with retailers such as ASOS, the boohoo group and Zalando having to revise growth forecasts. Moreover, a GlobalData consumer survey conducted in March 2022 revealed that under 35s – a key demographic for online fast fashion players – are the most likely to change their Clothing & Footwear shopping habits due to the rising cost of living. This not only means they are buying less, but are more likely to return items; an issue which is much more detrimental to the margins of pureplays, especially as fuel prices rise.

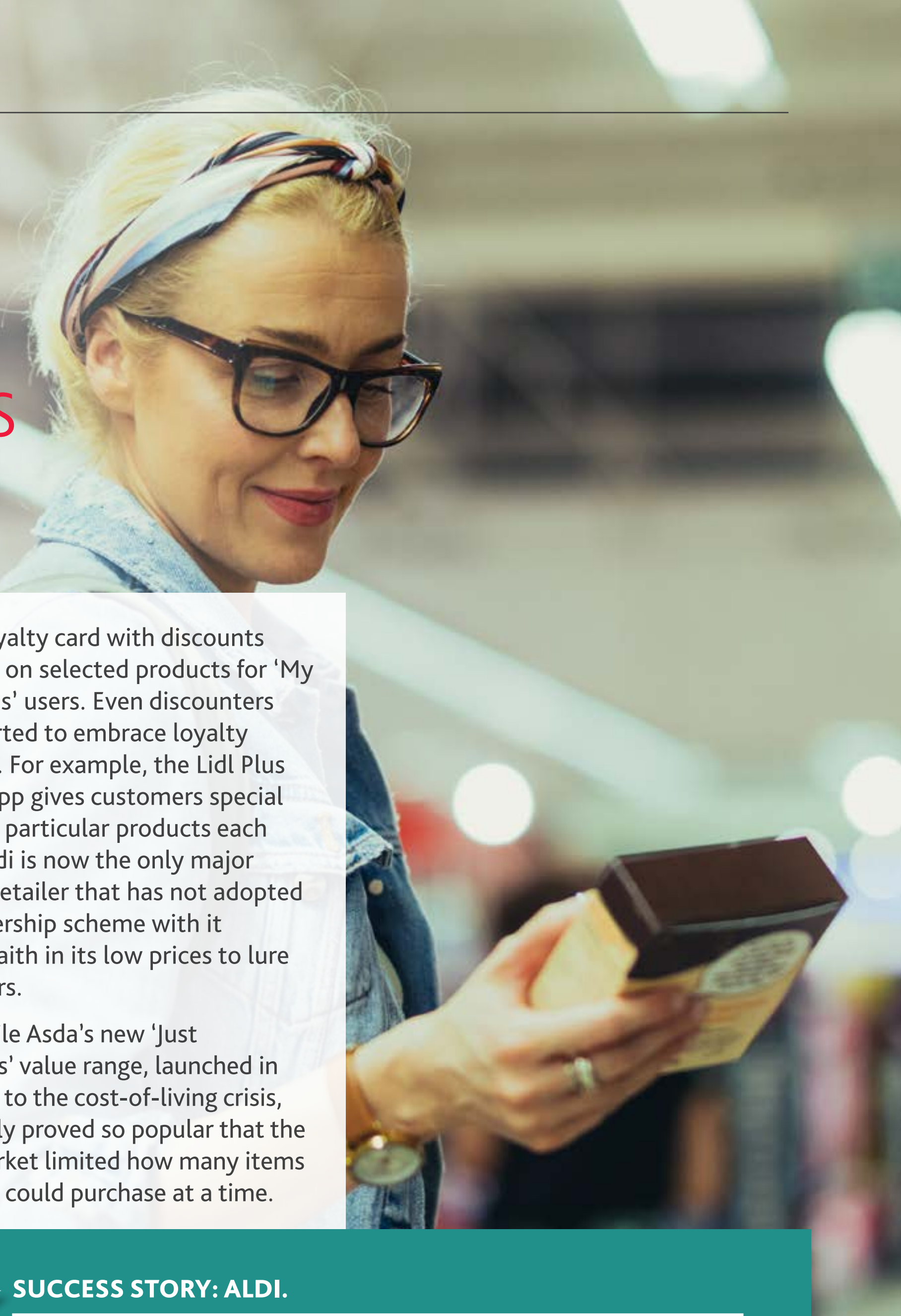
Increasing consumer demand for businesses to focus on ESG. Even in a moment where factors such as rising inflation and the Russia-Ukraine war are weighing on consumers and businesses, ESG concerns have endured and even assumed greater relevance. For example, price increases and budgetary concerns have pushed consumers to give greater consideration to shopping secondhand, whereas the situation in Ukraine has forced many businesses to re-consider their approach to operating overseas in certain nations.

