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Christmas trading in the recession: the challenges and possible impacts

Introduction

As we approach the key Christmas trading period, the KPMG/Synovate Retail Think Tank's (RTT) latest discussion focused on the challenges and impacts the sector faces during this crucial time for retailers.

Christmas trading in 2009 will be set against a backdrop of this year's tough economic conditions, part of the longest recession the UK has encountered since at least 1955.

Though 2009 has been challenging, the RTT's latest Retail Health Index found that declining health in the sector "bottomed out" in Q3 2009 and predicts that health will improve in Quarter 4, albeit marginally.

With this in mind, the RTT debated the impact the recession and economic conditions will have on retail this Christmas and how retailers are coping with the challenges it presents.

In summary, the RTT predicts that Christmas 2009 will see:

- Relatively solid trading for retailers on the back of reviving consumer confidence;
- Margin protection as the business imperative for retailers;
- Disappointed bargain hunters who may have expected a repeat of the bumper sales of Christmas 2008/January 2009, due to retailers adjusting their stock levels to suit current demand;
- A Christmas of two tales. For the fortunate, with more disposable income this year, spending will be buoyant. For others who remain squeezed by lower credit thresholds and the uncertainty of their employment, Christmas spending will be more constrained. Christmas spending and shopping behaviour is likely to be clearly polarised between these two groups;
- A further increase in the importance of post-Christmas trading – it is not just about the run up to December 25th;
- Shoppers looking to secure high ticket goods before the expected VAT rate rise on January 1st;

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- A logistical challenge for retailers due to the rise in VAT which will require getting the pricing and messaging tactics right both before and after the increase;
- A "stay at home Christmas" with less holidaying abroad, which will have a favourable effect on Christmas trading.What does Christmas retail usually look like?

While last year could not be described as "normal", Christmas 2008 saw the continued shift in the balance of power towards consumers and away from retailers. Christmas 2008 was a buyer's market due to a surplus of excess stock, caused by unpredicted weakness in demand disadvantaging retailers who had bought as early as April before the extent of the recession had really hit.

The day of the week on which Christmas day falls inevitably affects trading patterns. Last year, it fell on a Thursday meaning much of the country took a ten day holiday and spent time after Christmas shopping for bargains. With Christmas on a Friday this year we expect much of the same, except for the affect of the reduced Sunday shopping hours on the first day after Boxing Day, which might mean a busier than ever Boxing Day.

More important still though is the trend to shop for presents later and later. Tim Denison of Synovate explains: "The post-Christmas trading period is becoming increasingly important, with the extended holiday season now as influential as the weeks preceding Christmas. Changes in society have created a shift away from Christmas itself to become a wider celebration or holiday. Furthermore, we are increasingly time-poor, so we tend to plan ahead less, shop later and believe that the later we leave it, the better the bargains will be."

The push to later shopping is not one that is welcomed by retailers. Sales not made in the early run up to Christmas are never recovered later. Regaining the lost ground is never easy and usually not achieved. The RTT therefore expects retailers to push hard on early promotions of "bargains" to get the tills ringing early and give them some confidence of achieving a solid Christmas performance.

The internet continues to play a larger part in Christmas trading, with non-store sales growing 30% in December 2008 according to the BRC-KPMG Retail Sales Monitor, when total retail sales fell by 1.4% year-on-year. To put it in context though, the RTT points out that the internet is still a small contributor to the total value and members advised that it should no longer be seen as a separate channel but that it is incorporated into one cross-channel model. The days of separating out the performance of clicks from bricks are fast disappearing.

The RTT felt that while people will continue to turn to the internet, this Christmas activity may still be impacted by the now postponed/resolved postal strikes. In past times delivery to the door has certainly been an Achilles' heel. Helen Dickinson of KPMG pointed out: "There is much evidence that retailers have permanently 'switched horses' or are holding onto contingency plans to avoid the brand damage that non-delivery could create."

Finally, food has become an increasingly important feature of the Christmas retail experience with retailers demonstrating innovation in food ranges for the festive season in a way that isn't seen at other times of the year, both for home consumption as well as gifting.

How will Christmas 2009 be different this year for consumers?

The retail sector has remained remarkably buoyant so far this year, and given Christmas trading has always been better than expected during previous recessions, the RTT expects a solid performance in 2009, contrary to the thoughts of many commentators.

Their explanation is comprehensive. Disposable income has been rising rapidly for some consumers, and some of this extra cash is now finding its way onto the High Street. Although income growth will be squeezed in the months ahead, it should remain strong until the end of the year. Nick Bubb of Pali International said: "The huge Government stimulus launched at the end of last year is still working through and Christmas falls in a favourable window before the big payback begins, in the form of significant tax rises and spending cuts after the election."

