Taking Stock

2022

The outlook for Consumer & Retail

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Tom Scourfield
Co-Head of UK Consumer & Retail
T +44 20 7367 2707
E tom.scourfield@cms-cmno.com

Katie Nagy de Nagybaczon
Co-Head of UK Consumer & Retail
T +44 20 7067 3519
E katie.nagydenagybaczon@cms-cmno.com

Quick stock take

A year in review

For many consumer brands and retailers, 2021 was a pivotal year. It was a year characterised by exploration, innovation, new partnerships, and novel approaches to overcoming challenges – many of which still remain. Operating within a disrupted industry however meant that business models were severely stress tested, with some high-profile brands falling into administration. Those that survived are now equipped with increased resilience to face the uncertain geopolitical climate of 2022 and consequent pressure on raw materials, food prices and supply chains.

By mid-2021, the UK economy began recovering faster than many economists had forecast. The relaxation of restrictions drove a strong rebound in activity and throughout the year, consumer spending remained relatively robust as pent-up demand was released. The industry as a whole fared better than expected. Retail sales increased by 7.8% year-on-year, albeit against soft comparisons.

Disruptive influences remained. As economies reopened following lockdowns, swift upticks in demand exerted significant pressure on the availability of labour and key global commodities, ranging from microchips to gas. Inevitably, the knock-on impact to the supply of goods and services was sustained throughout 2021. Localised Covid-19 outbreaks and lockdowns also triggered a disabling domino effect across entire networks placing global supply chains under intense pressure.

These influences created noticeable headwinds for the consumer & retail sector, albeit unevenly distributed across categories. Supply chain disruption particularly impacted those reliant on overseas imports such as apparel, furniture and electricals. Some retailers even switched to more costly freight options such as chartering flights to secure stock levels. High value categories where in-store ‘touch and feel’ is critical (e.g. furniture and flooring), suffered particularly from store closures.

For some categories like apparel, fluctuating Covid restrictions led to altered product mixes. Demand for formal and occasion wear ramped up with increasing opportunity to socialise and return to offices, while lockdowns gave rise to more comfort-inspired purchases.

Covid restrictions also benefitted certain categories by demand being pulled forward – electricals being a prime example. It functions with a relatively slow churn, but cyclical purchases were accelerated during lockdowns by demand for home office equipment and home entertainment. Similarly, grocery retailers benefited from mandated hospitality closures of pubs, bars and restaurants, as well as working from home.

In summary, 2021 presented many key challenges for brands and retailers, but it provided fertile ground for learning, exploring and developing. Many business models were unable to sustain the pace of change, or to generate the levels of investment necessary to survive. However, those that adapted to overcome key challenges throughout the year appear to be fortified by the process. Whether they are sufficiently fortified to withstand the uncertainty of 2022 is harder to predict.

2022 - What's in store?

The backdrop

Economic growth has been hit by geopolitical events…

The UK economy is on course to grow 3.8% in 2022, significantly downgraded since the beginning of the year. Many households are walking out of a pandemic into a cost-of-living crisis with real household disposable incomes on course to fall at the fastest rate since records began in 1956-57.

There are also elevated levels of uncertainty following Russia's invasion of Ukraine which will likely dampen business investment and prolong supply chain disruption. Meanwhile, the ongoing impact of the pandemic remains a key threat.

…and confidence has weakened sharply…

GfK's consumer confidence index recovered to its pre-pandemic level in July 2021. Business confidence also hit a turning point from being 'defensive' during lockdowns to 'expansionary' heading into 2022. But the impact of a 30-year high in inflation of 6.2% in February and the invasion of Ukraine has seen consumer confidence plummet back to the levels seen in January 2021 during lockdown.

...with disposable incomes getting tightly squeezed...

Although the labour market has driven strong nominal earnings growth, rising inflation caused real earnings to slip into negative territory in November 2021 and concerningly this trend is expected to accelerate this year.