GlobalData B2B research highlights that pressure from customers was the most important factor in determining a company's ESG performance plan, cited by 51% of respondents, with pressure from investors coming in second with 46%.

Moreover, the power of social media now allows consumers to give immediate and direct feedback to businesses they feel do not align with their values.

Shifting to value-led sustainability. A big area of growth has been secondhand fashion, and the cost-of-living crisis could also further accelerate this. According to GlobalData, the secondhand apparel market in the UK is set to grow 85.5% between 2022 and 2026, as consumers look to save money and improve their environmental footprint. Indeed, 58.0% of consumers who bought secondhand apparel in the past 12 months did so to get items at a lower price, while only 26.5% did so for environmental reasons.

The popularity of platforms such as Vinted demonstrates high demand for resale in the UK and Europe. The least active consumer age group in the same resale market was those aged 65+ at 11.9%. However, when looking into the resale market it is also essential to consider the ongoing growth of the bricks and mortar secondhand retailers, such as charity and vintage shops. This still makes up a large proportion of the industry and has the added benefit of being more accessible to older shoppers who have shown to not be as open to online shopping as younger demographics. More than three-quarters (77.7%) of resale fashion shoppers aged 65+ purchased from a charity shop in 2021.



HOW RETAILERS ARE RESPONDING TO THE CHALLENGES

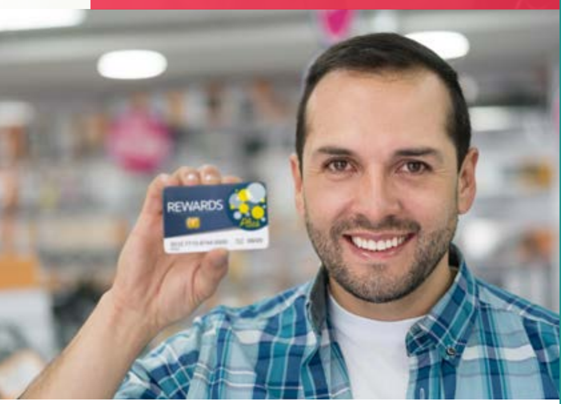
Strengthening own brands, budget lines and loyalty schemes to discourage switching. In grocery, with the mainstream supermarkets often unable to compete with the discounters on value credentials, they have instead adopted creative methods of building brand loyalty in an effort to prevent switching.

The most popular strategy has been the introduction of membership schemes and incentives to encourage repeat visits. While the Sainsbury's Nectar and Tesco's Clubcard schemes have been around for a long time, other supermarkets are now also creating their own schemes. For example, Morrisons has launched a new loyalty card with discounts available on selected products for 'My Morrisons' users. Even discounters have started to embrace loyalty schemes. For example, the Lidl Plus loyalty app gives customers special offers on particular products each week. Aldi is now the only major grocery retailer that has not adopted a membership scheme with it putting faith in its low prices to lure customers.

Meanwhile Asda's new 'Just essentials' value range, launched in response to the cost-of-living crisis, reportedly proved so popular that the supermarket limited how many items shoppers could purchase at a time.

