WHAT'S NEXT – THE FUTURE OF SCOTTISH RETAIL

A REPORT ON PRODUCTIVITY AND INNOVATION IN SCOTTISH RETAIL

ABOUT THE SRC

Retail is an exciting, diverse and dynamic industry undergoing transformational change. The SRC is at the forefront – enhancing, assisting, informing and shaping. Our mission is to make a positive difference to the retail industry and to the customers it serves.

Our broad range of stakeholders demonstrates how retailing touches almost every aspect of our culture. The SRC leads the industry and works with our members to shape debates and influence issues and opportunities that will help make that positive difference. We care about the careers of people who work in our industry, the communities retail touches and competitiveness as a fundamental principle of the industry's success – our 3Cs.

In addition to publishing leading indicators on Scottish retail sales, footfall and shop vacancies in town centres, our policy positions are informed by our 255-strong membership and determined by the SRC's Board.

For more information please contact

Ewan MacDonald-Russell | SRC Head of Policy and External Affairs
ewan.macdonald-russell@brc.org.uk

CONTENTS

EXECUTIVE SUMMARY

THE SCOTTISH RETAIL INDUSTRY

- Scotland has a diverse and dynamic retail industry. However, due to geography and the evolution of the UK retail industry there is a higher proportion of stores per head than elsewhere in the UK. There is also a lower proportion of head office roles against the profile of the UK retail industry as a whole.
- The Scottish retail industry is a significant part of the Scottish economy. However, the cost of public policy makes operating in Scotland more expensive than elsewhere. This is because significant increases in business rates and employment taxation have had an enormous impact on businesses that have traditionally been dependent on large property holdings and large work forces.
- This combination makes the Scottish retail industry vulnerable to the impacts of changes in the wider industry.
- The consequences of these changes could be very serious. In future years retailers will be employing significantly fewer workers, who will be in better paying roles. However, low skilled workers, and those whose town centres may struggle to attract investment, are likely to find work in retail significantly more difficult to access in than they do today.

THE IMPACT OF COMPETITION AND TECHNOLOGY ON RETAIL

- The Retail Industry is going through a period of transformational change. New market entrants have created a highly competitive market which has significantly contributed to falling shop prices.
- New technology has changed the relationship with the consumer, giving them more information about products and new channels for shopping and delivery.
- Technology has also opened new opportunities for brands to compete directly with retailers without any necessity for the same people and property investments as traditional retailers.
- Public policy has also incentivised automation and digital technology over traditional property and labour intensive models.

- The retailers which succeed will be those who are able to harness new technology and higher skilled workers to drive productivity gains and engage an ever more demanding customer base.

ANALYSIS OF SCOTTISH RETAIL PRODUCTIVITY

- There are a number of challenges in calculating Scottish Retail Productivity due to a scarcity of comparable data, and some concerns over some of the datasets.
- Scottish Retail Productivity has improved between 2008 and 2014. However, much of this improvement is a consequence of a shrinking workforce rather than significant economic growth.
- Scottish Retail Productivity appears to be growing at a slower rate than elsewhere in the UK.
- Scottish retail research and development spending appears to be increasing at a slower rate than elsewhere in the UK.

HOW IS THE SCOTTISH RETAIL INDUSTRY ADAPTING?

- Scottish retailers are taking a variety of approaches to the productivity puzzle. Some retailers are investing in higher wages, capital investment, and training and development of their workforce.
- This is leading to an overall reduction in the number of retail jobs, something which is predicted to accelerate over the next decade. However, those workers who remain in retail are likely to benefit from higher wages and more varied work.
- If Government policy does not change these changes may disproportionately affect less affluent or more remote communities where it will prove increasingly hard to operate profitable stores on the current scale.

THE ROLE OF THE SCOTTISH GOVERNMENT IN GROWING THE SCOTTISH RETAIL INDUSTRY

- The Scottish Government has the opportunity to significantly affect the process of retail change. If it chooses to ameliorate the economic conditions by lowering the cost burden and developing an overarching retail strategy; it could provide the opportunity for retailers to focus on modernising their businesses.

- Failure to make these decisions will see the continuation of the current concerning trends. Scottish retailers will be forced to focus on managing increasing cost pressures whilst their capacity to invest in the future will be hampered. That will inevitably accelerate the process of store closures and job losses which we are already seeing. Without investment there is a risk that Scotland will miss out on many of the new and better retail jobs which are being created.
    - Specifically, to promote productivity, innovation, and economic growth, the Scottish Government should:
    - Take action to develop a Retail Industry Strategy to ensure a clear, coherent, strategic approach is taken to planning for the future of Scotland's retail industry.
    - Create the conditions for investment by reducing the cost burden faced by Scottish retailers. In particular, there should be a move to end the culture of penalising larger businesses which discourages growth and investment.
    - Rapidly develop the physical and digital infrastructure to ensure Scottish retailers can compete on a level planning field with those in England and abroad.
    - Work with retailers to ensure the correct skills provision is in place to ensure retailers can train and develop workers to meet the productivity needs required.
    - Improve the regulatory landscape to ensure Scottish businesses can operate efficiently on a level playing field with competitors.
    - Where possible, develop public policy approaches in collaboration across the United Kingdom to minimise the cost implications of a different Scottish approach.
    - Ensure that, regardless of the debate over Scotland's constitutional future, the benefits of the UK Single Market are maintained.

FOREWORD

THE IMPORTANCE OF PRODUCTIVITY IN SCOTTISH RETAIL – ANDREW MURPHY, SRC CHAIRMAN AND GROUP PRODUCTIVITY AND CHANGE DIRECTOR, JOHN LEWIS PARTNERSHIP

In September 2015 I was appointed as the John Lewis Partnership's first Group Productivity Director. This new role was our acknowledgment of the increasingly evident fact that, for any large retailer to survive and thrive amidst the new realities of our market, sales growth was no longer enough. We all have to find ways to produce "more from less" and progressively build a new business model.

The changes we have seen in our industry over recent years are unprecedented in our lifetime and genuinely transformational. They pose an existential threat to most established retailers' operating models. Thanks to anytime, anywhere access to the internet customers can now access everything they could possibly want to know about a product at any moment - with hugely disruptive effect to the retail industry.

The traditional role of a retailer is to act as the link between the producers of a product and the customer market for those goods. Using our skills, trading assets and buying power to deliver a compelling range of products to customers in their local market place. Digital shopping has changed that forever. Manufacturers and the online curators of data (e.g. Google) can now cut retailers out of the process and reach the customer directly through online offerings which demand much lower upfront investment than a network of physical stores would. And the development of this phenomena and their consequences have really only just begun.

John Lewis & Waitrose have, like most other established retailers, invested millions of pounds in developing the new assets and capabilities demanded by modern retail. But this introspection into and re-focussing of our retail model is hugely time consuming and demanding. Much more so because, in Scotland particularly, that process has taken place in an environment where we've frequently been distracted by often random regulatory changes and are constantly pressured by increases in taxation on property and the cost of labour.

Scotland is hugely important to the UK's retailers and we know it. However, the inverse is even more true; Retail is of huge economic and social importance to Scotland today. The Scottish Government must start to demonstrate that they know this through their deeds as well as in their words - and do so now - because thousands of jobs and the health of every Scottish town centre depend on it.

This is why the SRC has conducted this investigation into the Scottish Retail Industry's approach to productivity. It's crucial we share a greater understanding of the industry trends and realities in order to give Government and MSPs the information necessary to make informed and successful choices on how to grow the Scottish economy. I believe this report is an excellent first step in that process - but it is no more than that. It will have succeeded only if it enables us to work collaboratively, urgently and dynamically with the Scottish Government to develop the right conditions for retail success, sustainable economic growth and a prosperous, socially cohesive Scotland.

INTRODUCTION

In June 2016 SRC Chairman Andrew Murphy announced the SRC would develop a report into productivity in the retail industry in Scotland. This report has synthesized Scottish Government and SRC data with analysis from retail experts to produce this publication.

The findings of the report are in line with the work done by the BRC in their Retail 2020 reports. Those reports looked in detail at the changes in the retail industry, and the impact that those changes would have upon businesses, communities, and the wider economy.

That analysis explained retailers currently face a challenging and volatile market. Strong competition has created significant market disruption, with both new entrants and new technology revolutionising the industry. Retailers who have failed to evolve to become more productive, dynamic, and efficient have struggled to survive, whilst new market entrants (often from overseas and employing relatively few UK citizens) have grown, often at the expense of established businesses.

The consequences for customers have been clear. New technology allows them to learn more about products, what their prices are, and every piece of salient information. Competition has driven prices down for over three years. And it's never been more convenient to shop, whether in a hypermarket, a diverse shopping centre or high street, or through online portals and marketplaces. It may never have been a better time to be a customer.

Because of this, retail jobs across the UK are changing. They are becoming more skilled, more interesting, and more productive. The advent of technology is allowing the automation of many of the tedious and laborious elements of the work. By removing these elements and improving the quality of work, whilst also increasing pay, retailers are creating interesting and challenging new roles. At the same time these changes will lead to there being fewer retail jobs.

However, this report looks more closely at how these changes are impacting on the Scottish retail industry. The findings are concerning. It's clear Scottish retailers are engaged in the same transition as elsewhere in the UK, with a reduction in the number of workers and the number of shops.

The most significant finding is that due to structural reasons the Scottish retail industry is at greater risk of deleterious outcomes because of these changes. This report has found that investment in innovation and productivity in Scotland appears to be lower than elsewhere in the UK. Productivity is not growing at the same rate, and what productivity growth exists is as much a consequence of falling employment as advances in technology.

It is likely this is a consequence of the public policy environment faced by Scottish retailers due to decisions taken by both the UK and Scottish Governments. A potentially lethal cocktail of business rates and high employment costs is restricting the ability of retailers to invest in the technology and skills of the future. Retailers are focused on keeping stores open and profitable, without being able to invest in the technology and training which would allow them to compete in the new retail environment. Since Scotland has proportionally more shops than the UK as a whole this puts a large number of businesses and jobs at risk. We believe this process is already starting, and without action will only accelerate in coming years.

