

2019 Retail Outlook

**Why growth in 2019 is all about share
and where to invest to achieve this.**





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Executive Summary



Lisa Hooker
UK Consumer
Markets Leader

The run-up to Christmas 2018 saw a flurry of dire retail predictions in the media. It was going to be the worst festive period on record, with consumers playing Scrooge as high-street retailers struggled by on thin gruel and the online giants took the richest pickings.

Despite the sensationalism it was not the worst Christmas on record. Overall, Golden Quarter performance was similar to previous years. Shoppers were cautiously festive as real earnings grew. Black Friday popularity held up. On-line grew too, although sales in this channel are slowing generally as it matures. And, the High Street is not dead. Shoppers estimated that 50% of their Christmas spending came from there over the festive period. Some retailers had a great Christmas. On the downside, footfall decline accelerated, retailers who were already struggling continued to do so and overall shoppers estimated they spent less.

Taking this, and the global economic outlook into account, our predictions for 2019 are for relatively flat economic growth – Brexit outcome depending.

We expect to see consumer spending caution increasing, borrowings to fall and spending cutbacks across the board, with the exception of grocery, where shoppers expect to spend more as costs rise. There's no doubt trading will continue to be tough, but there are still some opportunities to win.

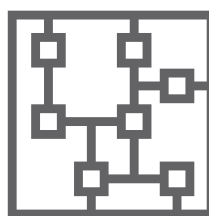
Whatever the Brexit outcome, it's clear that the UK retail market overall isn't going to grow very much in the foreseeable future. So the route to growth lies in taking share from other players. Transforming your organisation to better meet your shoppers' rising expectations of their interactions with you. And doing this better and faster than your competitors.

In our view, to win with cautious consumers, focus on three areas:



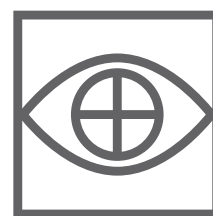
Investment in technology:

Using artificial intelligence (AI) and data analytics to aid decision making and improve customer experience.



Ruthless efficiency across your operating model:

Using digital technologies to transform your supply chain, save cost and benefit customer experience.



A fresh look at your corporate structure:

Using M&A, divestments or partnerships to improve corporate health and expand your touch points with customers.

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These are challenging but exciting times in retailing, and there's enormous value up for grabs. Now's the time to transform to seize it. In the era of the cautious consumer, the brave will win out.



The macro economic outlook:

Low growth with a number of risk factors



Jac Windsor
Partner

Barring the eventuality of a 'no deal' Brexit scenario – the expectation is that UK GDP will continue to grow at 1.4% (See Figure 1). However, any optimism here should be tempered by the global picture.

Growth is projected to slow this year in all three of the world's major trading blocs – China, the US and the Eurozone – amid rising concerns over global trade in a more protectionist world. Our recently-published Annual Global CEO Survey, reported a record jump in pessimism – with nearly 30% of CEOs expecting global GDP growth to decline, compared to a mere 5% last year.

There are a number of factors which will impact consumer spending. On the positive side, a combination of a pick-up in wage growth and a slowdown in retail price inflation means real earnings are projected to increase in 2019, putting more money in consumers' pockets.

But there are reasons to think the sustained strength of consumer spending is now on borrowed time. With disposable incomes rising at 1.3% over the past six years, and consumer expenditure rising at 3.1%, there's been a gap between the two. And households are filling it by taking on debt: essentially spending more than they earn (**See Figure 2**) and borrowing to make up the shortfall. There are limits to how much further this can go, with interest rates starting to edge up, the housing market remaining subdued and consumer credit regulations tightening supply. There are already signs of a slowdown in consumer credit in markets like car loans.