KEY ACTION FOR RETAILERS:

Strengthen loyalty schemes and own brand entry-level value options to allow shoppers to trade down, and discourage switching.



GlobalData's Monthly Tracker from August shows that **14.2%** of UK grocery shoppers are switching to cheaper retailers.

SUCCESS STORY: ALDI.

Aldi has thrived amid economic uncertainty and has overtaken Morrisons to become the fourth largest retailer in the food & grocery market. Its rate of growth has caught the attention of other supermarkets, with Tesco and Sainsbury's now competing more aggressively with Aldi via price match schemes. Aldi's high mix of own-brand products has allowed it to remain price-competitive; major food brands are increasing prices as much as five times faster than supermarkets' own ranges. GlobalData's Monthly Tracker from August shows that 14.2% of UK grocery shoppers are switching to cheaper retailers. Aldi is absorbing the biggest proportion of the switch at 37% with Lidl the next popular at 33%. Many of Aldi's new customers were from Morrisons, abandoned by 12% of switchers. Aldi's continued investment in its bricks and mortar model and bold expansion plans to open 16 new stores by the end of 2022 will help it poach more shoppers from rivals.

Also interesting in this shift towards the discounters is that Aldi has reported a 29% increase in sales of specially selected range. This indicates that, for many consumers, value for money is more important than low prices, and that they are willing to trade up within Aldi.

HOW RETAILERS ARE RESPONDING TO THE CHALLENGES

CONTINUED

Offering value ranges and products for shoppers. As in Food, to meet the demands of cost-conscious consumers, Home and Apparel retailers are starting to offer cheaper alternatives and value ranges. John Lewis & Partners, for example, launched its affordable ANYDAY homewares range in 2021. It has since made a promise to not pass inflation on to customers for certain product lines, such as school uniforms, where 95% of its products remain at previous prices or lower. These initiatives are showing signs of success with its total trading sales year on year for H1 2022 up 2.6%, to £2,136m.

KEY ACTION FOR RETAILERS:

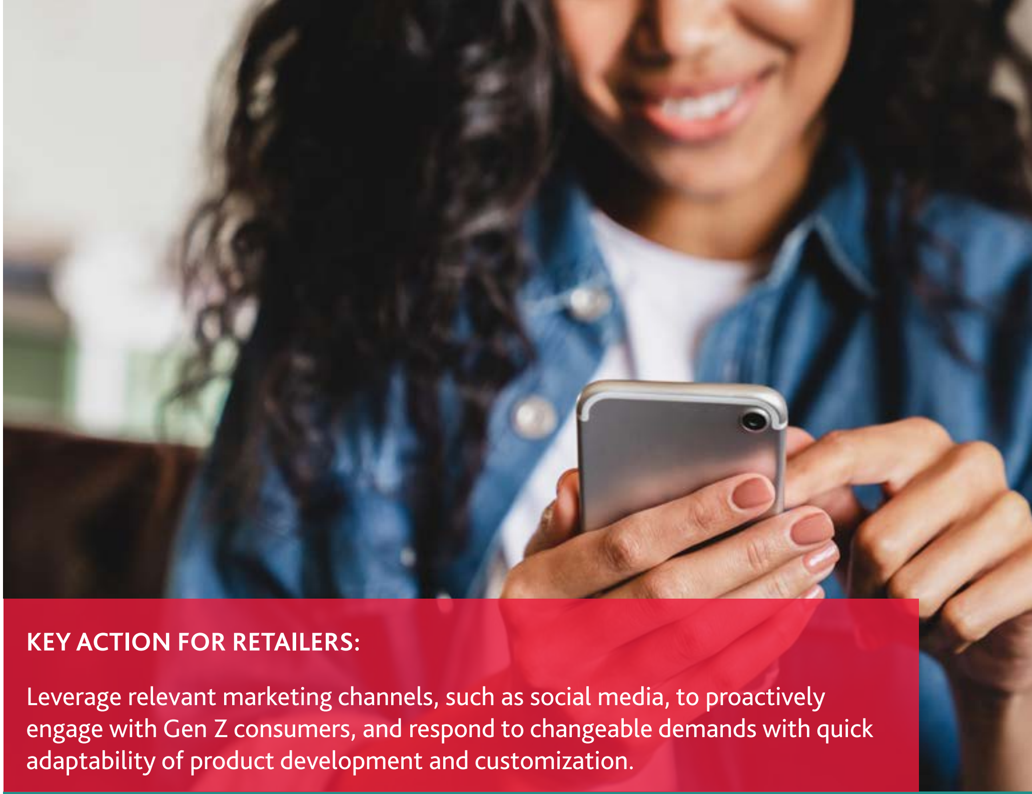
Retailers benefit from understanding and tracking fast-evolving consumer demand, at both a macro and micro level. For example, in the Home category, focus on promoting small home items that are relatively affordable and appeal amid rising energy costs, such as blankets and throws.