Heading into 2022, consumers face an array of pressures on disposable income. Nearly two-fifths of consumers expect their personal finances to weaken over the first quarter. From the second quarter, high inflation (expected to peak at c.8.5% in Spring) and squeezed earnings will be embedded into the economy with hospitality VAT returning to 20% (from 12.5%), an increase in National Insurance Contributions (NIC) of 1.25%, and the prospect of a 50% uplift in the energy price cap.

…putting discretionary spending under pressure…

The impact of rising NIC and energy bills alone will see the average household suffer a £1100 reduction in income in 2022, according to The Resolution Foundation.

As the cost of essentials rise, households expect to cut back on discretionary purchases such as electricals and eating out and to scale back big ticket purchases. 48% of consumers expect to spend less on non-essential items in Q1 2022, rising markedly from 36% in Q4 2021.

...and disproportionately impacting vulnerable households.

The most economically vulnerable households spend a disproportionately high share of expenditure on essential goods and services. For staple expenses such as food, drink and energy, the least affluent spend around two thirds of their household spending, compared to less than half among the most affluent.

So all in all, the outlook is challenging!

How this all translates to consumer & retail remains hard to tell, as the squeeze on finances will be cushioned by excess savings for some households. Bank of England estimates show UK consumers accumulated an additional £260bn of savings throughout lockdowns from less commuting, holidays and social activities, but this is highly concentrated across middle to high income households.

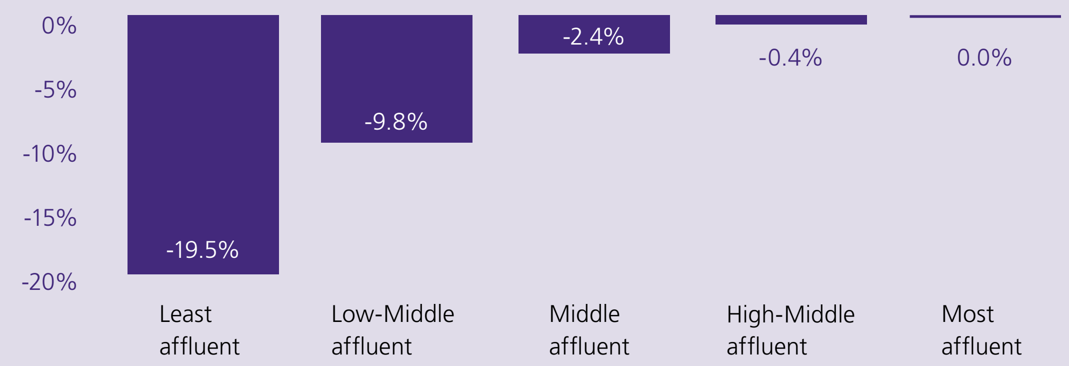
How quickly these savings are spent down and where, will be critical in determining the strength of consumer and retail sales throughout the year.

But it is inevitable that the most disadvantaged households will be under the most intense pressure.

Despite a raft of supportive measures announced by the Chancellor in the Spring Statement (March 2022), the least affluent families are expected to see their discretionary income (what they have left after paying for essentials) fall by 19.5% per household – almost £850 - in 2022. For the average family, the cash left after paying for essentials will fall by almost 6.5% or £430.

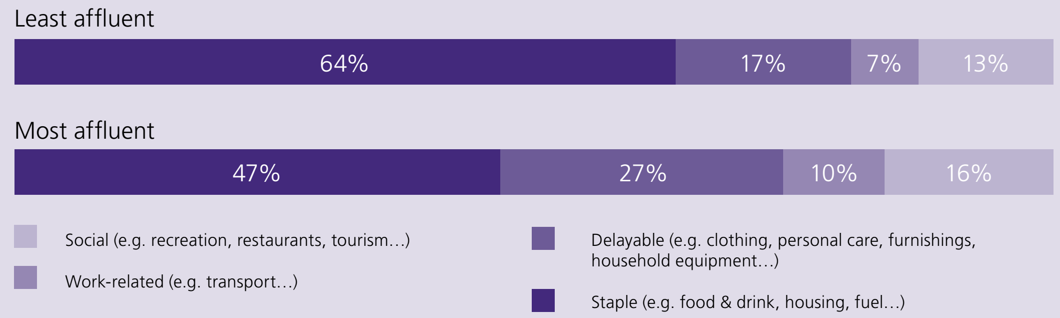
Across the economy, over £12 billion worth of spending on non-essentials – equivalent to almost the entire DIY and Gardening sector – will be wiped out.