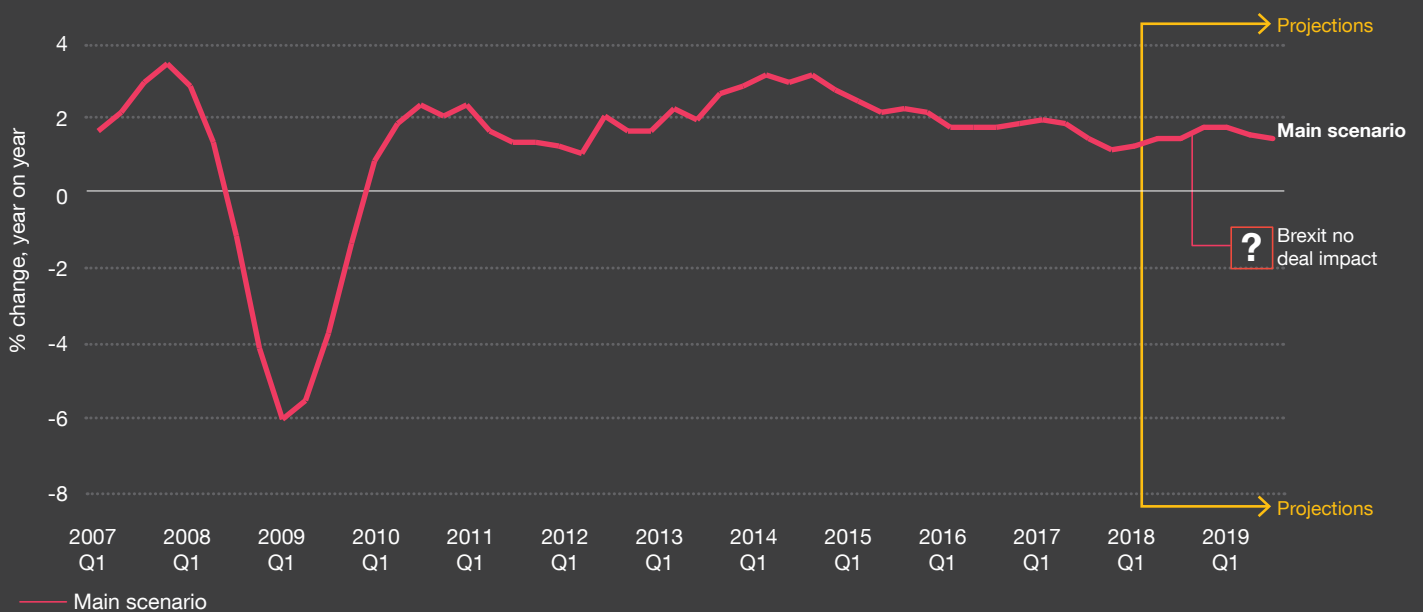
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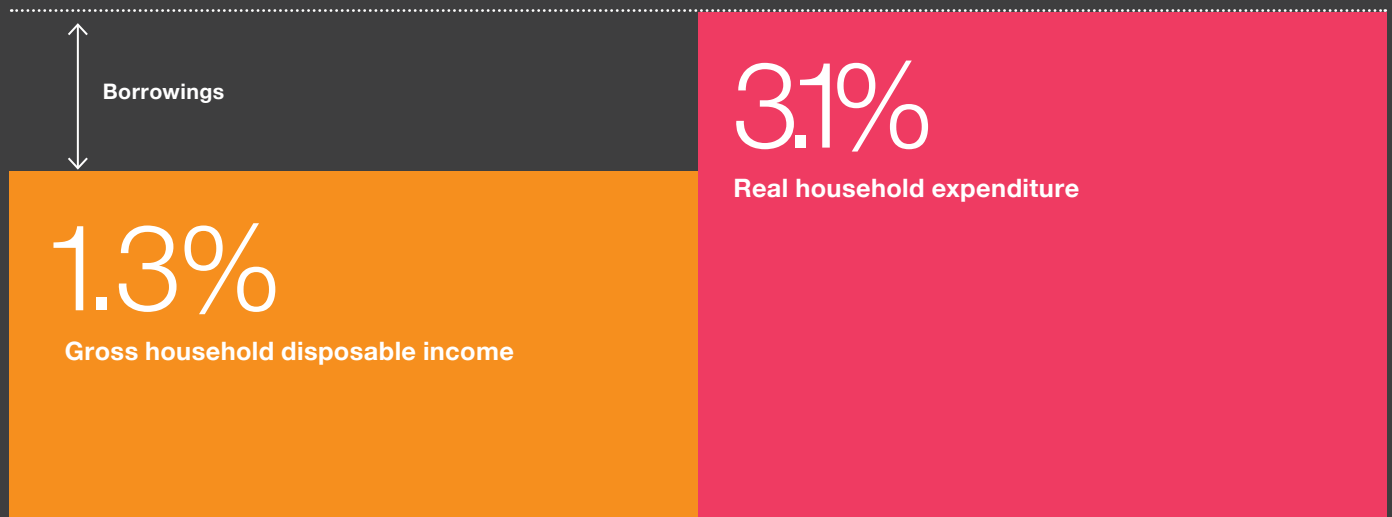
Against this background, we expect to see continued moderate growth in consumer spending of around 1.5% in 2019, provided there is a smooth Brexit.

Figure 1: Growth in UK gross domestic product (GDP), 2007-2019



Source: ONS

Figure 2: Annual change in real household disposable income and expenditure since Q3 2012



The consumer outlook:

Entering the era of cautious consumption

Brexit is already affecting consumers' spend

Our research into consumers' Brexit-related perceptions and how they've changed their spending as a result confirms it has already started to affect how much people spend and on what. The impacts vary significantly by region and demographic (**See Figure 3**).

Nationwide, 27% of consumers say they've already changed their spending because of Brexit, and further 13% say they will do so during 2019.

Those in London, Wales and Scotland have the highest proportion who've already changed their spending – this is especially interesting, given that London is currently the most optimistic region about the economic outlook – while the North East has seen the smallest effect on spending patterns.

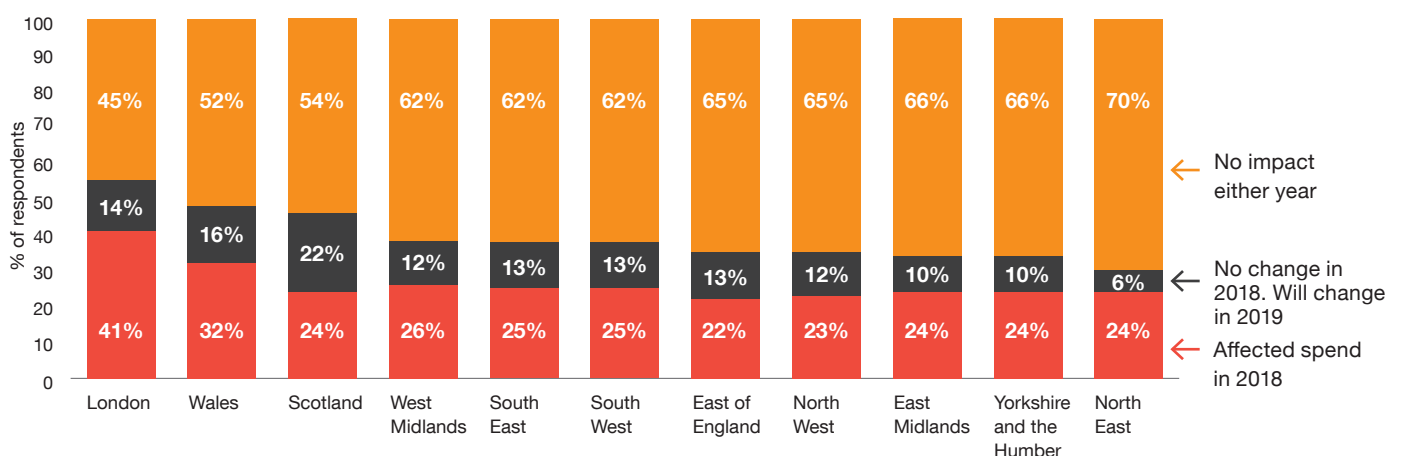
The proportion of consumers who expect to change their spending in 2019 also varies widely, from 22% in Scotland to just 6% in the North East.