However, that outcome is by no means certain. The SRC believes that a more reasonable approach to taxation, changes in policies such as the Apprenticeship Levy, and a clear and coherent retail industry strategy, could help to support the retail industry through this process of immense change.

Over the next decade the Scottish retail industry will change enormously. It is up to policy makers to decide what they want that change to look like. With the right mixture of policies and support Scottish retailers will be able to adapt and develop, becoming more agile and dynamic. The number of retail jobs will decline, but many will be replaced by new and better roles in the industry, or supporting retailers in the wider economy.

However, a failure to recognise the scale of the challenge could well be fatal to a large number of businesses. The impact of the digital economy, automation, and new technology on retail roles cannot be underestimated. Without a more favourable environment tens of thousands of jobs will be lost, and those jobs are most likely to go from the least popular retail destinations, causing significant hardship and a hollowing out of those communities.

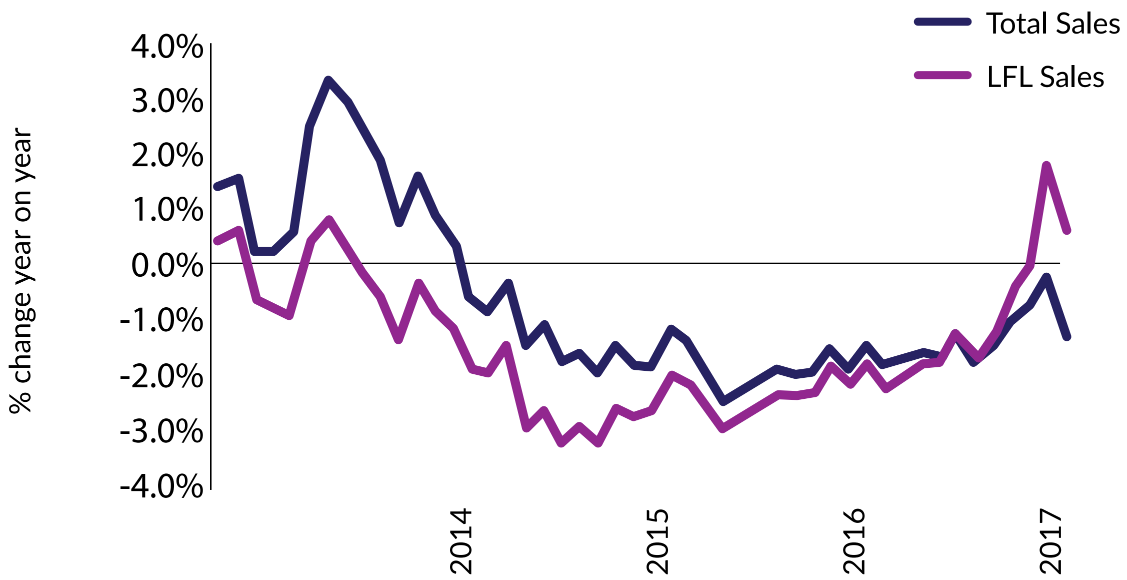
This report lays out the context behind these changes, and the clear steps government can take to ensure the Scottish retail industry can continue to flourish and play its crucial part in driving growth in the Scottish economy.

CHAPTER ONE: THE SCOTTISH RETAIL INDUSTRY

The retail industry plays a significant role in the Scottish Economy. Retail sales total £26.88 billion a year[1], which equates to 20 percent of Scottish GDP. The industry is one of the most dynamic and innovative, accounting for 13% of all new firms formed last year[2]. This innovation can be seen through significant new investment in store formats and layouts including online, in-store technology and order points, home delivery and logistics capabilities, click and collect services, digital customer loyalty and payment arrangements, and new and refreshed own-brand products. The industry is in the midst of a customer-led revolution, and all of its investment - from new ways of working to sharpening prices – is because customers are either demanding it directly or as a consequence of their changing shopping preferences.

The Scottish Retail Consortium publishes a Scottish Retail Sales Monitor each month which tracks the value of Scottish retail sales in a number of categories. This monitor tells a clear story over the last five years.[3]

SCOTLAND 3M ROLLING AVERAGE GROWTH OVER FIVE YEARS



……………………………..

1 Scottish Annual Business Statistics 2014 (p219)

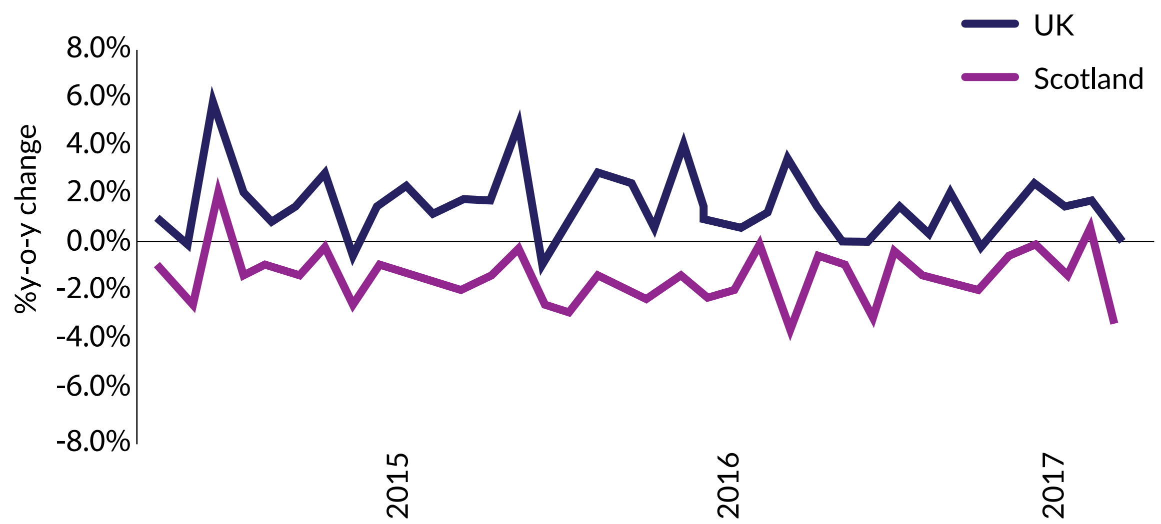
2 Ibid

3 SRC Scottish Retail Sales Monitor (January 2017)

Retail sales fell from 2013 to 2015, and have subsequently remained relatively flat, albeit with a small uplift at the end of 2016. It's too early to say whether that uplift will be maintained, but even so, it's clear Scottish retail sales have been at best static over that time.

It's worth noting over this period that Scottish retail sales have tracked below those across the United Kingdom. Part of this is due to the economic growth in London and the South-East, but it's regrettably true that Scottish retail sales are showing little sign of life.

SCOTLAND VERSUS UK TOTAL SALES GROWTH COMPARISON



Source: SRC/BRC-KPMG RSM (including Food data from IGD).

That should be of significant concern to policy makers. Retail is currently Scotland's largest private sector employer, employing 252,000 people[4]; 13 per cent of the private sector work-force. However, the most recent data indicates there were 9,200 fewer jobs in the industry between 2014 and 2015[5]. Embracing these changes and becoming more productive requires retailers to invest in new technology (both software and hardware) a higher skilled workforce, revamped warehouses and stores and transformed logistics capabilities.

……………………………..

4 Ibid

5 Business Register and Employment Survey (BRES) Office for National Statistics (via Parliamentary Question: http://www.parliament.scot/parliamentarybusiness/28877.aspx?SearchType=Advance&ReferenceNumbers=S5W-03110&ResultsPerPage=10) . These figures are more recent than the Scottish Annual Business Statistics which are used in Chapter 3 but it's unclear which figures are more accurate.

The profile of the Scottish Retail industry has evolved in recent decades to be different from the rest of the United Kingdom. Over recent decades the number of retailers of scale has decreased across the United Kingdom as the benefits of agglomeration have become apparent. This included a number of retailers with significant Scottish infrastructure such as Wm Low and Safeway, whose head office operations were moved elsewhere.

That has implications for the profile of retail jobs in Scotland. Whilst Scotland is blessed with several domiciled retailers of prominence and renown, such as Scotmid, M&Co, Sterling Furniture, and The House of Bruar, the fact remains head offices are significantly more likely to be based elsewhere in the UK. Therefore proportionately Scottish retail jobs are much more likely to be based in stores.

However, one development of this focus on scale, as a consequence of the geography of the UK, many of the largest distribution and fulfilment centres in the UK are not based in Scotland. Those facilities which are in Scotland tend to be primarily focused on supporting the Scottish retail industry rather than fulfilling a significant role in the larger UK market.

Beyond this, retailers have a number of support or diversified operations in Scotland. These include contact centres, administration or buying offices, and in some cases financial service enterprises. Many of these facilities have in many cases been developed in partnership with government or local authorities. The location of such sites is often dependent on regional assistance grants, a strong local skill base, and property and employment costs. As technology develops further the competition for such sites and centres will increase as these facilities can serve wider geographical areas. These operations in particular are vulnerable to the cost of business being higher in Scotland than elsewhere in the UK.

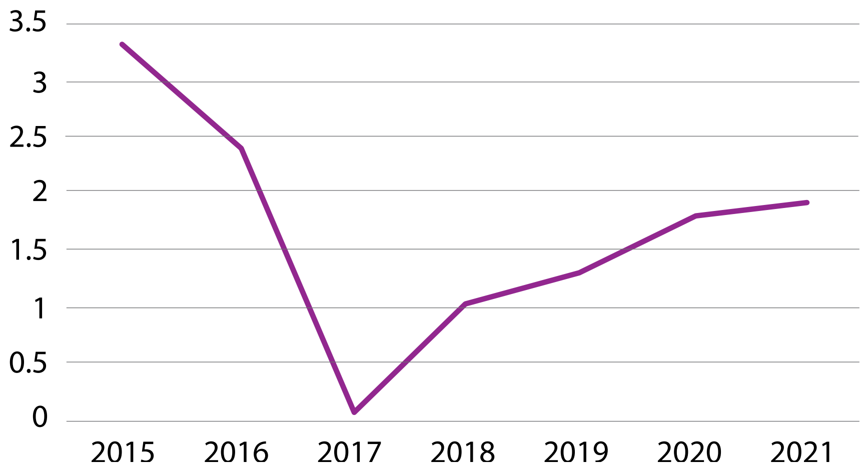
There is one further factor which affects this profile. Historically for retailers to reach the whole of the Scottish population from physical premises a higher number of shops per head of population was required due to the dispersed nature of parts of the population. That has been a boon for a number of towns and smaller communities who were able to benefit from this in terms of jobs, used commercial premises and business rates receipts. But concentration is now the order of the day as evidence by the 1,700 reduction in the number of stores over the past seven years[6].