SUCCESS STORY: DUNELM.

With a requirement to keep prices low to maintain strong sales, retailers in all categories are being forced to become as cost-effective as possible. This requires trimming down on any unnecessary costs, while still meeting customer demands. Dunelm is a successful example of this. As a home specialist, it continues to be negatively impacted by the cost-of-living crisis and sales have fallen 8% to £357m in the 13 weeks to 1st October. However, revenues are up 36% against pre-pandemic levels. Due to Dunelm's detailed management of costs, its pre-tax profits have risen this financial year by £51.2m on last year. Dunelm is also anticipating a 1.3% growth in sales for FY2023. While this will be largely down to rising prices as a result of inflation, the ability to produce any form of profit in what is a very challenging time for the homeware category is impressive. Dunelm's success has come from its ability to continuously innovate its product range and services. It has continued to enhance its website to create an easy shopping experience for customers and has increased its value range, offering trend-led products at affordable prices. As well as better value, it has also expanded its furniture range to become more of one-stop shop for home products. Dunelm's success shows the importance for retailers to now look both outward at the customer base and their shopping patterns, but also to look internally, and structure the most cost-effective process as possible, to provide those all-important lower prices to customers combined with a relevant product range.

HOW RETAILERS ARE RESPONDING TO THE CHALLENGES

CONTINUED



Shifting marketing to appeal to Gen Z. As Generation Z are starting to become independent consumers, retailers are having to implement strategies and products based on what appeals to this new generation, resulting in growth in personalization, online and sustainability initiatives.

The companies that have been most successful at appealing to Gen Z are those that offer convenience, ESG, personalization and S-commerce (social commerce).

Moreover, with Gen Z consumers being the most active users of social media, and more impressionable, retailers are able to impact their purchasing decisions using product placement and 'influencer' advertisements. This has led to social media platforms promoting sponsored adverts based on consumers search histories, as well as offering stores of their own. Gen Z are particularly pertinent for this shopping habit, which is supported by the statistic that over two thirds of Instagram's one billion users are ages 34 and younger. In particular, categories that have been a popular choice of purchasing are: apparel and accessories, and health products and electronic products.

KEY ACTION FOR RETAILERS:

Leverage relevant marketing channels, such as social media, to proactively engage with Gen Z consumers, and respond to changeable demands with quick adaptability of product development and customization.

SUCCESS STORY: ASOS AND M&S.

ASOS has built a very strong social media following, with 13.9 million followers on Instagram. It has also in the past partnered with celebrities such as Zoella, a popular YouTuber boasting a following of 10 million. As well as teaming up with social media celebrities, ASOS has utilized User-generated content, or 'UGC'. This is any content created by consumers instead of brands and is preferred due to its authentic look. ASOS' #AsSeenOnMe allows it to post the user's content on its official page. This offers free advertising for ASOS and also provides the opportunity for the user to build a social media following. Having genuine customers promoting the product adds legitimacy to the reviews and is far more relatable for potential consumers.