The demographic split of the findings is also interesting. About half of consumers under 35 say they've changed or will change their spending in response to Brexit, compared to less than a third of the over-45s. Just as older demographics were more likely to vote for Brexit, so they seem to be more relaxed about its impacts on their ability and willingness to spend.

27%

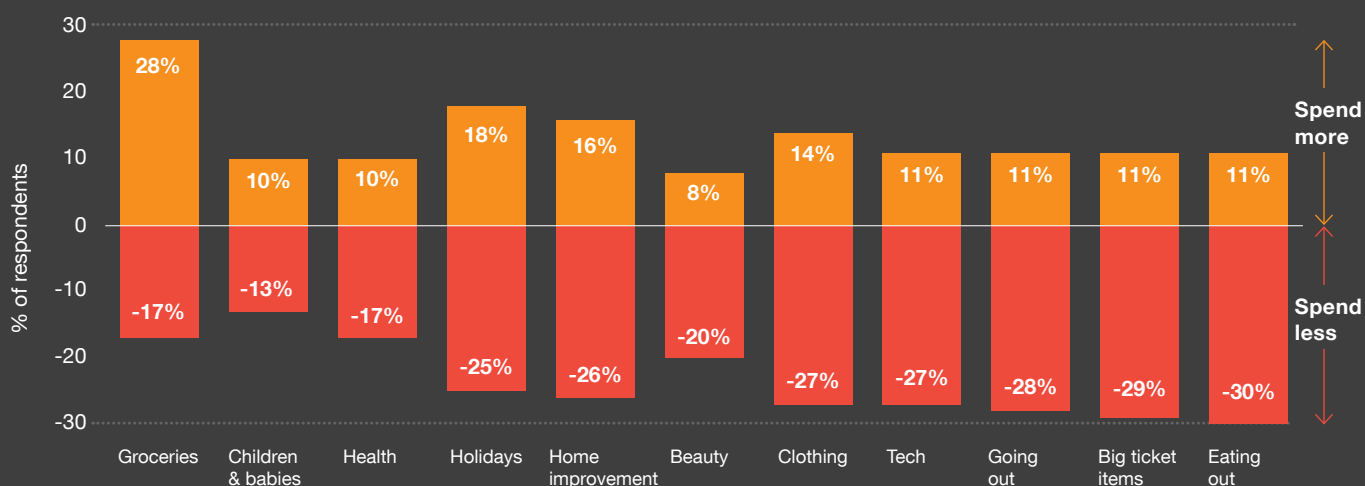
of consumers Nationwide say they've already changed their spending because of Brexit

Figure 3: Has Brexit affected the way you spend in 2018 and will it impact your spend in 2019?



Source: PwC Consumer Sentiment Survey December 2018 (n = 2,053)

Figure 4: How will your spending change in 2019?