The consequence of these structural differences is that Scottish retail employment is much more distributed towards working in the selling element of retail. There are, of course, still roles in other areas, but there is a structural bias towards roles based in stores rather than support functions.

……………………………..
6 *Ibid*

This is likely to be exacerbated this decade as the impact of economic conditions make things harder for consumers. The OBR forecast given in the 2016 Autumn Statement[7] indicates household disposable incomes will face a squeeze over the next couple of years. This is primarily being driven by limited wage growth and the likelihood of higher inflation. However, policy decisions such as higher employee minimum pension contributions over the next couple of years will also play a part.

REAL HOUSEHOLD DISPOSABLE INCOME



With retailers already seeing lower levels of spending due to competition from hospitality and entertainment, this further reduction in spending will only increase the level of competition.

There are two further risks in Scotland. The first customers are already facing council tax rises [8]. The second is that lower levels of economic growth[9] may also limit the available consumer spend for retailers, leading to challenges in ensuring stores can run profitably without in some way reducing costs.

……………………………..
7 UK Government Autumn Statement 2016, p54, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/571559/autumn_statement_2016_web.pdf More information on Real Household Disposable Income can be found on the Office for National Statistics Website here: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/571559/autumn_statement_2016_web.pdf
8 The 2017-18 Scottish Government Budget proposes freezing the Higher Rate Income Tax Threshold at £43,000 whilst the UK Government intends to increase the threshold to £50,000 by 2020: http://www.gov.scot/Publications/2016/12/6610
9 The Fraser of Allander Institute last year provided a comparison of Scottish and UK GDP performance: http://www.strath.ac.uk/media/departments/economics/fairse/fecvol40no3/Outlook_and_appraisal.pdf

Profitability can also be affected by Scotland's geography. Whilst some products can be sourced in Scotland, and indeed a number of lines are both sourced and exported from Scotland, there are a number of categories where products are imported from England, either directly from manufacturing sites or indirectly from outside the United Kingdom. The majority of these products will be imported into the South of England and then transported north. In these lines, profitability is already lower than elsewhere in the UK due to the cost of transporting these goods.

However, this profile means the Scottish retail industry is more vulnerable to the impact of some of the changes affecting the wider industry as described in the last chapter.

Retailers across the UK have faced a number of costs as a consequence of public policy, which have increased the cost of operating from property, and of employing workers. Whilst the aims of individual policies may themselves be beneficial or desirable, this cumulative burden has incentivised the adoption of technology and deterred investment in people.

In the last two years the UK Government have introduced a new National Living Wage, increased the National Minimum Wage[10], and set in motion increases in statutory pension contributions and employer national insurance contributions. They've introduced the burdensome Apprenticeship Levy. All of these measures make employing workers much more expensive. Retailers have stayed ahead of this curve for now, with retail wages rising 5.6 percent last year[11].

These changes have of course impacted on shop and distribution centre operating costs to a significant degree, which has a greater proportional cost on Scottish retailers.

Additionally, Scottish retailers have also faced a number of public policy measures which were due to decisions made by the Scottish Government. One of the inevitable consequences of devolution is that the Scottish Government will take different policy decisions than elsewhere in the United Kingdom.

However, for an industry which operates on scale, those differing approaches inevitably impact on retail productivity. This takes two forms. Firstly, the impact of Scottish specific taxation makes operating in Scotland more expensive, and consequently affects retail investment. Indeed, there is a fall in official figures on retail investment in research and development[12] which correlates with much of the period in which the Large Retailer Levy operated.

…………………………..

10 https://www.gov.uk/national-minimum-wage-rates the National Living/Minimum Wage for full time workers has increased by 17 percent since 2010, and increased by 6.5 percent between 2015-2016.

11 SRC Pay and Reward Paper 2017 – the Median Retail Wage is now £8.30 an hour, or £8.81 Total Financial Reward.

12 Scottish Annual Business Statistics 2014 (p219) – There is more detail in Chapter Three on this. The Large Retailer Levy operated between 2012 and 2015 – costing retailers around £95 billion: http://www.bbc.co.uk/news/uk-scotland-scotland-business-25676222

Secondly, different decisions on policy, such as the implementation of the Apprenticeship Levy, the continued absence of a Primary Authority system for devolved regulations, and different approaches to social policy issues all increase the cost and complexity of operating retail premises in Scotland[13].

The consequence of these changes is difficult to evaluate fully. However, with retail premises increasingly expensive and struggling to be profitable, it is virtually certain there will be fewer retail jobs in the future. We are already seeing signs of this, with 10,000 jobs lost in Scottish retail in the last seven years[14]. The reality is that public policy combined with a changing market, significantly incentivises investment in technology over people and property. That may lead to statistical productivity gains, but with potentially deleterious consequences for employment and revenues from local property taxes.

Of course, whilst it is likely there will be fewer jobs in the future, there are some positive points to consider. New retail roles will be better jobs, much more focused around engaging with customers and operating significantly more productively and efficiently than before. Secondly, whilst shop-based roles are at risk, there will be a rise in jobs in other areas of the retail industry and indeed in the wider economy, which may offset some of the potential losses. In particular fulfilling customer orders is something in which short term attrition of roles is less likely due to the limited impact of technology – delivery drivers and warehouse staff are still required. Nonetheless, these areas are under the same cost pressures as elsewhere and therefore also vulnerable to the impact of technology.

Our major concern would be that the profile of jobs in Scottish retail is such that if these changes continue on this trajectory then Scotland may be exposed to even more significant job losses in retail over the next decade.

…………………………..

13 For example, Grocery Retailers have to deal with a completely different, and more complex, alcohol licensing system in Scotland.

14 Scottish Annual Business Statistics 2014 (p219)

CHAPTER TWO – THE IMPACT OF COMPETITION AND TECHNOLOGY ON RETAIL

For decades the role of retailers has been straightforward. It was to source products, negotiate the best price, and then present them in the best manner to customers. Different retailers took different approaches, involving different products, markets, sources and ownership models.

That model evolved. As the importance of manufacturers and producers waned, retailers took a more prominent role at the start of the supply chain as well, even to the point of some grocers owning farms. The development of own-brand products allowed retailers to differentiate themselves from competitors, and better tailor themselves to consumer tastes, as well as allowing direct competition with producers.

At the other end some retailers were also part of the fulfilment element of the supply chain. However, in the pre-internet era a world of magazines, directories, and deliveries had only limited appeal.

The rise of digital technology has fundamentally and irreversibly changed this relationship between the retailer and the customer, often offering the opportunity of a deeper relationship. Where previously it would be laborious to compare prices and products, search engines make it straightforward – ensuring retailers are less able to compete on price as savvy shoppers are always able to calculate the best price for the product.

The advent of this information provided enormous opportunities for disruption. Online retailers could provide a range of products far greater than any physical store, providing search technology which obviated the need for enormous physical retail spaces. Similarly, the cost savings from a small number of fulfilment centres, particularly for non-perishable products, meant prices could be set at a competitive level to those of the high street store.

It has also created opportunities for brands to control their products in a way previously not possible. Some of the largest manufacturers, particularly in technology and fashion, now sell directly to customers through online, or even a small number of physical shops.

That increased competition has ensured there can be little opportunity for retailers to create much in the way of a margin on these products.

The success of online sales is undeniable. Online sales now account for a quarter of non-food sales, and in many cases more than 100 percent of the new sales growth. This also continues to increase. The highest ever monthly online sales figures were for November 2016. December 2016 had the third highest level, only behind November 2015[15].

Of course, technology has driven these disruptions, but also provided significant opportunities for established retailers to react to improve their own operations. Established retailers have responded in a variety of ways to this, developing their own online activities. Indeed, the majority of the top ten online brands in the UK[16] are established retailers. The rise of multi-channel retailing in particular shows how the lines between online and in-store shopping have become blurred.

Of course, within stores technology is changing every element of the customer experience. Self-checkouts and till free shops, targeted loyalty programmes, and in-store wi-fi are all amending and improving experiences for customers. The next wave of technology will be just as significant. Technology such as virtual or augmented reality will take us beyond images of products to literally being able to visualise them in home or being worn. Customers looking to improve their homes will be able to see exactly how paint, furniture, or pictures will change the way the room looks.

Every element of the store experience is being reimagined to see where there is a synergy between improving the customer experience and making stores more efficient. For example, some retailers are experimenting with till-free shopping experiences altogether[17]. These changes will be capital intensive, but will further encourage and reward shoppers. Power in the relationship between retailers, manufacturers, and consumers has well and truly shifted to customers.

That technological innovation will become just as apparent in fulfilment. The UK Government is already considering the implications of driverless vehicles[18], which could revolutionise that element of the supply chain. Further experimentation with automated deliveries, aligned with increased innovation on managing and adapting to customer expectations will, in an effective market, lead to disruption, improved service, and decreasing customer costs – again of course with capital investment, primarily in ICT, logistics, and marketing.

……………………………..