The cost of living crisis will hit discretionary incomes of the least affluent the hardest



Source: Retail Economics

The least affluent households spend a disproportionate amount on essentials



Subsector outlooks

Sector	Summary	2021 Actuals	2022 Forecast
Food and Grocery	Heading into 2022, food and grocery will face greater competition from hospitality spending on events and a return to offices. This will lead to a decline for the category, softened by rising food inflation. As consumers face rising costs of living, they are likely to engage in recessionary behaviours such as shopping around and become increasingly cost-conscious. The 'big four' supermarkets are well aware of the market share that discounters captured in the aftermath of the financial crisis, hence they will work hard to secure their share by focussing on price and value. Grocers will also continue to invest in developing online capacity and efficiency, supported by digital platforms including Deliveroo, Uber Eats and Gorillas.	+1.7%	-1.0%
Apparel	The apparel sector is sensitive to changes in Covid-19 restrictions, such as working from home guidance and restrictions on social events. This undermines demand for formalwear. Assuming restrictions will be more relaxed compared to 2021, consumer demand for work, holiday and occasion wear should recover. But supply chain pressure will impact lead times and put pressure on margins – particularly fast fashion players operating on thinner margins requiring faster turnarounds. The squeeze on incomes will see replacement cycles prolonged and spending focused more on functional-wear and distressed purchases.	+29.1%	+3.1%
Health and Beauty	Health and Beauty demonstrated fluctuating performance, with beauty in particular coming under acute pressure from Covid-19 restrictions. However, as socialising and office work returns, cosmetics sales are expected to receive a vital boost as consumers replenish beauty products which will ultimately drive overall category sales.	+9.7%	+7.0%

Sector	Summary	2021 Actuals	2022 Forecast
Home, Furniture and Flooring	The furniture sector is likely to face continuing supply chain disruption into 2022, stunting sales and causing delays. With the housing market intrinsically tied to the performance of this category, it is worth nothing that the residential market is cooling compared to the highs in 2021 (supported by the temporary Stamp Duty relief, involuntary savings during lockdowns and households' 'race for space'). As the pandemic fades, contributory Covid factors associated with housing activity are also likely to fade. Homewares is expected to stabilise in 2022 as consumers make incremental improvements to their homes.	+15.6%	+3.3%
DIY and Gardening	The level of DIY & home development projects will wane in 2022 compared 2020/21 when many workers were at home on furlough during lockdowns. Now, the category will be competing with greater discretionary spending with consumers focused on previously restricted activities, including outdoor pursuits, socialising, leisure and hospitality.	+13.7%	-0.4%
Electricals	Following strong demand in 2020/21, electricals spending in 2022 is set to soften against strong comparisons as demand wanes. Electricals are very income sensitive, and it is often one of the first areas consumers will look to cut back on. Electrical purchases are typically cyclical, and consumers brought forward purchases of big-ticket items for improving home offices and entertainment systems. Also, the latest generation of games consoles saw a burst in demand in late 2020, which will create tough comparisons as demand for Playstation 5 and Xbox Series X tails off. Delays caused by supply chain disruption including microchip shortages are set to undermine growth potential for much of 2022.	+2.1%	-6.3%