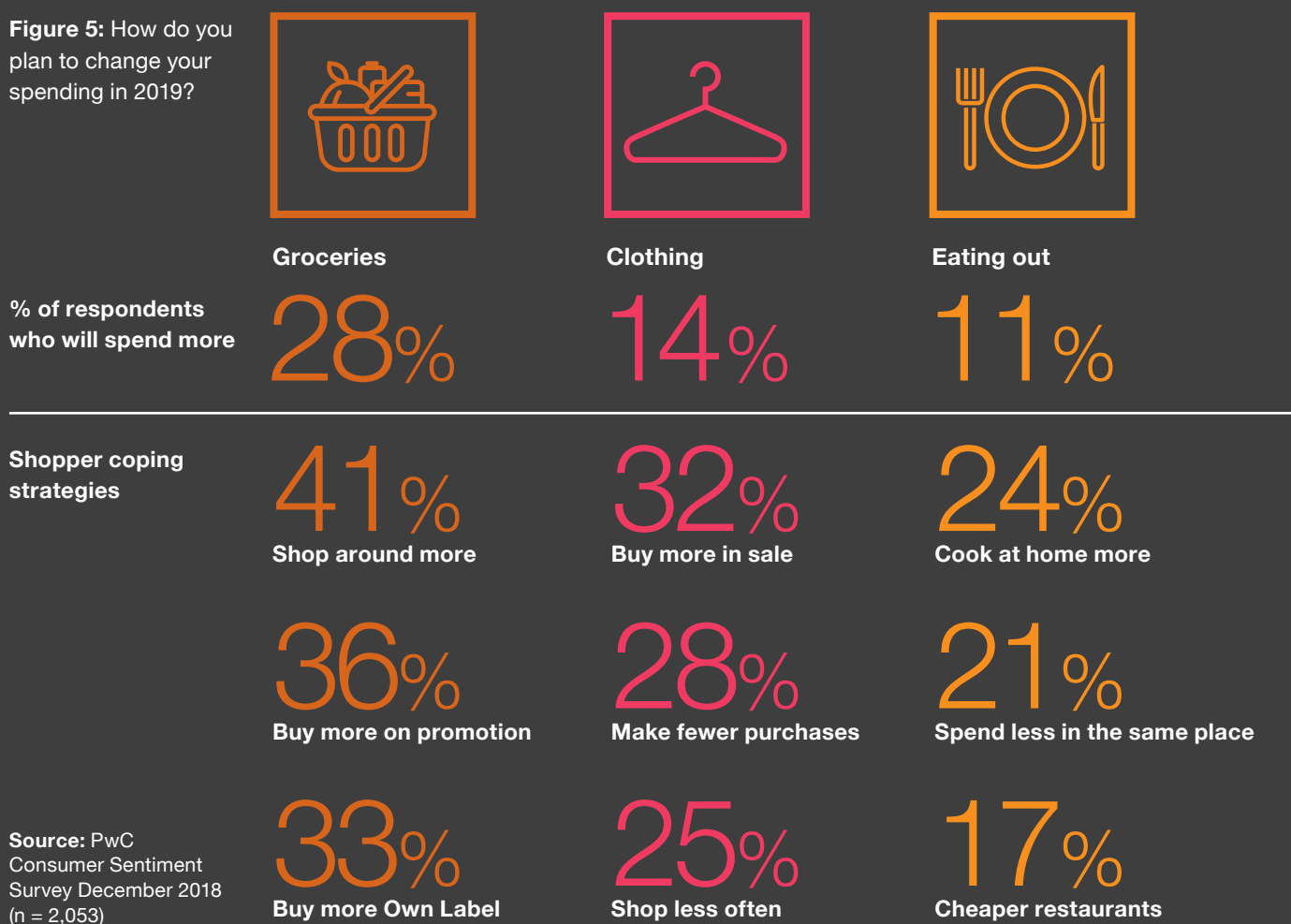
Source: PwC Consumer Sentiment Survey December 2018 (n = 2,053)

Shoppers will cut back across all categories, except grocery

Figure 4 shows the % of respondents who said they would spend more (above the line) or less (below it) this year. The chart is ordered on the balance of option (net result). The only category where the net result is positive, is Groceries. But consumers told us this was because they anticipated rising prices. Interestingly Holidays are usually higher on this list, than 4th position, but in uncertain times, shoppers are clearly protecting spend on the things that matter most. As a result Children & babies and Health are then the categories which will see the lowest net spend reductions.



Figure 5: How do you plan to change your spending in 2019?



Source: PwC Consumer Sentiment Survey December 2018 (n = 2,053)

Asked how they've changed their spending, 41% of those who've already done so say they've bought less, 33% have postponed big-ticket purchases, and 32% have gone out less. Among those who expect to change their spending in 2019, 48% will buy less, 35% will go out less, and 32% will postpone big-ticket items.

Not surprisingly even those who say they'll spend more, are going to be more careful about what they spend their money on, adopting a variety of coping mechanisms (**See Figure 5**).

As the chart shows, shoppers will shop smarter. Even the 28% who will increase their grocery spend also say they'll shop around more, buy more items on promotion, and buy more Own Label products. Similarly, the 14% who will increase their spend on clothing intend to buy fewer items and/or buy them in sales. And the 11% who will increase their spending on eating out will also cook at home more or economise, either by spending less in their usual restaurants or seeking out cheaper ones.

All of this points to the rise of a more cautious consumer mindset – a trend that varies by age. A comparison between the responses given by consumers aged 18 to 24 and those between 55 to 64 show that the younger group are intending to trade off their spending on different categories, for example spending less on technology to free up money for their homes, health and beauty. The older group, by contrast, expects to spend less on everything except groceries.

A comparison between consumers inside and outside London reveals a virtually identical picture, but with some differences in the prioritisation of categories. For example, Londoners will spend more on home, health and children & baby items, while the rest of the country will spend less.



Shoppers will adopt a mix of coping mechanisms to shop smarter.



You will need to fight harder to attract and retain your customers in 2019.

Consumers want to shop seamlessly between bricks and mortar and on-line, but the on-line experience needs improvement

Where experience or proximity matter, consumers still want to shop in-store. Our latest consumer study found that 50% of Christmas spending came from bricks and mortar. Having a click and collect offering drives impulse buys in-store when shoppers visited to pick up their goods. We do know that the ability to offer a seamless experience across a strong on-line offer and well-stocked, well-staffed and conveniently-located stores maximises revenues.

But we found that the on-line experience has room for improvement. When we asked consumers whether they had encountered problems with on-line shopping, we found that the volume of delivery-related problems had declined – but only to be replaced by issues around navigating to the right product, pricing, and sites simply not working. One area where on-line has improved is flexibility around returning unwanted goods, but this appears to have promoted an acceleration in return levels this year. Retailers should critically assess the functionality and ease of navigation of their websites, to ensure that the consumer shopping journey, from browsing to returns is as easy and as engaging as it can be.