M&S is also making strides on social media; it recently introduced a virtual influencer, Mira, which it will use to promote clothing and accessories on Instagram. This will help engage with a younger audience and allow it to respond more quickly to emerging trends. However, this is the UK's first virtual influencer, and many consumers have responded with skepticism. In addition, M&S must not forget its core, older customer base, and ensure it invests in making its website and social media channels easier to use and more accessible to all generations.

HOW RETAILERS ARE RESPONDING TO THE CHALLENGES

CONTINUED

Creating innovative subscription models and emphasizing the value of these models to retain loyalty. With consumer finances coming under ever increasing pressure, any subscriptions they are committed to are coming under new levels of scrutiny.

In the entertainment space, the big hitters are still reporting growth in subscriptions, but the rate of growth has slowed. Amazon's subscription revenue, mostly from Prime, increased 10% year-on-year in Q2 2022 – a slowdown from the previous quarter growth of 13% and a noticeable drop from the average quarterly growth rate of 30.5% over the last three years. In response to these reduced levels of growth, Amazon has unveiled a 'Buy with Prime' scheme which will enable Prime members to access their Prime benefits when buying directly from a merchant's own online store.

Painting a similar picture, Netflix's revenue is climbing at its slowest rate in many years. Like Amazon, it too is exploring alternate offerings to maximise its perceived value for subscribers. One of these options is an ad-supported membership plan which would be available at a lower price. The plethora of options now available to customers means that in a time when they are looking to reduce their spending, they will have determined which platform brings the most value and if that cost can be justified.

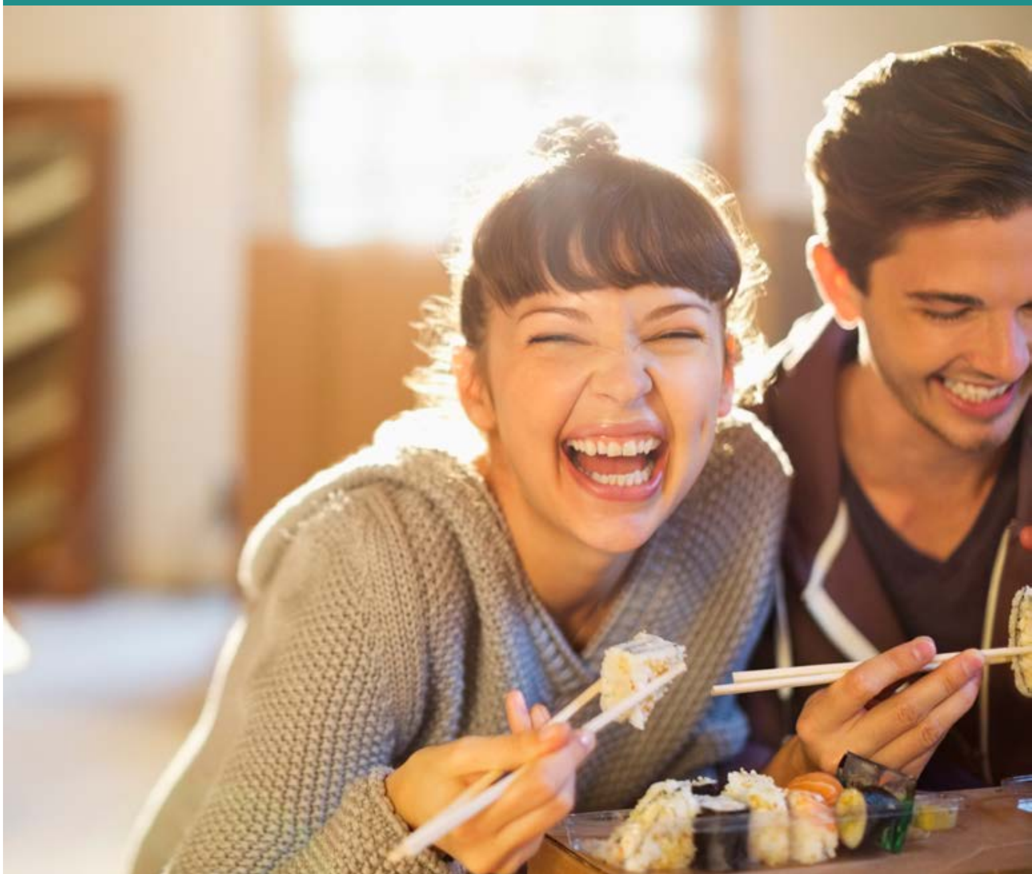
> Amazon's subscription revenue, mostly from Prime, increased **10% year-on-year in Q2 2022** – a slowdown from the previous quarter growth of **13%.**