15 SRC/KPMG Scottish Retail Sales Monitor

16 Retail Week@ https://www.retail-week.com/analysis/data/data-top-10-ranking-of-the-uks-biggest-online-retailers/7003865.article

17 http://www.bbc.co.uk/news/technology-38212818

18 https://www.gov.uk/government/news/new-measures-to-help-britain-lead-the-way-in-developing-driverless-technology

However, as technology has become relevant for customers, it's just as crucial for the manner in which businesses operate. The enormous increases in computing power and battery life, allied with enormously reduced costs, mean tasks which previously could only be done on pen and paper in stores or warehouses can now be done electronically. Instead of sales figures needing calculated and delivered, mobile technology can instantly perform tasks which previously required significant human time and investment. There is no doubt that this leads to significantly greater productivity. However, there is a huge challenge for retailers to ensure they can effectively repurpose those hours, and of course ensure workers are properly skilled and equipped to benefit from this.

CHAPTER THREE: QUANTITATIVE ANALYSIS OF SCOTTISH PRODUCTIVITY

SUMMARY

- There are a number of challenges to calculating Scottish Retail Productivity due to a scarcity of comparable data, and some concerns over some of the datasets.
- Scottish retail productivity has improved between 2008 and 2014. However, much of this growth is a consequence of a shrinking workforce rather than significant economic growth.
- Scottish Retail Productivity appears to be growing at a slower rate than elsewhere in the UK.
- Scottish retail research and development spending appears to be increasing at a slower rate than elsewhere in the UK.

CONTEXT AND CAVEATS

Retail productivity is a complicated area for economists to calculate. Traditional metrics of calculation, which tend to use GVA added as the metric, can provide less clarity than in other industries as the link between workers and sales is often not direct. For example, the impact of a large queue at a check-out. The most productive use of workers would be to have the minimal number of check-out staff which would prevent queues reaching the point where customers would abandon trolleys and leave. However, such an approach would be likely to negatively impact on the perception of the store, and the retailer. Consequently, check-outs will almost always be staffed in a manner which prioritises customer satisfaction over purely maximising output.

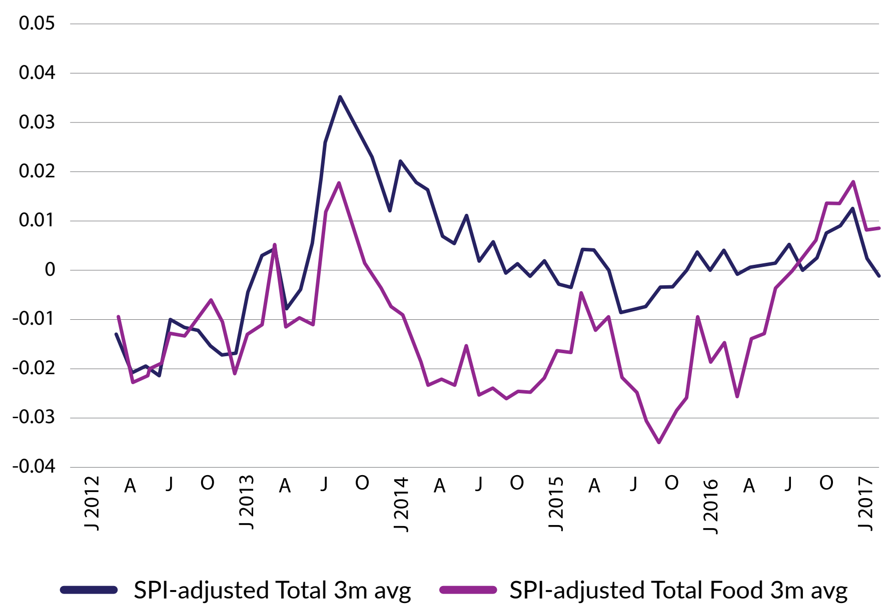
Even comparisons between retail in different nations are challenging. For example, superficially retail is less productive in the UK when compared to France or the United States[19]. However, that is to a large degree a result of very different roles and indeed customer expectations of great service. Retail workers in the UK take on a multitude of tasks which are not as obviously directly related to profitability.

19 Oxford Institute of Retail Management, Templeton College, 2004,

From helping customers to supporting the community, retail workers in the UK have a much wider portfolio of responsibilities and expectations beyond stacking shelves, collecting trolleys, or swiping groceries through the check-out.

Beyond that, an analysis of Scottish retail productivity is also difficult. Scotland has a relatively static population, and in line with much of the rest of the UK, has seen limited growth in real terms disposable income. At the same time technology and strong competition have led to falling prices[20].

BRC-NIELSEN SHOP PRICE INDEX



That deflationary effect also means the GVA figures used below probably understate any productivity gains. Deflation means that although sales volumes have increased (3.1 percent in the last year[21]) retail sales values have been static. Consequently, there may be productivity increases within the economy which are not translating directly into increased economic growth due to the wider impacts of competition and technology on retail.

However, the SRC's own retail sales index shows that even with deflation included retail sales have struggled for consistent growth.[22]

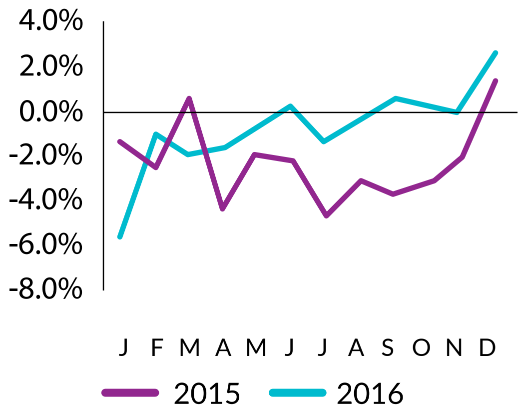
……………………………..

20 The BRC/Springboard Shop Price Inflation Measure tracks 500 categories of products. Although this is calculated on a UK-wide basis due to the preponderance of UK-wide retailers of scale it is likely the figure for Scotland would be nearly identical.

21 http://www.gov.scot/Topics/Statistics/Browse/Economy/PubRSI/RSIS2016Q4

22 Source: SRC-KPMG RSM

SCOTTISH TOTAL SALES: FOOD



ONLINE ADJUSTED NON-FOOD

It's worth noting that capturing online 'Scottish' retail sales is something the SRC finds challenging. We would very much like to see Scottish Government figures which could disaggregate this data – which might help to uncover some of the specific changes we are seeing.

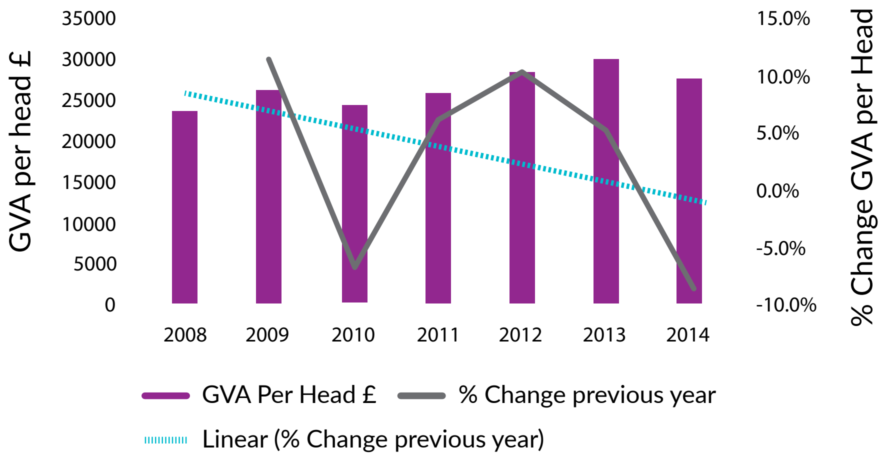
It has also been challenging to identify direct comparability with UK data for retail. The analysis provided reflects the best available data, but is deliberately qualified as there are elements where different metrics are being discussed.

There is one further condition worth highlighting. The sectoral data on retail employment in particular is not as comprehensive or accurate as might be desired. We believe the ONS figures capture the correct trends in Scottish retail employment. However, some of the data indicates very significant volatility in retail employment which does not correlate with the wider picture nor indeed with the SRC's experience in recent years. Regrettably, that data provides the best available evidence to conduct an examination of retail employment, and more broadly productivity. To assist with clarity, trend lines have been used in certain circumstances in order to look at the picture over a number of years rather than focusing too specifically on annual variations.

SCOTTISH RETAIL PRODUCTIVITY ANALYSIS

The latest Scottish Annual Business Statistics provide the most recent data regarding Scottish retail productivity. Measured by GVA per head retail productivity has increased by 17 percent since 2008. However, there is enormous variance within those changes. If the baseline is amended to 2010 then the increase is only 5.2 percent.

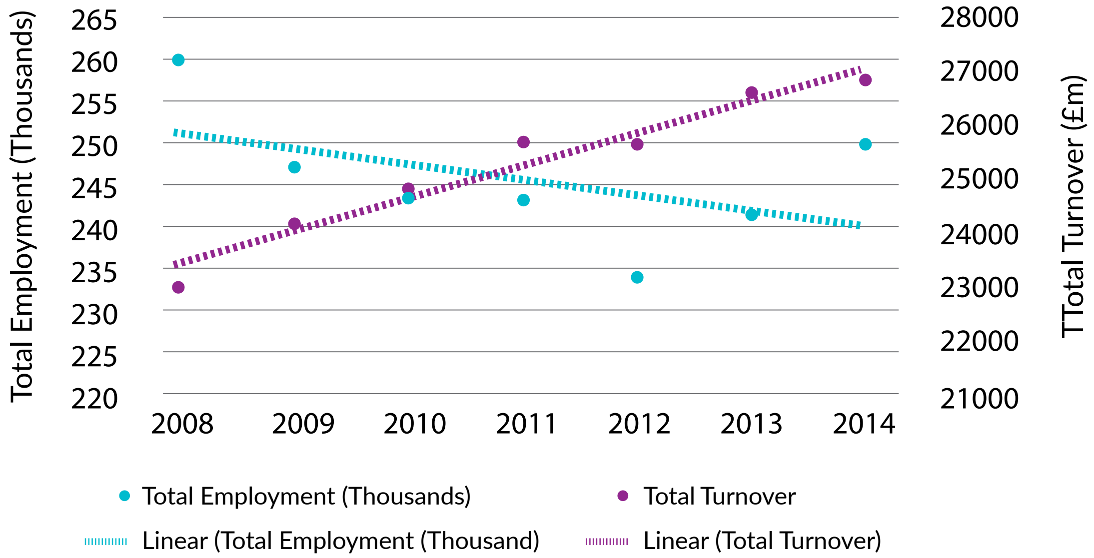
SCOTTISH RETAIL PRODUCTIVITY



The story is similar if measured by GVA Basic Prices. The productivity increase is 12.5 percent. However, using the 2009 baseline it changes to -6.7 percent.