And conscientious consumption is increasingly affecting shopper choice

We are seeing a widespread shift from conspicuous to conscientious consumption. More and more shoppers are starting to use retailers' ethical and sustainability credentials in the choices they make. Once only on the agenda of the select few, sustainability is now firmly in the mainstream. This goes beyond a more environmental perspective, like the "3 Rs" – reduce, recycle and reuse – to a much more extensive view. From how brands treat their people, to where and how they source, what credentials their investors have, how much energy is used in production as well as how sustainable their offering is.

Retailers have picked up on this and are responding with their own initiatives. Examples range from H&M's Take Care store format which recycles and repairs clothes to ASOS's recent sustainability conference, and the entry of online disruptors such as Rent the Runway, with its strapline: "Buy less. Wear more. Be you." Outside fashion, similar dynamics are clear – like Iceland's stance on palm oil and with other retailers' initiatives like compostable packaging, banning plastic straws and more recycled board and plastic used in packaging.

What does all this mean for you? Essentially your consumers are becoming more careful and choosy in what they buy, where they buy it and how they chose to spend. So, depending on which demographics you're targeting and which regions you're weighted towards, you will need to fight harder to attract and retain your customers – and their previous levels of spending – in 2019. We'll now look at how retailers should respond.

Focus for 2019:

Strategies to drive profitable share in a flat economy

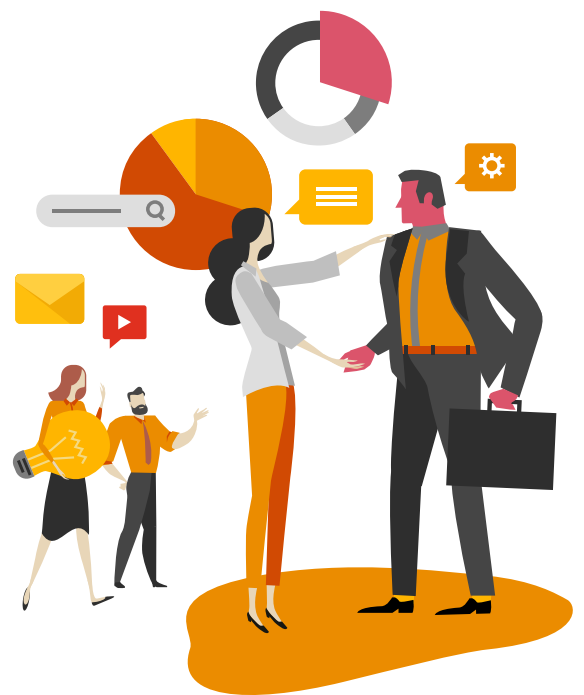


Tom Woodham
Digital Supply
Chain Leader

How to win share in the “New Normal”?

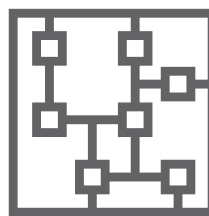
Overall, the signals on the economic outlook point to a sustained “new normal” where many economic indicators – GDP growth, real earnings, consumer spending and more – remain relatively flat. In this type of subdued environment, the only practicable way to achieve incremental growth in retail revenue is to take market share away from other players.

If the cake is staying the same size, you need to eat into someone else’s slice. The question is how? We’ve mentioned the rising importance of trends like conscientious consumption. The need for a seamless on and off-line relationship with your shopper. A recognition that shoppers will be adopting coping strategies to manage their spend. We believe the route to success lies in investing in the moments that matter across your customer journey. Here are three areas of focus to help you do just that:



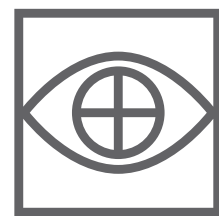
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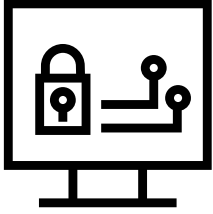
Ruthless efficiency across your operating model:

Using digital technologies to transform your supply chain, save cost and benefit customer experience.