KEY ACTION FOR RETAILERS:

Seek consistent innovation across subscription services – whether that be via product selection or value-added options – in order to maintain a satisfactory perception of value among consumers.

SUCCESS STORY: GOUSTO.

Once again, consumers are showing a willingness to spend on products they believe still provide good value for money. For example, recipe subscription service, Gousto, had great success during the pandemic. It has been able to achieve consistent funding with the most recent funding raising $100m from SoftBank's Vision Fund 2 and $50m in new debt capital from HSBC and Barclays. This funding would value the company at $1.7 billion, which is a significant increase from November 2020's valuation of $1 billion. Gousto appeals to the current market trends of convenience, health and sustainability which, as long as it stays cost effective for the customer, bodes well for its future.



HOW RETAILERS ARE RESPONDING TO THE CHALLENGES

CONTINUED

Diversifying to meet demands of omnichannel shoppers: The pandemic-driven online surge has started to wane and emerging now is a new hybrid model of instore and online offers. The challenge presented to businesses is trying to seamlessly integrate instore and online in a profitable way.

Even Amazon has shown that it is not immune to the current macroeconomic situation, with global Q2 sales down by 2.5% compared to the previous year, of which, online sales have fallen by 4% in the same time period. However, its diversified portfolio of income streams has offered it some protection and its services side from cloud computing to advertising continues to grow, thereby offsetting the decline in retail, which has been under increasing pressure with the general reduction in spending. Moreover, Amazon's omnichannel approach is proving its value, as sales through its physical stores, in the form of Whole Foods and Amazon grocery stores, are up by 12%, albeit on weak prior-year comparatives.

Other pureplays are also now having to react to the improved online offering from omnichannel retailers as they improved their online capabilities during COVID-19. ASOS is planning to open a pop-up store to sell products at a discounted price. This is due to ASOS having surplus stock that is now out of season. While this store is temporary and there are no current plans for a permanent location, it shows an appreciation from online pureplays that physical stores can still provide value and opportunity.

Meanwhile, as more customers than ever are now willing and able to browse for products online, high street stores need to offer something different, and there is a growing trend to create an 'experience' and bring in-store intrigue for shoppers.

Moreover, offering an enhanced store experience can also help retailers to differentiate themselves within the market and justify higher price points. Online pureplay, Gymshark, will soon open its first physical store on Regent Street, with a focus on providing an engaging in-store experience. As well as selling clothes in the store, Gymshark will host special events, community 'hangouts' and offer workout spaces, in the form of a sweat room and pro-bench, where experts will be situated to provide fitness advice. It will also have a 'hub' section where its community can produce podcasts and host panels, workshops, screenings, and live streams.