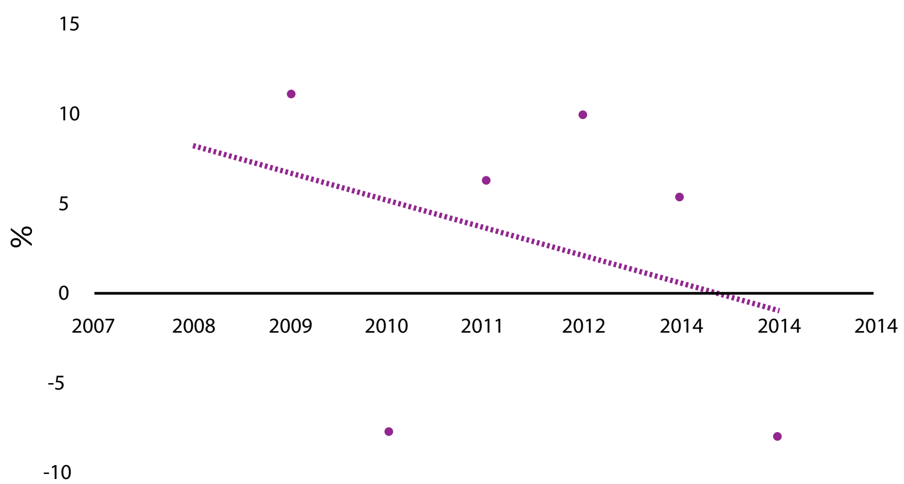
Those figures are driven by two factors. On one had we have seen a small overall growth in the value of Scottish Retail sales. However, the primary driver of productivity growth is the fall in retail employment. The productivity changes correlate with the rise and fall in recorded retail employment.

RETAIL SALES AND EMPLOYMENT 2008-2014



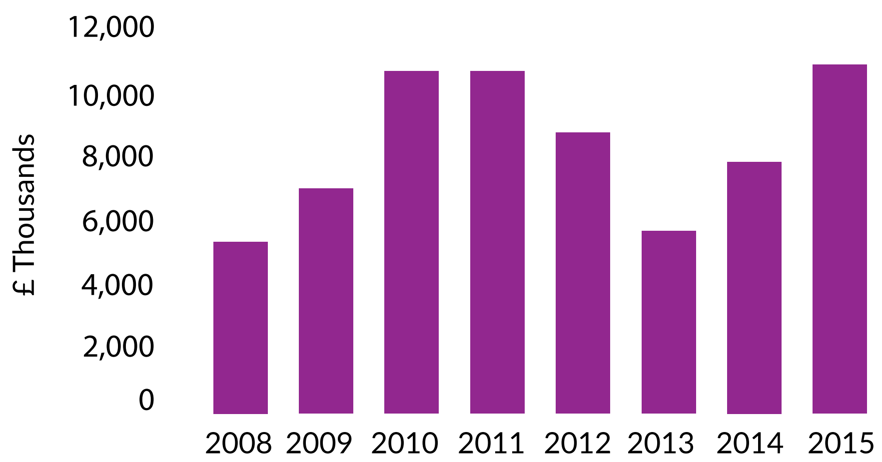
When those GVA figures are considered against the changes in retail turnover a clearer picture emerges. Stripping out the year on year variances and using a trend line there is a clearer trend, that recent years have seen a slowing in productivity growth.

GVA BASIC PRICES £ % CHANGE



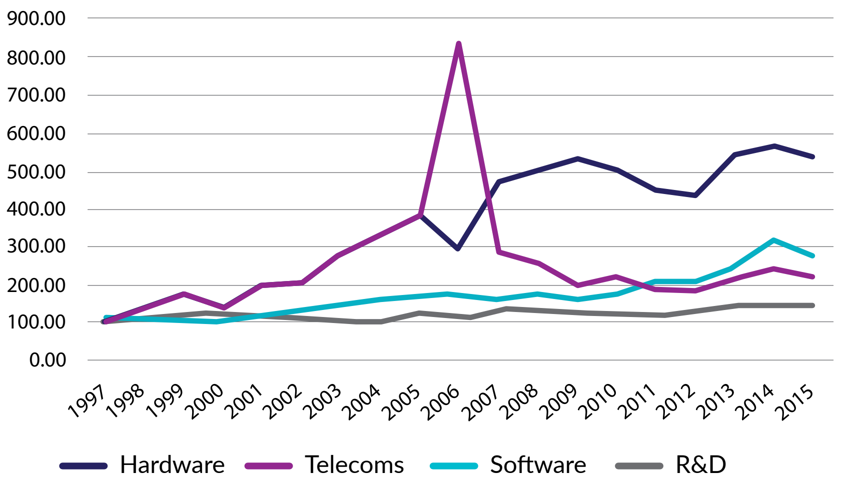
That approach is also in line with the evidence surrounding retail spending on research and development. That data shows there was a real decline in research between 2011 and 2015, which would correlate with the challenges in increasing productivity.

EXPENDITURE ON R&D PERFORMED WITHIN RETAIL BUSINESSES IN SCOTLAND: CURRENT PRICES



It's not been possible to draw direct comparisons with UK data on productivity for retail. However, work done by the BRC's Retail Insights Team on Intellectual Property Products (IPP) on retail across the UK indicates that spend has grown faster in the UK as a whole.[26] That would indicate Scotland is at risk of falling further behind the rest of the UK retail industry, albeit with the caveat that these are not directly comparable metrics.

INDEX OF GROSS FIXED CAPITAL FORMATION, RETAIL INDUSTRY, SUBCATEGORIES, 1997-2015(1997=100)



It's worth noting that these retail trends are not out of line with some of the Scottish wide figures for productivity. This shows an increase, but still relatively behind the UK figures for productivity. In one sense that's not surprising; the South-East of England and London are very different from the rest of the UK and consequently there is a discrepancy. However, that difference is also apparent when a comparison is made purely for the retail industry.

Labour productivity in retail across the United Kingdom has been on an upward trajectory since the end of 2014, and this improvement has accelerated in recent quarters.

Labour productivity is at its highest at any point in the last ten years in the retail industry, and is outperforming pre-crisis levels. It is currently 9 percent higher than in 2013. In comparison our Scottish assessment indicates only a 3.8 percent increase in the same period.

LABOUR PRODUCTIVITY IN RETAIL: GVA PER HOUR 4 QUARTER ROLLING AVERAGE GROWTH

In summary, there is little evidence to suggest the Scottish Retail Industry is currently engaged in growing productivity in an economically sustainable manner. The limited growth corresponds with the fall in retail employment. The Scottish Government and SRC figures indicate at the same time there has been limited growth. In essence retailers are tightening their expenditure in Scotland in order to maintain profitability. That approach is different from what is being seen across the rest of the UK where there is a greater focus on investment in skills and technology. It is worth noting much of the data used here pre-dates policies such as the Large Business Supplement and the Apprenticeship Levy, which may well exacerbate these trends.

CHAPTER FOUR – HOW IS THE SCOTTISH RETAIL INDUSTRY ADAPTING?

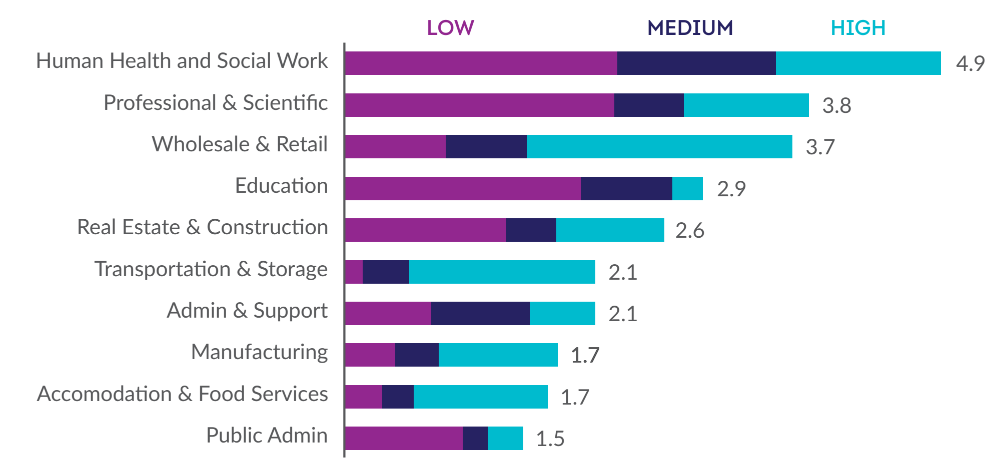
There are two clear factors which explain what is driving the changes we see in retail productivity in Scotland. Firstly, the impact of high costs on retailers correlates with lower productivity gains and less research and development.

The other clear trend is the fall in retail employment in Scotland, which we believe is being driven by a combination of public policy and technological change.

The most recent employment statistics saw a 3.8 percent fall between 2014 and 2015 in Scottish retail employment. That is a more significant rate than we've seen across the UK as a whole, which is in line with the analysis presented earlier.

This process of workforce change will accelerate as the digital revolution reshapes the industry. As more shop leases come up for renewal and as the cost of labour versus technology diverge. The sources of potential productivity will vary by retailer but greater automation will play a bigger role. A recent Deloitte study[23] suggests that 60 per cent of retail jobs are at a high risk of automation in the next 20 years, higher than any other industry as highlighted below.