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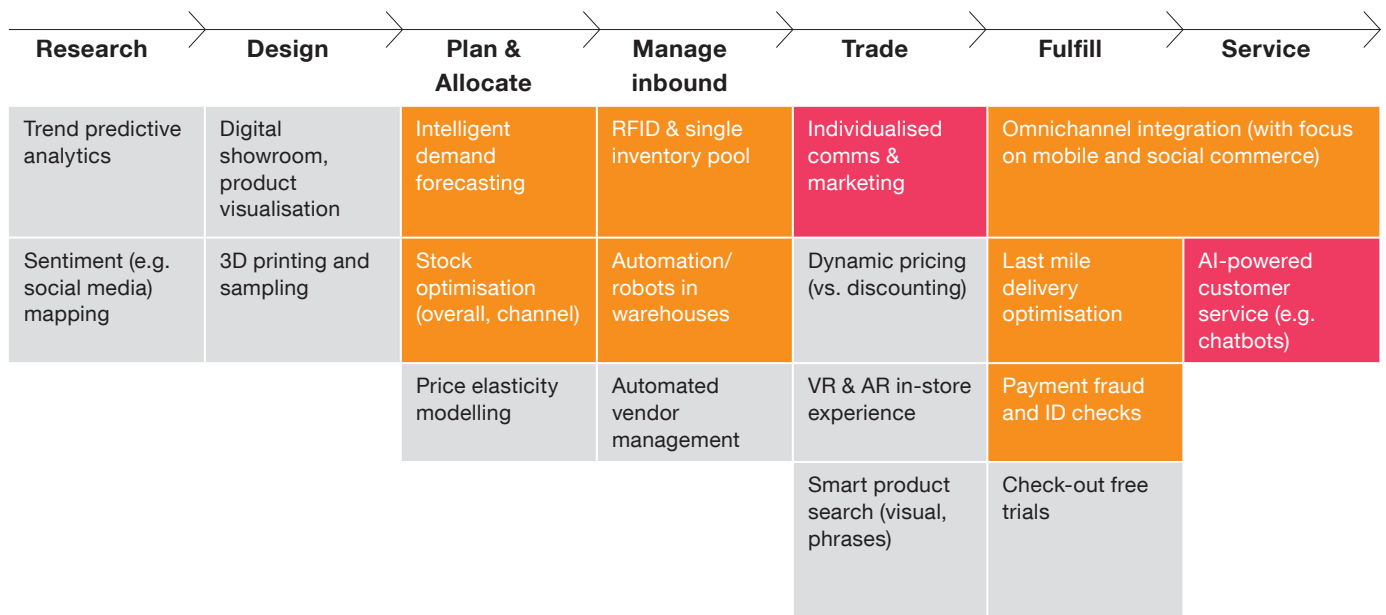
We've all been there – someone asks what you are doing with AI and “Big Data” and there's an uncomfortable silence. Both feel broad and intangible, so it's often difficult to know where to begin. In the words of Crieghton Abrams, “When eating an elephant take one bite at a time”. Simply put, AI is just a way of using mathematical models to recognise patterns in data to aid decision making. Once you approach AI in that way, one step at a time, the whole topic becomes much more actionable.

The most common use of AI in retail is to solve long-term, structural problems cost-effectively, often to keep pace with rising consumer expectations.

Trading has been challenging and there's been less investment in AI in the past year than expected. But the fact is, it's an essential, and valuable tool to win, particularly in supply chain. So where do you need to focus in 2019 to grow share?

Figure 6 shows some of the most common applications of AI and data analytics across the retail supply chain. In 2018 we highlighted intelligent demand forecasting and more cost efficient last-mile delivery as focus areas, both of which are increasingly becoming part of ongoing business-as-usual in retail. So where next?

Figure 6: The shifting focus on where AI and data analytics can help retail



Commercial data strategy – 360 degree view of internal data based on structured and unstructured data, supplemented by external insights

Key for activities by retailers: ■ Continual focus ■ 2019 focus ■ Investigations/ trials

35%

of Amazon's sales come from personalised recommendations to their customers

In 2019 we believe the three areas of focus for growth around AI & Data Analytics are:

1. Individualised consumer communications and marketing:

This means going beyond tailored emails to truly personalised communication. 35% of Amazon's sales come from personalised recommendations to their customers, which use their in-house algorithm to anticipate a customer need, before they do. Shoppers shop where ever they have access to their phones, so ensuring your website and communications are mobile first is critical. E-commerce has evolved into social commerce, so you need to play here. Use social to target your advertising more effectively; use relevant influencers; and trial or apply social selling. But when doing this, ensure you hold your chosen social media platform to account about who sees your advertising and where it appears.

2. AI-powered customer service:

This technology can cut costs and improve customer experience. It can be used in multiple ways, from automated FAQ pages, through to chat-bots which use natural language techniques to chat to customers in a human-like manner. Far from being off-putting, Many millennials prefer chatbots to true "human" interaction because the communication is easier to anticipate and respond to. Sephora has used chatbots very effectively to grow conversion rates by 11% vs. other channels for appointment bookings. It offers 'Sephora Reservation assistant' which allows for bookings in-store and their 'Sephora virtual assistant' allows a customer to scan an image and view a list of matching lipsticks

3. Clear commercial data strategy:

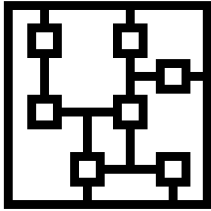
At the end of the day – it's just about how data gets used to support decisions. Sometimes the missing ingredient is having the right capabilities. Recruiting talent is not always about hiring data scientists but also about upskilling internally. As long as the end result is an organisation that knows how to navigate a big dataset, or brilliantly interact with external parties who do. Think about how you can embed an appreciation of the power of data up, down and across the organisation. From data-driven decision makers at the top, through to functional analysts. No longer should the concept of insights and business intelligence be treated in silos. Set KPI expectations, integrate data into your existing infrastructure and use it to know your shoppers better and better and so improve their interactions with you. This builds loyalty and drives upsell.

In tough times it's easy not to invest here. Other more familiar priorities and legacy systems can hold back adoption. It's important to remember here that fortune favours the brave. Failing to invest means falling behind. The hardware, software and brains are all available now to help you. So, be brave. Work out which AI initiatives you need to stay in the game. Apply them. Then the ones that give you competitive advantage. Trial them. Apply them. And drive share.

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Technology can cut costs and improve customer experience. It can be used in multiple ways, from automated FAQ pages, through to chat-bots which use natural language techniques to chat to customers in a human-like manner.





Ruthless efficiency across your operating model:

Using a digital supply chain in retail is not new news. What is, is that improvements in the application of technologies across our daily lives, have made us all much more demanding.