HOW RETAILERS ARE RESPONDING TO THE CHALLENGES

CONTINUED

In-store innovations are happening across all areas of retail, with grocery retail stores also exploring methods of improving the customer experience. The focus for grocery retailers has been convenience, with facilities such as self-scanning tills. While the pandemic heavily impacted convenience stores, particularly those located in city centres, 2022 has seen a revival of these convenience stores, as people returned to the office. GlobalData research shows that spend via convenience stores reached £38.1 billion in 2022 and is forecasted to continue to grow into 2023, with the market reaching £42.7 billion in 2026. Moving beyond self-scanning checkouts, many grocery retailers are trialing cashierless stores in the UK, including Amazon, Tesco, Sainsbury's and Aldi. This provides potential for further future convenience and would be popular with the modern-day consumer; 74.2% of consumers in Global Data's 2021 convenience survey said they would use a checkout-free store if it opened near them. While the technological and set-up costs involved are significant, over time this can both improve the customer experience and the payroll costs for the retailers. Any increase in efficiency that a retailer can find, in terms of speeding up the process for customers and minimising payroll costs, will be beneficial during this period of reduced spending and lower sales.

> Spend via convenience stores reached **£38.1 billion** in 2022 and is forecasted to continue to grow in to 2023**.**

KEY ACTION FOR RETAILERS:

Drive innovation both online and in physical stores to enhance value, convenience, and customer service during the shopping journey; Innovate modern store concepts to build brand awareness, differentiate from competitors and add to the multi-channel offering, to entice shoppers.

SUCCESS STORY: GYMSHARK.

Gymshark opened its first flagship store in London on 1st October 2022. Located at 165 Regent Street, the store goes far beyond just selling products. The 18,000ft2 store features a Sweat Room with bookable classes, an exclusive Joe & The Juice location, a space called 'The Hub' which will host events and guest speakers, and studios where podcasts can be recorded. This demonstrates that omnichannel approaches can encompass online pureplays entering the high street, as well as physical retailers improving their online capabilities. The long-term success of this venture from Gymshark remains to be seen, but it sets the benchmark for others in the industry to rival its in-store offering.

HOW RETAILERS ARE RESPONDING TO THE CHALLENGES

CONTINUED

Revamping operations to meet ESG demands. Many areas of retail operations drive ESG considerations. However, two of the major offenders are vehicle usage and apparel materials. Vehicles are responsible for the most emissions in processing online orders. For example, Ocado orders produce 73% of the company's total emissions, followed by electricity usage, at just 20%. As a result, retailers and logistics companies are moving towards electric fleets and natural gas-powered vehicles to reduce emissions. For example, Tesco launched a fleet of 2,000 fully-electric HGVs in February 2022, (though this makes up less than 1% of its total fleet); and Amazon is launching five electric HGVs in its delivery fleet in the UK.

Retailers are also improving the sustainability of the materials they use, especially in apparel, and this is starting to move beyond just looking at using a small proportion of recycled materials. For instance, the Boohoo Group opened Boohoo Lab to test the performance and durability of its garments, using technologies such as X-ray fluorescent guns and dye migration testing, helping to ensure that its products can last, and are suited to a 'circular economy'.

KEY ACTION FOR RETAILERS:

Incorporate ESG into everyday operations, from how the business is run to how products and materials are sourced. The focus on this will only increase as Gen Z continue to account for more of the UK's consumer spending.

SUCCESS STORY: WAITROSE.

The John Lewis Partnership has initiated a new sustainability policy for Waitrose, centred on "protecting and restoring nature." It has revealed fresh sustainability targets, with the aim to have zero deforestation when obtaining key commodities across all Waitrose own-brand product supply chains. As part of this new plan, Waitrose has partnered with the World Wildlife Fund to invest £2 million into conservation projects in both the UK and India. The UK-based project will protect and restore nature in Norfolk, where Waitrose sources its meat, cereal and vegetable products. Waitrose has also promised to make sure that at least half of its fresh products come from areas that are managing water use responsibly by 2030. As well as this, Waitrose is aiming to omit all fossil fuels from its transport fleet by 2030 and it will target to have all large lorries using biomethane fuel by 2028.

Retailers and logistics companies are moving towards **electric fleets** and **natural gas-powered** vehicles to reduce emissions.