JOBS AT RISK OF AUTOMATION
PEOPLE EMPLOYED (MILLION)

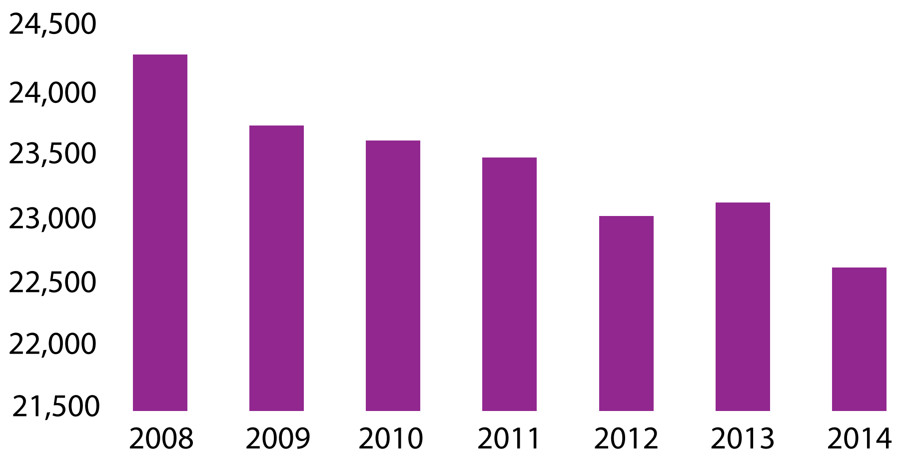


Across the UK that process could well be accelerated as the rate of store closures is likely to increase. The rate of reduction in retail space will accelerate as growth in grocery space slows sharply and because 60 per cent of retail leases are due for renewal in the next five years, many more than in the previous period. This equates to approximately 20 per cent of existing retail space[24]. Scotland has seen year on year falls in the number of shops since 2008[25].

……………………………..

23 Deloitte: Transformers, 2016

NUMBER OF SHOPS IN SCOTLAND 2008-2014



The BRC Retail 2020 report[26] explains in detail how over the next nine years there will be fewer jobs in retail, but those which remain will be more productive and higher earning. However, the effects will be uneven across the country and in how they impact on different sizes of business and groups of people within the industry. Of most relevance to policy makers is that areas which are already economically fragile are likely to see the greatest impact of store closures. Furthermore, some of the people affected by changing roles will be those who may find it hardest to transition into new jobs.

Retailers will work both individually and collectively to improve productivity and the customer offer. The industry would like to work with both the Scottish and UK Government to ensure the successful implementation of policy and to mitigate the impact of the changes we expect to see in places and on people who may be most vulnerable. The policy environment we think would be most beneficial is outlined in Chapter Five.

……………………………..

24 Centre for Retail Research: Retail in 2018

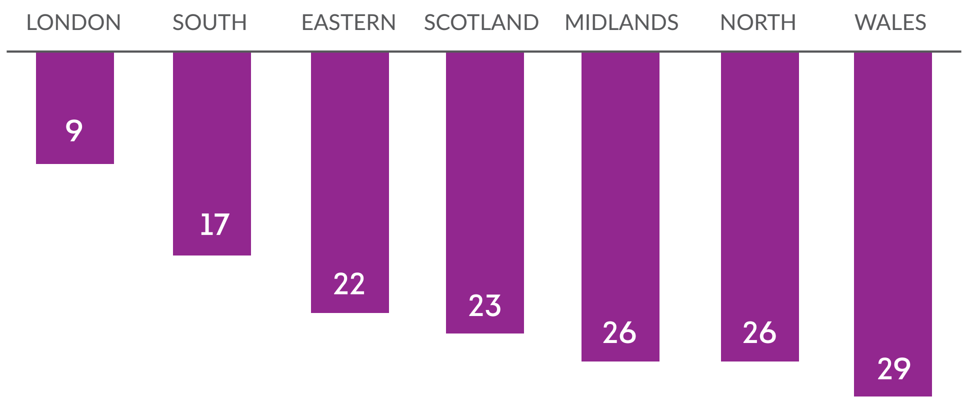
25 Scottish Annual Business Statistics

26 BRC Retail 2020 – Fewer but Better Jobs

FEWER JOBS

Our study suggests that the combined effect of ongoing structural change, an accelerated rate of store closures and productivity improvements make it certain there will be fewer jobs in Scottish retail by 2025. The only questions are at what pace this occurs, and to what degree new and better jobs replace some of those lost.

PROJECTED STORE CLOSURES (%)



Undoubtedly the impact of existing drivers such as technological change would have reduced the roles needed in the future. However, the combined effect of public policy induced costs, different labour-technology cost equations, and physical space vs -digital investment equations will increase the rate of reduction in roles.

In particular, Government should be concerned that public policy is incentivising an approach of employing fewer people in fewer stores. The Retail 2020 report found 23 percent of Scottish stores could be lost over the next decade.[27]

PERCENTAGE DECLINE BY REGION

The impact of this is likely to be asymmetric. Popular retail destinations, such as Princes or Buchanan Streets, are likely to continue to flourish. However, less affluent or well-connected destinations are likely to see an erosion of their retail footprint as shoppers move online or to different destinations. This will see retailers either reducing the hours worked by employees, effectively reducing jobs, or indeed the outright closure of stores which cannot be made profitable.

…………………………..

27 BRC Analysis; Centre for Retail Research (Retail Futures 2018, May 2013)

The impact of this will be felt by workers and communities, but it's unlikely to impact significantly on consumers. Advances in customer fulfilment mean shoppers will still be able to get the products they want. However, for those towns affected, this decline in jobs and shops will have a significant impact.

This is also likely to impact upon part time workers as well. Currently retail provides a significant number of part time and flexible roles. Many workers find this flexibility very important, allowing them to combine employment with other commitments such as family or studying[28]. These roles will specifically be at risk from the changes described. As employers invest in their workers, providing them with training and higher wages, part time or short term workers will be less important to the industry. Of course, there will still be an important role for them, but full-time workers are likely to be more important to growth in the industry.[29]

However, it's also important to note there is a positive story as well. Across the UK the BRC have seen the creation of 100,000 new roles within the industry that didn't exist five years ago. All workers are benefitting from higher wages, with Scottish retail wages rising 5.6 percent in the last year. Over the next ten years we would expect to see retail wages continue to rise. For those workers who remain in retail this will provide opportunities for a wider and more diverse work experience. However, the question is how many of these new roles will be part of the Scottish retail industry.

…………………………..

28 Retail 2020 Part Two explores the Retail Workforce in significant detail

29 The Business Register and Employment Survey (BRES) Office for National Statistics figures indicate this process of the erosion of part-time roles is already taking place.

CHAPTER FIVE: INNOVATION AND PRODUCTIVITY IN SCOTTISH RETAIL

Scottish businesses are not standing by waiting for these changes to occur. They are taking direct action to make their businesses more productive, using innovation and enterprise to drive changes in their businesses and customer engagement.

Three SRC Members have provided case studies which indicate different approaches, showcasing how this dynamic industry is adapting. From smaller stores to restaurants, and from high streets to digital innovation, these examples help illustrate the work all SRC Members are engaged in, adapting to the challenging market to be efficient and effective businesses.

CASE STUDY

SCOTMID – MAKE IT SIMPLE

Scotmid has an ethos of continuous improvement and constantly drives to improve productivity across its trading operations. The Make It Simple initiative was established several years ago and draws together a cross-functional team covering all areas within the Society to review ways of working and generates ideas for improving current processes by either reducing, removing or automating task from Stores and Central Teams.

With the announcement of the National Living Wage, Scotmid took the Make It Simple initiative to a new level. A stores 'operating model' was defined and all stores mapped to this. Further resource was dedicated to the initiative and all aspects were brought under a unifying programme of delivery. Historical ways of working have been fundamentally challenged and technology solutions are being trialled and accelerated through delivery where they show return.

Over 2016, Make It Simple has delivered 40 process improvements giving a significant reduction in task and corresponding weekly time saving for the store teams. Examples of larger Make It Simple initiatives delivered include:

- Moving Scotmid's direct suppliers onto an electronic data interchange (EDI) system so stores receive electronic delivery notes rather than having to manually record the deliveries.
- A new solution was created to remove Point of Sale for promotions, replacing it with promotional shelf edge labels for each variant instead. This not only has a task benefit in store but gives the customer a clearer promotional message.
- Scotmid now has 80 self-service check out (SSCO) devices in selected stores and is currently trialling two card only SSCO devices. SSCO frees up staff time to deal with more complex sales transactions, improves customer service by dealing with peaks and adds modernity to the stores.
- Scotmid has focussed on its cash management processes - introducing an Epos integrated coin cash counting device and moving to a real time cash system that has seen the removal of paperwork and calculators! Having trialled the Volumatic intelligent counter cash over 2016, Scotmid is now implementing it across 50 further stores. The solution reduces cash handling, gives fewer banking errors and better cash results.

As a measure of success, originally, every Scotmid Food store used to have twenty folders of paper work in their back office - this has now been reduced to only two.

As well as time saving ideas, Scotmid has taken feedback from Store Managers to make 'quality of life' changes – making every day processes just easier although even these small changes when added up mean time saved.

Through continuous improvement, process simplification and by leveraging innovative products Scotmid is progressing at pace to a vision of freeing up time and supporting our stores staff to be on the shop floor more - serving customers.

MCDONALDS RESTAURANTS: EXPERIENCE OF THE FUTURE

Since McDonald's first came to the UK 43 years ago, opening its first store in Woolwich, London, it has continued to expand to more than 1,270 restaurants in towns and cities up and down the country. The business constantly strives to innovate and provide the best quality service to its customers. The latest restaurant reimaging programme is no exception. Through the largest and most ambitious conversion programme, the 100 restaurants in Scotland, employing some 10,000 people, will be future-proofed to adapt the changing customer needs of the sector we serve.

This significant investment by the 13 Scottish franchisees and the company in Scotland demonstrates our ongoing commitment to evolve the customer experience we provide and is in part a cornerstone of the ongoing success of the brand in the UK market. Our continued drive to evolve our offering is twinned with our desire to improve food quality, trust and corporate social responsibility across the board which has led to McDonald's UK restabilising itself as a market-leader in the sector, now enjoying its 43rd consecutive quarter of sales growth.