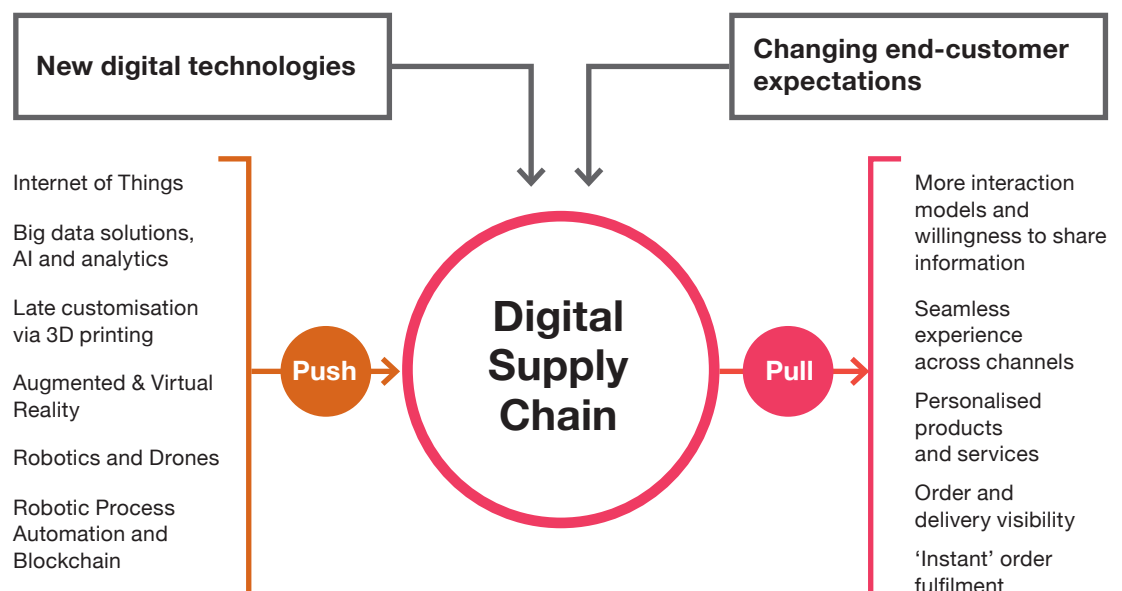
Figure 7 shows the digital technologies that are accelerating end to end customer expectations and what those expectations are.

To pick out just a few, the Internet of Things (IoT) is opening up real-time end-to-end visibility along the supply chain and a single view of stock using IoT-connected sensors. Big data AI and analytics are enabling retailers to process the resulting information and connect insights across previously separate silos. Augmented reality is being used in warehouses to pick stock and automate its movement. And drones are being used to reduce the need for manpower, typically in warehouses initially and later for customer delivery, with payback likely in three to four years.

While investments in AI in retail are still at a relatively early stage, the development of digital supply chains is much more advanced. It's an easier investment case to prove as cost savings are more immediately tangible. As a result, digital supply chain is now effectively business-as-usual in much of our industry. That said, the main barriers should not be overlooked – Integration with legacy systems and the cost of rebuilding the supply chain end-to-end. Areas where new entrants without legacy, such as ecommerce players, are at an advantage.

It's important to grasp that implementing a digital supply chain is a major undertaking. It can cost up to £20m and take two years to implement. But the payback can be quick: We are currently working with several large retailers who are on track for payback in less time and with 30% cost savings through less stock, less stock handling, and fewer miles. The benefits can be especially significant in general merchandise with lots of fast-moving SKUs, where our experience shows that stockholding can be cut from four weeks to two.

Figure 7: Technology push and consumer pull creating the digital supply chain



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Overall, what's clear is that digital supply chain is no longer a nice-to-have for UK retailers, but is housekeeping. Given the strength of the business case, investing in this capability should now be a priority for any retailer that hasn't yet done so.

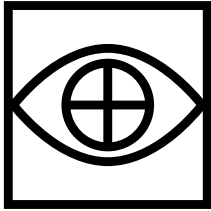
For 2019, we believe UK retailers should focus on three digital supply chain investment areas:

1. **Demand sensing:** Building on backwards looking, historical forecast algorithms and adding new, future looking ones. Adding non-standard and external information such as weather, advertising impacts and competitor offers allows you to increase the accuracy of your forecasts, so maximising stock efficiencies and improving customer experience.
2. **End-to-end visibility:** Using above-market visualisation tools to see real-time stock information across the store, on-line estate and on your trucks. Plus, extending this to include suppliers and returns. Knowing exactly what you've got, where.
3. **Warehouse automation:** Developing new automated warehouses to reduce lead times, make better use of space and improve labour productivity. The US retailer Kroger is using Ocado's technology to great effect do this.

This may seem daunting. But if you lack the current internal skill set, don't forget there are many, very capable and experienced supplier partners out there who can get you started and work with you on your organisation's transition.

Some retailers are also experimenting with emerging technologies likely to be key in 2020 and beyond, including drones, autonomous vehicles and blockchain. While still at an early stage, WalMart is trialling the use of blockchain to trace food from field to fork. While the above areas of focus are essential for 2019 it's also important you consider what is today's trial. Knowing that, what works, will quickly become tomorrow's business as usual.





A fresh look at your corporate structure:



Lisa Hooker
UK Consumer
Markets Leader

On the face of it, what follows may not look like a focus for share growth. Our M&A and divestments research with Mergermarket and Cass Business School uncovered just how difficult it is to drive shareholder value via mergers, acquisitions or divestments in the retail, consumer and leisure sectors. But we believe there are key learnings from this study that can be applied.