What's popping

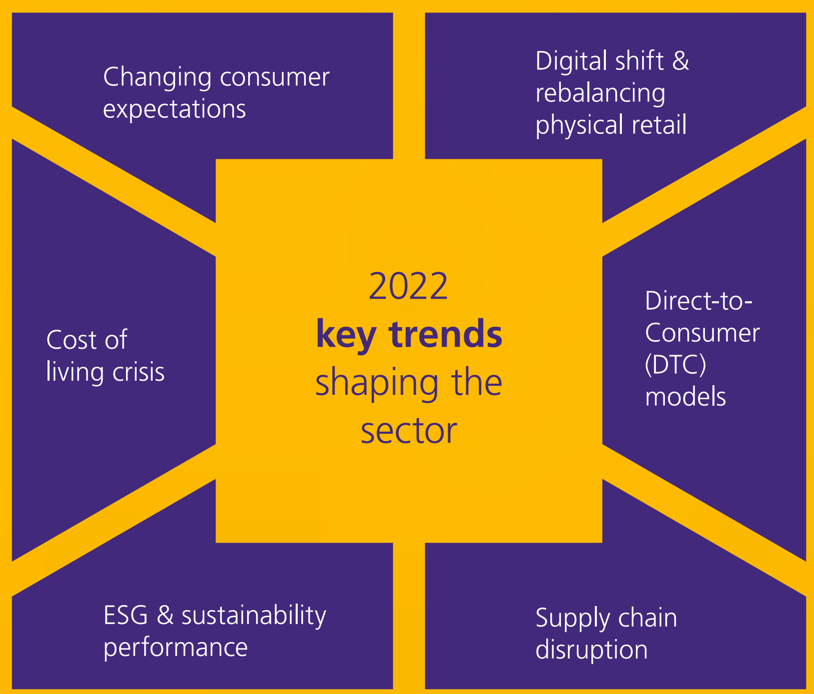
Key trends for 2022

Pandemic-induced disruption has continued to fuel structural changes across the entire consumer landscape. In many instances, consumers were 'forced' into new shopping behaviours due to mandated store closures and fears around the virus.

While certain groups of consumers will revert to previous habits (and in some cases already have), many behaviours have now become engrained, underpinned by a new set of customer expectations.

The sector has already been 'shaken up', bringing with it much fallout. More nimble, financially stable and adaptable businesses survived, gaining market share, while others fell into administration. During this period, a raft of acquisitions followed (e.g. Asos acquiring Arcadia, Boohoo buying Debenhams). Partnership exploration with other retailers and suppliers also ensued, aimed at reducing costs, ramping up online capacity and delivery capabilities (e.g. Reiss partnering with Next, and Marks and Spencer with Deliveroo).

With the latest global shock of the invasion of Ukraine, disruptions persist requiring continued vigilance if brands and retailers are to remain profitable and relevant. We identify numerous (established and emerging) industry trends currently shaping the outlook for the sector in 2022; and explore elements of the most influential ones below.



Bricks to clicks: rebalancing physical retail

Through successive waves of restrictions and lockdowns online shopping hesitancy has been challenged, exposing new cohorts of shoppers to digital touchpoints across the entire customer journey. Despite easing restrictions across the UK, these newfound behaviours have been sticky for a significant proportion of consumers, with online sales rising, accounting for 28% of total sales in 2021 from 19% in 2019.

As e-commerce traverses a period of 'forced' acceleration, increased investment is being required for digital marketing, warehouse automation and courier networks. Essentially, five years of digital development was achieved in just 12 months as new technologies, modes of operating and innovative partnerships were formed.

However, these relatively sudden shifts have fundamentally altered the structure of operating costs, squeezing profitability. Online sales involve higher variable costs. These costs are associated with digital marketing, delivery costs and higher levels of returns (especially for apparel). Additionally, the price transparency of online typically puts pressure on prices and seemingly exposes shoppers to an almost endless aisle of brands and retailers. Consequently, retailers typically operate on considerably lower margins than bricks-and-mortar businesses.

The shift online has left many retailers that operate expansive store estates at risk of grappling with cost structures disproportionately weighted towards physical channels. This is leading to store rationalisation amongst those that have more outlets than are commercially viable going into 2022.