HOW RETAILERS ARE RESPONDING TO THE CHALLENGES

CONTINUED

Established retailers looking to replicate marketplace successes. The best indicator of appetite for the secondhand market is in the growth and development of online marketplaces. However, marketplaces are now facing additional competition from resale options within established retailers. While John Lewis is just starting to explore this area, the likes of Levi's, New Look and PrettyLittleThing are already offering similar services to customers. This is not just limited to apparel categories, with B&Q also launching a successful marketplace that has outperformed expectations and contributed to 8.0% of its online sales in the six months to the end of July 2022.

John Lewis & Partners has also recently entered the reusable fashion space by introducing a clothing hire option for its customers. It has partnered with Hurr and offers shoppers the option to hire female fashionwear for 4, 8, 10 or 20 days. This trend has continued with Flannels also launching an online rental scheme, again with Hurr. It will follow the same guidelines as John Lewis for days available to rent and will primarily focus on women's clothing and accessories.

Even grocery retailers are striving to improve sustainability through embracing the circular economy, in line with consumer demand. For example, Lidl has recently unveiled a smart refill machine to reduce waste. It is located in the store's laundry detergent section and uses automated touchscreen technology that enables customers to pick up pouches and select a detergent of choice. Lidl states that the machine will be capable of filling more than 245 individual pouches, increasing capacity by 300%. This shows how sustainable options can also reduce costs for both the consumer and retailer, as customers will save £0.20 on each refill and at the same time save 59g of plastic. This will also allow Lidl to increase sales density and means replenishment tasks are not required as often.

KEY ACTION FOR RETAILERS:

Leverage the changes in consumer preferences and buying behaviours by responding to the demands of Gen Z particularly around the circular economy.

Vinted is now the largest consumer-to-consumer marketplace in Europe, with more than 50 million members in 13 European countries, as well as also being present in the US and Canada. Its biggest opportunity is among consumer aged 25-34 were the most active buyers in the resale market for clothing, footwear and/or accessories in 2021, with 38.1% consumers in this age-group purchasing resale items.

SUCCESS STORY: eBAY

The best indicator of appetite for the secondhand and circular markets is in the growth and development of online marketplaces. This is seen clearly in eBay which has innovated consistently over the last couple of years, to take advantage of the increasing demand. For example, it launched a new interactive shopping platform 'eBay live' which gives users an opportunity to purchase products in a live environment. This is designed to allow customers to come together and interact over shared interests and merchandise. eBay has gone through a period of rebranding to appeal to a younger audience which is showing the most appetite for the secondhand market. This is clear with eBay's recent sponsorship of the reality tv program Love Island. As well as encouraging buyers to its platform, eBay is also providing support and incentives for sellers to use its platform to increase its share of the growing resale market. To promote local businesses, eBay has dropped final value fees by 50% on transactions made during select periods over the next three months. This is an attempt to make it easier and cheaper for small business and sellers during the festive period.

CONCLUSION

As we approach 2023, the retail outlook is undoubtedly once again a challenging one, mixed with high levels of uncertainty as to how some of those challenges will impact. Retailers are facing a plethora of headwinds as consumers spend less, and the cost of imports, raw materials, and energy rise. Added to this, the government's recent u-turn on plans to scrap a rise in corporation tax from 19% to 25% will put further pressure on any profits that are generated.

Remaining relevant is critical and will require retailers to navigate these financial challenges, while also responding to changing consumer demands when it comes to areas such as sustainability and cross-channel shopping. All of this will need investment at a time when cash is in short supply and borrowing costs are rocketing, requiring a tricky balancing act that encompasses both short-term stability and long-term strategy.

However, as noted in our opening, those retailers that are able to adapt and harness an operating model that feeds the post COVID-19 shopping behaviors will build a sustainable business that will outperform others when we emerge from this economic turmoil.

Hopefully 2024 will finally be the year that things begin to stabilise and we return to a steadier environment of the kind last seen around 2015. As for 2023, it seems to be another year in which retailers will need to once again be exceptionally well run but still remain incredibly agile, just to stand still.

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