Central to the conversion programme, now in its third of a four-year schedule, is improving the customer experience. Bringing in touch-screen kiosks has improved efficiency in the ordering process and enabled 500 UK restaurants to provide table service for the first time in 2016. These changes have been designed with changing customer needs in mind, and the dedicated dining room hosts ensure the process is as quick and easy as possible. The technology we have introduced will act as the platform for other elements which are currently being tested such as mobile ordering from an app and providing the option to customise the classic burgers that customers know and love.

This is all made possible by an enhanced reliance on technology in the ordering processes but also through significant changes to the way the food is prepared in the kitchens. By changing the processes underpinning the cooking and preparation of our products, meals are no longer cooked in batches but made to order – improving quality but this also reduces waste.

CASE STUDY

BOOTS – SUPPORTING SCOTTISH HIGH STREETS

As the UK's leading pharmacy-led health and beauty retailer, at Boots UK, we're committed to providing exceptional care to our customers and patients, and using our pharmacy-led expertise to help improve the health and wellbeing of our local communities.

Our unique place at the heart of Scotland's high streets is playing a role in supporting the retail sector's contribution to Scotland's economic growth.

For example, as part of our commitment to supporting the Business in the Community Healthy High Streets programme, our teams have been using their business expertise and local knowledge to help support other retailers in Dunfermline.

With a team of other high street business, Boots UK was able to help a local store, The Sweet Shop, with a major refurbishment. Boots colleagues and the other trouble-shooters provided insight and advice to help The Sweet Shop identify how to build and develop its business. After closing for 3 days for a refit, the business is back and more popular than ever with customers in Dunfermline.

Following on from the success of this initiative, the group of businesses, led by Boots UK, has now focused its efforts on supporting a struggling local charity shop before moving onto the redevelopment of a waste site in Dunfermline. The success of this group of colleagues collaborating and pooling their skills demonstrates the impact of using local people to lead on community regeneration efforts.

Boots UK believes is can use its scale, expertise and presence at the heart of Scotland's high streets to meet the changing needs of customers, and in addition support the economic and social aspirations of its communities.

CHAPTER SIX – THE ROLE OF PUBLIC POLICY

Retail is an industry which has historically been less reliant on direct public policy interventions than many others. It is an industry that has grown with little if any subsidy, that is part of a highly competitive market, which plays a vital role in the economy. The majority of the workers who enter the profession are trained within businesses, as the skills for successful retailing are generally better taught in a practical environment.

That approach means that the public policy initiatives which traditionally support productivity growth (skills and infrastructure investment) are relevant, but will have less direct impact. The Scottish, and indeed UK, Governments must examine a broader agenda in order to genuinely help retailers on their journey to being more productive, efficient, and successful businesses.

The existential nature of the challenges facing retailers means there is urgent need for public policy to adapt to support the industry.

A RETAIL INDUSTRY STRATEGY

Perhaps the biggest challenge to retail growth and productivity is the asymmetric approach taken by government towards the industry. Whilst some departments are focused on making it easier for Scottish retailers to operate efficiently, there are a number of departments whose impact is to make it more expensive or complicated to operate. That will often be as a consequence of the Government's necessity to raise revenue, or other social policy goals which require businesses to adapt their models.

That is a consequence of the unique position the industry has in the Scottish economy. Both primary producers and manufacturers are key suppliers to retail. Service industries, from bankers and lawyers through to electricians and plumbers, are key customers of the industry. That means the success and health of the retail industry is crucial to the almost every element of the Scottish economy.

Every person in Scotland will, in one way or another, be a customer of the retail industry. Unsurprisingly, government sees the industry as an opportunity to engage with those customers.

The cumulative burden of this on retailers is significant as they have many touch points with government policy. Indeed, there is little of the Scottish Government's agenda which does not affect the industry. Whether the debate on climate change, health, or crime; there will always be an intersection with the industry.

However, the challenge is that these public policy initiatives will come from different government departments and without consideration of their cumulative impact. A policy such as deposit return vending may appear to be one with only environmental impacts. But in fact such a move would have significant implications on retail capital budgets and store investment decisions. This is replicated across much policy. It is not that retailers are unaware of issues, or unwilling to respond. However, the sheer scale of change which impacts businesses, at a time where they have enormous economic challenges, is immense.

That is why the SRC wants to work with the Scottish Government to develop a retail industry strategy. This would allow the industry and government to agree on a shared approach to sustainably growing the industry. It would also ensure retailers were able to continue the strong work done to support the Scottish economy and communities. However, it would also ensure the Scottish Government took a strategic approach to policy interventions within a cohesive framework. This would significantly reduce the uncertainty which has characterised much of public policy over the last decade.

The benefits would not be limited just to the industry. By taking a more holistic approach government would be better able to align public policy across supply chains, and into households. A more strategic approach could ensure different policy agendas could be focused around delivering the overarching goals of the Scottish Government.

Perhaps most importantly the real beneficiaries would be consumers. A fully developed strategy would let retailers focus on the public policy outcomes Government wants to deliver without having to divert resources to unnecessary or contradictory distractions. That of course increases the efficiency of those measures. However, by taking those costs out of the system retailers are able to focus on delivering the goods customers want at the best possible price. That's in the interests of everyone.

It would also allow Government to assert its own hierarchy of priorities in its engagement with retailers. Rather than a piecemeal approach from different departments, government would be better able to establish what was crucial to support, making it easier for industry to respond. Similarly, this approach can then be aligned with the economic framework and incentive structures to create a single strategy which aligns these public policy goals.

A further element of this strategy could be an exploration of how it would be possible to generate better and more comparable data on the performance of the retail industry in Scotland to help better analyse productivity in the industry, particularly in comparison with elsewhere in the UK.

CREATING THE CONDITIONS FOR INVESTMENT

The single biggest challenge resulting from public policy which challenges the Scottish retail industry is the impact of direct taxation. In particular, the Business Rates system costs retailers in Scotland £650 million per year.[30] Business rates are far and away the largest individual tax burden retailers face, enormously outstripping the cost of Corporation Tax.

That burden is then increased by a number of other significant costs, including the Large Business Supplement (paid by 1 in 10 commercial premises in Scotland) and the Apprenticeship Levy[31]. Those two costs alone will cost Scottish retailers around £40 million in 2017-18.

The disproportionate burden retailers have faced through businesses rates is the most significant of these costs. Retail contributes 5.5 percent of Scottish GVA, but is the biggest industry contributor to the overall Scottish rates bill. On top of that retailers have faced extra levies, for example the Large Retailer Levy which added a further £95 million to the rates bill between 2012 and 2015. For most of the Scottish Parliament's existence the retail industry has reliably paid a large portion of Scottish Government revenue – something which will only grow as income tax and VAT Assignment are devolved to Holyrood.

The rates system requires significant reform[32]. As well as being a cost burden, the current approach sees irregular and insufficiently frequent rates revaluations, and an overly complex approach to assessment and appeal. One of the biggest challenges is that the irregular revaluations leads to enormous changes in rateable values. That makes anticipating what the costs will be in the future incredibly difficult.

This system is exacerbated as in previous years the Scottish Government has seen the retail industry as a regular and reliable extra source of revenue. The £95 million Large Retailer Levy is the most egregious example of a policy taken for revenue raising purposes with no consideration of the wider impact on the industry.

……………………………..

30 SPICE Briefing on Local Government Taxation found the Rates Bill in 2015 was £2.8 billion. Retail pays one quarter of the Business Rates Bill.

31 The Large Retail Supplement will raise £24.5 million from retail in 2017-18 http://www.parliament.scot/parliamentarybusiness/28877.aspx?SearchType=Advance&ReferenceNumbers=S5W-06256&ResultsPerPage=10 . The SRC previously calculated the Apprenticeship Levy would cost Scottish Retailers £12 - £15 million (BRC Retail 2020 Paper 3).

32 For more detail on how to reform the Business Rates system please see the SRC Submission to the Barclay Review of Rates.

These costs make investing for the future very challenging for retailers. With such a significant tax burden, retailers have limited resources to make the capital investment required to prepare their businesses for the new economy. New market entrants, whose operations are far less reliant on occupying large premises or employing significant numbers of workers, are much abler to invest innovatively in technology and workers.[33] Regrettably it appears the extra costs in Scotland are deterring this investment.

PROMOTING A COMPETITIVE MARKET

One of the corollary conditions for investment is preserving a competitive and efficient market in Scotland. Currently consumers benefit enormously from the competition between retailers, which has raised standards whilst reducing prices.

Along with a competitive tax environment, the Scottish Government should ensure that the conditions for wider economic growth are maintained. In the SRC's 2017-18 Budget Submission there was a clear call that income tax rates for most Scots should stay at their current rate, and not go above the rate elsewhere in the United Kingdom. The reason for that is straightforward. The more money customers have to contribute in taxation, the less they have to spend on high streets. Consumer spending is a crucial component of the Scottish economy. Maintaining that spending, which creates the space for a truly competitive market, is essential. It is also essential to support the domestic manufacturing and producing industries who create the products sold by retailers.

As part of the Scotland Act, the Scottish Parliament also gained competency over some elements of competition and consumer policy. It's important those powers are used to advocate on behalf of the benefits of a competitive and efficient market which benefits consumers, and acts as a challenge to over burdensome regulation and legislation which makes the economy less efficient and ultimately impacts on costs and choice for consumers.

In upcoming years, the Scottish Government will become even more dependent upon the success of this competitive market. Already government revenues are dependent upon economic performance due to the devolution of income tax[34]. The assignment of VAT in 2019 will further incentivise the Scottish Government to develop the Scottish retail industry.

……………………………..

33 As mentioned in Chapter 3, this investment is apparent at a UK level but it appears that isn't being replicated in Scotland.

34 The Office of Budgetary Responsibility has forecasted the impact of the devolution of income tax, most recently in November 2016: http://cdn.budgetresponsibility.org.uk/DevolvedAS2016.pdf

EXPORTS

Retailers already play a significant role in supporting the export of Scottish products with billions of pounds of exports every year[35]. The industry provides a market for a wide variety of products, in particular in support of the Scottish food and drink industry.