Stores are also transitioning away from being purely transactional as digital becomes embedded across the customer journey and home shopping provides greater levels of convenience. Technology is being deployed in stores to support online sales. This encourages increased visits, including using stores as fulfilment hubs for click and collect and returns. In addition, enhanced digital integration (e.g. use of AI, augmented reality and virtual reality) can bring products to life - hence the purpose and role of physical stores is changing to increasingly align with marketing objectives. This merging of physical and digital channels will become critical to providing seamless shopping experiences.

Landlord and tenant flexibility: the key to unlocking retail's future

As the nature of retail changes so too does the relationship between landlord and tenant and the way in which spaces are used.

Retail property was once the darling of commercial real estate, feted by developers attracted by the transformation in land values brought by developing shopping centres and retail parks, and sought after by investors seeking predictable growth in capital value and incomes via upward only rent reviews.

Butin 2022, the picture for retail property is increasingly mixed. Certainly, the headlines have not been good, with at least one shopping centre recently said to be going to auction with a £1 reserve, and well-known retail landlords going into administration or having to dispose of large retail portfolios in order to meet banking covenants or shareholder demands.

In practice, the picture for retail property is more nuanced. Online only retailers such as Amazon have started to roll-out more physical stores. Similarly, click and collect retailers such as Argos provide a bridge between traditional stores and on-line.

Many retailers are rebalancing their store estates in favour of 'footfall hot spots', such as retail parks which were particularly resilient through the pandemic, but some do still see a value in a high street presence.

What is really changing is the relationship between landlord and tenant, with "flexible" being the key word in retail property transactions. Flexible in terms of how the rent is calculated and for how long (turnover rents and shorter-term leases being examples of this). Flexible in terms of the size of the space taken, and what it may be used for (retailers are trying new formats occupying smaller space or sharing it with other users such as coffee shops and concessions, and changing what they sell to encompass a wider range of goods, especially food). Such flexibility requires imagination and significantly changes the traditional relationship between retail landlords and their tenants. Landlords have also changed their outlook. New and existing schemes can no longer expect to be anchored by a single major retailer such as John Lewis or Marks & Spencer. Instead, dynamic independent stores can be as important for driving footfall due to their unique offer; unavailable elsewhere or on-line. Destination leisure is also now part of the flexible mix with restaurants and themed leisure acting as the draw to bring customers into town. Absentee landlords without active property managers are unlikely to thrive in the current retail climate.

The government is also doing its bit for flexibility by the introduction of a new permitted development right, Class E, which allows for the more flexible use of property previously limited to retail use (allowing changes to other commercial uses including gyms and offices without requiring express planning permission). The importance of vibrant town centres was also underlined in the recently published Levelling Up White Paper which set out the government's aspirations for the re-invigoration of towns and cities. In short, town centres will regenerate, shopping centres and retail parks will be developed and renewed, and real estate will undoubtedly remain part of the retail mix, but it will be increasingly joined by complimentary uses, including commercial, leisure and housing.

Households in a cost of living crisis

UK households will have significantly less cash for discretionary spending as the country enters a new age of financial anxiety. As economic uncertainty, rising inflation and rocketing energy drives the biggest cost of living crisis seen in 50 years the country remains on course for a cost-of-living crisis with the least affluent families expected to see the hardest hit to discretionary income. Two thirds of UK adults are worried about money (64%) – rising to 70% for under 45s.

Even among the highest income households, a third (30%) don't always pay off credit card or 'Buy Now, Pay Later' (BNPL) debt each month. Almost a quarter (23%) don't feel on top of their money and spending, and more than half (56%) agree money is a worry for them. A wave of further pressure can be expected.

Supply chains under the spotlight

Globalised and interdependent supply chains have been exposed to the impact of the pandemic, including mandated factory closures and shortages of drivers as workers self-isolate, retire and relocate. This has resulted in surging costs and delays, putting supply chain management firmly under the spotlight.