Our research explored the retail industry's track record of value creation through M&A globally. The findings make grim reading. In general, M&A's across most industries do enhance shareholder value. But, as **Figure 8** shows, shareholder returns driven by acquisitions in Europe lag significantly behind those in Asia

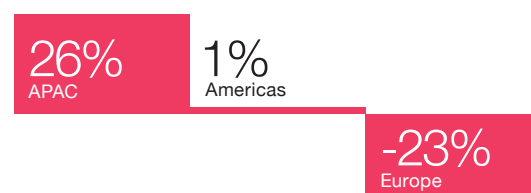
Pacific and the Americas. In Europe acquisitions in the consumer sector create only very marginal value, while those in leisure and retail usually result in significant value destruction. In retail, just three out of 19 acquisitions during the period generated positive value.

For retail, again the story in divestments is similar. Deals in Europe underperform overall, held back by retail (**See Figure 9**). A sector analysis shows that value from leisure divestments benefits from a handful of property/hotels and gaming deals, while only two of the 15 retail divestments made during the period were value creative.

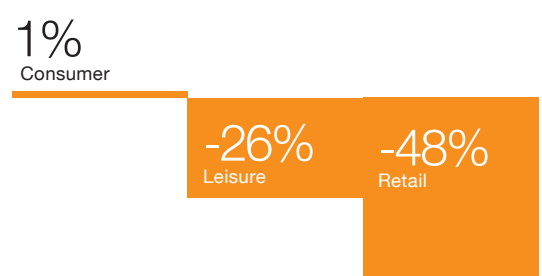
Note¹ n=40, Executives in RCL EMEA; (2) Does not include RCL transactions which are not typical RCL businesses (e.g. Automotive retailing, agriculture). Source: PwC, Mergermarket study and Cass Business School

Figure 8: Average shareholder value creation/destruction by acquisitions

Retail, Consumer & Leisure – 2 years after completion
Average Total Shareholder Return – 1 to +24 relative to industry



Europe performance
Average Share Price performance relative to industry benchmark by sub-segment



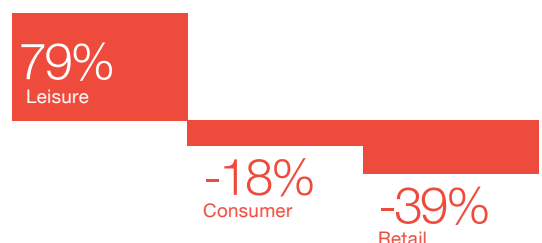
Note¹ n=40, Executives in RCL EMEA; (2) Does not include RCL transactions which are not typical RCL businesses (e.g. Automotive retailing, agriculture)/ non RCL targets. Source: PwC, Mergermarket study and Cass Business School

Figure 9: Average shareholder value creation/destruction by divestments

Retail, Consumer & Leisure – 2 years after completion
Average Total Shareholder Return – 1 to +24 relative to industry benchmark



Europe performance
Average Share Price performance relative to industry benchmark



So, why the destruction of value by most retail M&A deals? To find out, we spoke to 100 C-suite retail, consumer and leisure executives globally who had undertaken one or more deals in the past three years.

Their responses showed the top lessons in acquisitions are:



43%

Start integration planning earlier



30%

Improve integration resources



28%

Put value creation at the heart of the deal

In divestments, the top three lessons were:

1

Better understanding of the value trade-off

2

More effective programme management

3

Better communication with stakeholders

More generally for Retail, Consumer and Leisure deals of all kinds, cultural factors came up as an issue in two out of three transactions – more than in any other sector.

We think that M&A's and divestment activities are still important for retailers. In a flat economy they can be a useful tool to drive share, whether that be in the UK, or internationally.

Despite the sector's poor track record of value creation via deals, acquisitions and divestments of all types can create value. But, it's important you take on board those key learnings. To make sure your deal comes out ahead in value terms, you should plan thoroughly for the integration, be sure not to underestimate the complexity it will involve, and focus on value creation while staying alert to, and contingency planning for, unintended consequences.

Conclusion:

Now is the time to transform



Lisa Hooker
UK Consumer
Markets Leader

We began this report by saying that now is the time for retailers to transform for a changing retail landscape. We've now gone on to describe how this can be done: Through data and AI, to provide consumers with experiences that stay ahead of their advancing expectations. Through digitisation of the supply chain, to boost visibility and reduce costs. And, through M&A, with better planning more focused in value.

To win in retail in 2019 it will be all about driving share. So I will leave you with three questions to ask yourself, and your team in order to map your journey to success:

- 1** Who are you taking share from, how are you doing it and which consumers?

- 2** How do you capitalise on evolving consumer trends such as sustainability? Are you constantly giving a reason to shop either on your own or with partners? Are you using technology to enhance the moments that matter for your consumer?

- 3** Finally, how do you truly own the customer experience given that other brands, retailers and technology platforms are competing for them?

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So what will you do differently in 2019?



About the authors

Now is the time to transform



Lisa Hooker
UK Consumer
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Lisa is PwC's UK consumer markets leader. She has worked in transaction services for over 15 years, focused on the retail and consumer sectors and has undertaken due diligence in all areas of these consumer markets.

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Chain Leader

Tom is a director in PwC's consumer markets consulting team. He has over 17 years' management consulting experience, working with clients to transform their operations. He led the supply chain transformation project with Rolls-Royce that won the Management Consulting Awards Project of the Year in 2018. Tom is a Fellow of the Chartered Institute of Procurement and Supply. He has a keen interest in the emerging trends and priorities for supply chain and procurement, and the impact of digital technology.

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