However, there are also a growing number of Scottish producers who have developed a retail arm and are now looking towards further internationalisation. Our digital insight briefings have found significant interest worldwide in UK products, in particular from fast-growing economies elsewhere. This is a significant opportunity for the Scottish economy, particularly in light of the ability to produce high quality premium products.

It's therefore important the Scottish Government continues to support focused and targeted approaches through enterprise and skills agencies which help Scottish retailers who wish to expand their operations beyond Scotland.

INFRASTRUCTURE

Aside from taxation policy, government can also enhance productivity in the economy through direct infrastructure investments. Both transport and digital infrastructure are essential to retail operations, and continued investment in those areas is crucial to support economic growth.

Retailers will always be reliant upon good transport links in order to efficiently and effectively move products either to their stores, or to their customers. That is only going to become more important over the next decade.

The Scottish Government should continue to invest in trunk road capacity across Scotland. The disruption in the last part of 2015 caused by the closure of the Forth Road Bridge demonstrates how vulnerable the Scottish road network is to closures which shift capacity. The new Queensferry crossing, and the improvements to the M73 and M74 are also positive steps which will help ensure retailers are able to move products more efficiently. That movement tends to take two forms. Firstly, there is the exchange of products between England and Scotland, and secondly the distribution from predominantly central Scotland to cities and towns across the country. However, there is still significant capacity to invest to improve those networks.

35 SRC MSP Briefing on the economic support of the Retail Industry to the Scottish Economy 2014

Infrastructure investment will become more important to retailers over the next decade as the digital changes in the industry shift the focus of much retailing from transporting products to shops to fulfilling individual customer orders. Delivering a transport network with the capacity to support these journeys is essential to ensuring both customers, and local retailers, are able to fully participate in the digital economy.

Allied to that investment should be continued spend on digital infrastructure. Scottish businesses outwith the large cities are heavily constrained by poor or non-existent broadband. This firstly hampers those businesses ability to compete online with retailers in other parts of Scotland, and indeed elsewhere in the world. However, it also affects the opportunity for those businesses to harness new web-based technologies which can significantly improve productivity. This further unbalances the playing field for these retailers.

SKILLS

There is no doubt that improving skills is a key element of driving productivity. However, the retail industry is quite different from other industries as much of the best training and development happens within businesses rather than in schools or colleges. The key skill requirement for new shop floor workers will be familiarity with technology; something most young people are very competent with already. However, the traditional attributes to succeed in retail, which are determination, hard work, attention to detail, and understanding customers, are something best learnt in a practical environment. The success of a number of retail Chief Executives who started on the shop floor is testament to the effectiveness of this approach.

From a societal perspective this has always been one of the most significant contributions of the retail industry. Retailers have been able to take school leavers with few qualifications and help them to have successful and productive careers. Retailers have always seen the value of building effective internal training structures which develop workers whilst ensuring each business can take a consistent approach across the whole business.

However, public policy in recent years has created new challenges. TheApprenticeship Levy in England is leading retailers to look again at their training programmes to explore the scope for greater use of apprenticeships despite the existence of extremely effective in-house training programmes. In Scotland, the government has taken a more nuanced approach, where retail apprenticeships are not seen as the only legitimate training approach.

However, Scottish retailers are still liable for their paybill. Whilst the Scottish Government has taken some positive steps to make Apprenticeships more accessible, the reality is that for retailers trying to accommodate a different Scottish qualification is too time and cost impactful to be justifiable.

Similarly, the Scottish Government will understandably not want to equate their Modern Apprenticeship scheme with a different English approach.

This is not indicated as criticism of the Modern Apprenticeship system. Indeed, the Scottish Government Retail and Customer Service Frameworks contain much that is of value to apprentices learning how to work in multi-channel environments. However, that approach will not always be the best way to train workers for each individual retailer.

As a result, the most supportive approach the Scottish Government could take is to allow retailers who are liable for the Apprenticeship Levy to be able to reclaim a fair portion of those costs through a flexible workforce fund. There was an announcement to this end in December 2016, but at this stage the details are still unclear, and the value of the fund (£10 million) is less than the figure contributed by retail alone[36].

Beyond this the Scottish Government should be even more ambitious in encouraging the development of more advanced technology and digital skills. This would have to be a cross-sectoral approach which takes the requirements of industries like retail and works with skills providers, including colleges and universities, to ensure the Scottish economy has the high-skilled workers technology providers will require. Those skills will need to be relevant to all elements of the value chain. Everything from coding and algorithm development to hardware assembly and maintenance will be crucial to support the future retail industry. Should the Scottish Government make the right investment decisions now this could well be a crucial area for economic growth, delivering high quality jobs in the future.

REGULATION

The SRC has been at the forefront of the debate on better regulation, working through the Scottish Government's Regulatory Review Group to ensure that there is a regulatory environment that tries to support investment, innovation and economic growth. With a significant number of retailers operating on a UK and international stage the ease and cost of doing business is a major factor in their decisions of where to invest.

Important steps have been taken in recent years such as legislating to allow for the future introduction of Primary Authority which will guarantee greater regulatory consistency across the 32 local authorities, and the Scottish Government's adoption of SRC proposals to ensure the same rigour is brought to government-inspired voluntary regulation and agreements as is the case with formal, statutory legislation.

……………………………..

36 The BRC's 3rd Retail 2020 Report found that Scottish Retailers were expected to contribute £12-£15 million per annum through the Apprenticeship Levy.

We are keen to ensure future regulations take full account of the dramatic structural change occurring in industries like retail. In addition to full implementation early in this Parliament of Primary Authority, and a commitment to ensuring the Scottish scheme is up to date and in line with its UK equivalent, Inception Impact Assessments[37] should be introduced prior to any decision over whether or not to pursue either non-legislative and legislative regulations.

As the retail industry develops there will be an increasing number of disruptive new market entrants. This should not be seen in itself as problematic, as new businesses often deliver efficient and more productive approaches. However, it is crucial the regulatory framework ensures these businesses are subject to the same rules and regulations as existing businesses to ensure a level playing field.

BREXIT, SCOTTISH INDEPENDENCE, AND FURTHER DEVOLUTION

Whilst the focus of this paper is based around the Scottish economy itself, over the next five years the legislative and economic framework will change significantly as a consequence of the vote to leave the European Union, and now the potential second vote for Scotland to become independent.

The SRC has not taken a view on Scotland's constitutional future in the past. At this stage it would be very premature to offer any view on that question.

However, the debate over the UK's relationship with the European Union does provide some precedent for the key issues which retailers will want to seek clarity over.

As explained elsewhere, the retail industry is one which operates very efficiently to scale. The largest retailers in the UK, several of whom are domiciled here in Scotland, operate in both Scotland and the rest of the United Kingdom.

What is therefore most important is that these businesses are able to trade within the single UK market. Decisions or policies which create different market conditions in Scotland would create operating costs for retailers operating across the UK and ultimately reduce economies of scale which can be so beneficial to consumers.

……………………………..

37 SRC's Holyrood 2016 Better Regulation Document has more detail on some of the specific measures retailers have called for.

This is not an exclusive point to Scottish Independence. Devolving certain powers to Holyrood may not be economically desirable. For example, measures to devolve elements of employment law such as the minimum wage or industrial action, or indeed to devolve the power to set the rate of VAT could have significant effects upon the UK single market.

Such measures, no matter what decisions were made, would by necessity increase the disparity between operating in Scotland and elsewhere in the UK. That would effectively make it more expensive for both retailers and customers, and by extension also negatively impact on government revenue as well.

Regardless of Scotland's future constitutional arrangements, the existing and largely unfettered UK single market is hugely valuable to Scotland. It allows retailers and other businesses to capitalise on the efficiencies derived from regulatory consistency and economies of scale which in turn reduces business costs, increases productivity, and ultimately lowers prices and provides more choice for customers. Indeed, we would like to see the operation of the single market strengthened, for example with improved transport infrastructure links to the south.

It is premature to speculate on what arrangements might be put in place following either the conclusion of the UK's negotiation with the European Union, or indeed the outcome of a possible second Independence referendum. However, retailers will be keen to understand what measures and policies will be put in place to preserve the valuable UK single market.

CONCLUSION

Productivity and innovation are essential to the sustainable growth of the Scottish retail industry. The industry is going through a period of transformational change. Technology has changed every element of the retail experience. Customers now want products in different ways, and retailers have to respond. Competition has delivered low prices and fantastic service for customers, but has led to an erosion of profitability.

These trends leave Scotland in an exposed position. With most retail jobs in stores, the deleterious consequences of these developments could be severe unless action is taken. Jobs and businesses are absolutely at stake. Some will no doubt disappear.

However, whilst trying to stop the pace of change is impossible, Government does have the ability to shape how this occurs. Through developing a retail industry strategy, by reducing cost burdens from public policy, and by investing in productivity growth, the Scottish Government can help to mitigate the impact of these changes. In turn they also have an opportunity to benefit from the new, higher skilled, more productive jobs which the industry will create.

Ultimately supporting this process is crucial to the Scottish Government's own desire to grow the economy, and of course generate tax revenue. Retail jobs of the future won't be based in a single location, but will be much more flexible. In such a competitive industry any cost differential will be important. Those jobs will be located where there are highly skilled workers, where there are strong infrastructure links, and crucially where the public policy costs are lowest.

There are huge challenges ahead to drive real productivity growth in the Scottish retail industry. This report is intended to start the debate on how we can ensure that is sustainable growth, which benefits the industry, and the wider Scottish economy.

THE FUTURE OF
SCOTTISH RETAIL

SCOTTISH RETAIL CONSORTIUM
Box 112, 12 Southbridge, Edinburgh, EH1 1DD
+44 (0) 7880 039 743 | info@src.org.uk | scottishretail.org.uk

Scottish Retail Consortium - a company limited by guarantee
Registered in England and Wales No. 405720 | 10151mb17