As demand outpaces capacity, operating costs have soared. For instance, shipping container costs rose by more than nine times across most major shipping routes in 2021, compared with the previous year. In response, larger companies have turned to rising wages and bonuses to tempt HGV drivers into vacant roles. Additional checks and complexities associated with Brexit have also compounded delays, creating additional uncertainties around the continuity of supply.
Many businesses have reacted by building up greater inventory levels which in turn has boosted the cost of storage and unsettled balance sheets.

Although freight costs peaked in September 2021, brands and retailers are turning to alternative transportation together with near shoring, on shoring and re-shoring to secure future supplies.

Beyond introducing greater resilience for future disruption (e.g. Covid-related shutdowns), the reassessment of supply chains enables companies to benefit from new free trade agreements as the UK establishes its trade position in a post-Brexit environment.

Companies finally mean (green) business: sustainability goals intensify

Towards the UK's path to net zero emissions by 2050, government policy will trickle down to businesses, resulting in a growing number of companies committing to carbon neutrality. With the UK ahead of the curve in its sustainability aspirations, the government is grappling with how to decarbonise the economy given vast differences in carbon intensity by industry and size of corporation.

As government pressure on retailers intensifies, the urgency to operate and behave with sustainable principles will ripple across society. Consumers and investors will come to expect a minimum level of commitment as sustainability-conscious behaviour becomes normalised.

To this end, consumer and retail is ahead of industries such as mining, metals and minerals in terms of its ambitions to net zero. A sample of the largest 50 listed UK retailers (with a combined market capitalisation of £156bn) shows that around half (46%) have net zero commitments, with the average year to net zero being 2041.

As businesses look to build back better from the pandemic, brands will form strategies that accommodate the government's plans for a 'green revolution' as the UK supersedes other countries to leverage a possible competitive advantage in this regard.

Such a commitment requires significant transformation across operations. For instance, consumer manufacturers and retailers will need to source more renewable energy across manufacturing, distribution centres and stores.

There is growing pressure to also decarbonise short-haul final mile delivery through electrification, and retrofit stores and warehouses with energy saving initiatives and carbon capture measures.

Beyond regulatory pressure, other industries will demand better practices from brands and retailers too (e.g. financial services). Investors are increasingly backing 'green projects', with capital providers looking to fund ventures aligned to their ESG targets.
Large brands and retailers are making incremental changes that will ripple across the consumer landscape as new practices gain traction. Examples include Burberry refinancing its revolving credit facility to a £300m sustainability-linked loan as part of its ambition to become climate positive by 2040; and Tesco planning to operate a fully electric fleet by the end of 2028.

Consumer companies failing to meet their sustainability & ESG targets run the risk of reputational damage; and in the worst instance, igniting the potential for consumers to boycott brands if green practices are dispassionately implemented.

It's not all gas and plastics: don't forget the S in ESG!

When talking about whether organisations are hitting their ESG targets however there can be a tendency to default to "green" issues. It is not always clear how or where the S fits in. If you think about the term ESG as being interchangeable with sustainability however, things become clearer: measures that fall under the S for Social address how organisations build and retain a sustainable workforce, as well as their behaviour in business relationships, their supply chain and their interaction with their local community.

In 2022, being a good place to work is not just a nice to have. In a sector facing acute staffing shortages, it is a key component in attracting and retaining key talent. For example, a poll of 1,000 UK workers, conducted as part of the EY 2021 Work Reimagined Employee Survey, found that 47% would consider changing their jobs if flexible working wasn't an option. Individual consumers are attaching more and more importance to businesses' ESG credentials when deciding where to spend their money and investors are increasingly focused on companies' ESG ratings.

Within the consumer & retail sector, there is already a lot of positive work being done. A great example is Unilever's FairKitchens movement where chefs support chefs to inspire a new kitchen culture.
However, for those looking to build on their existing S action plan or kick-start S initiatives, key areas of focus could include diversity & inclusion, better workforce engagement, modern slavery, executive remuneration and community & social value.

Within each of these areas there are practical and measureable steps that can be taken and then publicised to demonstrate success. For example, progress towards closing your gender pay gap, running effective employee D&I networks, conducting (and acting on) employee satisfaction surveys, meeting external standards, e.g. Mindful Business Charter, carrying out due diligence into your business and supply chains (whether or not your business is legally obligated to publish a Modern Slavery Statement) and reviewing the pay gap between employees and executives.

“Green” advertising claims: proceed with care

With environmental issues becoming increasingly important to consumers, advertisers are understandably keen to share their green credentials. However, environmental or “green” advertising claims are the key area of regulator focus for 2022, in the UK and Europe.

Advertisers should be aware that even apparently innocuous claims are likely to attract scrutiny from regulators, campaigners and the public, and should prepare accordingly.

The UK consumer regulator, the Competition and Markets Authority, published an updated Green Claims Code in September 2021. The new code has six key principles:

- claims must be truthful and accurate
- claims must be clear and unambiguous
- claims must not omit or hide important information
- comparisons must be fair and meaningful
- claims must consider the full life cycle of the product or service
- claims must be substantiated

These principles are not new – they emerge from existing legislation and regulation, which are drawn together in the Code. However, the publication of the Code, and the CMA’s comment at the time of publication that it intends to start enforcement this year, signals a new focus on green claims. This is significant because the CMA has the power to conduct sector-wide enquiries. Also, unlike the first-line regulator the Advertising Standards Authority, the CMA can bring court proceedings against non-compliant advertisers.

The principles apply to business-to-business as well as consumer advertising. They also apply to all kinds of marketing communications, not just paid-for advertising, with business websites and social media channels a particular risk.

Some of these principles overlap: for example, a failure to consider the full life cycle of a product or service may amount to the omission of important information. However, key considerations for advertisers include the following:

- Claims should state what aspect of a product or service is “green”. Broad, general or absolute claims such as “green”, “sustainable” or “eco-friendly” are likely to be seen as suggesting that a product brand or business has a positive environmental impact as a whole, and the advertiser will need to be able to prove that.
- Green claims can be complex and often require a basic understanding of scientific concepts. Consumers can therefore be misled easily. Technical terms should be avoided or clearly explained, and any significant qualifications or clarifications made clear and prominent – not hidden in small print. This militates against making green claims in channels such as social media, where there is limited space to explain them.
- Advertisers should not “cherry pick” environmentally benign aspects of their products or services and ignore those that cause environmental harm.
- Comparisons must be like-for-like and use the same test methodology for both products compared. Any comparison with an identifiable competitor must also be “verifiable”. This means that the ad must include enough information to allow a reader to check the accuracy of the claim themselves, or a “signpost” to where that information can be obtained. This means that advertisers must “show their working” when making comparisons, and the data cannot be kept confidential.
- Claims must consider the full life cycle of the product. A claim that a product is “net zero”, for example, must cover not just manufacturing and transport, but also raw material extraction, retailing and end-of-life disposal. If the available data does not cover the full life-cycle, claims should be specific about what is covered.
- Green claims must be substantiated by evidence in hand at the time the ad appears. Advertisers should recognise that many green claims are challenging to substantiate, and that doing so may require significant investment.

The CMA has already launched a review of green claims in the fashion retail sector, and indicated that the travel and transport and FMCG sectors will follow.

In the meantime, we are already seeing a tightening of the ASA’s approach to complaints about environmental advertising. In a ruling against Oatly in January 2022, the ASA focused on the advertiser’s failure to make clear what part of its products’ life cycle the claims applied to, or to make a like-for-like assessment when comparing CO2 emissions from the meat and dairy industry and the transport industry. In a ruling against Innocent Drinks in February 2022, the ASA upheld complaints that apparently innocuous environmental messaging exhorting consumers to, among other things, “Reduce. Re-use. Recycle” – and which did not feature any overt green claims as such – nonetheless amounted to an implied claim that Innocent was environmentally friendly and its products had environmental benefits.

Green claims are therefore an area of significant risk. While advertisers should not be shy of communicating the genuine environmental benefits of their products and services, advertising that focuses on environmental issues should be approached with caution, and with a clear understanding of what claims the evidence in hand can and cannot support.

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