The RTT was first to highlight the divergence between two broad groups of consumers; the 'haves' and the 'have-nots' and believes that their behaviour will polarise Christmas spending this year. On the one hand, home owners with job security, greater disposable income and high credit ceilings will shop freely, constrained more by time than by money worries. They are likely to have their needs satisfied by fewer trips to bigger centres/stores. The second group, who may be out of work or concerned by job security with limited access to credit, remain deeply disadvantaged by the economic situation, will be mindful of every pound they spend and will shop around in order to get the best deals from a greater number of outlets. Nevertheless they may well feel constrained by family and other pressures to spend at Christmas, which may well have a knock on affect on their spending in the New Year.

The RTT reinforced its comment by stating that even some affluent consumers who can afford to spend more may be planning to save or reduce their levels of debt as opposed to splash out at Christmas as, for them, the shock of last year's economic events has yet to subside. Vicky Redwood of Capital Economics said: "One area that has certainly shown no improvement is unsecured borrowing. According to the latest Bank of England credit conditions survey, lenders anticipate reducing the availability of unsecured credit further in the final quarter of the year." However the RTT acknowledged that Christmas is often a time of overspending and those who have been assiduous in reducing their debt levels will have more "headroom" on their credit cards and may be tempted to release their grip a little.

Regardless of which group consumers fall into, the RTT believes that they will continue to leave their gift shopping later. This year main purchases could well be delayed according to John Dawson of the University of Edinburgh "until the weekend of 19th December". Even with warnings of low stock, the RTT felt that consumers may remain sceptical that this is a ploy to drive demand, assuming that the later they leave it, the bigger and better than ever the bargains will be based on last year's experience. The RTT cautions strongly against this assumption, this year at least. The RTT suggests that, nevertheless, the peak in footfall could even be after Christmas this year though the stock they want may not be still on the shelves.

RTT members predict that this year will be a "stay at home Christmas" for the majority and this will have a favourable effect on Christmas trading. In the UK last year, despite declining confidence, many consumers had already paid deposits on their regular winter holidays before the worst of the economic situation became apparent and went abroad anyway, somewhat to the detriment of the nation's coffers. However, the RTT predicts that many will think twice this year about holidaying aboard, despite the heavy discounting already being seen in the travel sector reflecting the huge overcapacity. This bodes well for UK retailers and the home economy.

How will Christmas 2009 be different this year for retailers?

The RTT acknowledges that retailers in the UK have adapted well to the lower growth environment. They have planned their Christmas campaigns accordingly with less stock, more efficient advertising spend and less high risk, marginal range. Mark Teale of CB Richard Ellis said: "Given that the economic panic has subsided since last autumn, retailers will be less apt to be drawn into heavy discounting this year: Christmas will be less fraught."

The RTT believes that protecting margin will become the business imperative for retailers this Christmas. It will be more important than last year as less volume needs to be shifted, given the reductions in forecast sales due to the current trading environment. Richard Lowe of Barclays Retail & Wholesale Sectors said: "Last Christmas, retailers were going into it trying to move stock as quickly as they could, to generate cash and reduce their overall stockholding. This year stock is far 'cleaner' and they will be managing their margin very carefully."

The RTT expects household and electrical retailers should perform significantly better than last year. Capacity in this sector has been taken out over the past twelve months and the combination of pent up demand, deferred replacement, and the focus placed on the home at Christmas will provide a sales boost. Inevitably, householders will look to buy high ticket items before VAT rates rise again in the New Year.

Despite the RTT's prediction that 2009 will not be the bargain bonanza of last year, promotions will and already are playing a key role this Christmas. Vicky Redwood pointed out: "We noted last year that retailers suffered regardless of whether they cut prices or not – will this put some off slashing prices this year particularly when stock levels are so much lighter." The RTT applauds the recent trend towards building a more targeted approach to customers – avoiding general mark-downs, e.g. less "25% off everything" and more value-added offers to tempt cherished customers.

Retailers will need to respond to consumers trying to leave gift shopping later. To this end, they are likely to implement more tactical advertising. Members believe that vouchers and viral campaigns will play an even greater role than last year building on their established effectiveness. For Christmas 2009, the maturing use of social networking, will allow retailers to engage increasingly directly with an interested audience and enable them to create "tribes", which will help to get across key messages and build new "in" fashions.

The RTT warns that Christmas trading on more than one front will be complicated by VAT this year. VAT is due to go back up to 17.5% on 1st January, subject to an announcement in the forthcoming Pre-Budget Report on 9th December. The industry is keen to see the start date delayed for logistical reasons, but assuming that the return to the higher rate goes ahead, the pattern seen following previous VAT rises in the UK saw spending surge the month before then drop the month after. Whilst this may boost trading in the final part of 2009, it makes the outlook for 2010 somewhat grimmer.

Some retailers will try to encourage early spending with "buy now to beat the VAT rise" marketing messages; others will try to prevent the early peak by committing early to avoid passing on the VAT rise early in the New Year. Nick Bubb commented: "It may simply be a zero sum game, but the most nimble – or desperate – retailers will try to shout loudest to try to steal a trading advantage."

On the retail property front, the RTT believes there will not be a significant rise in short term lets for the Christmas season. However, the recession is actually creating a shortage of the primary property which modern retail demands, as less new developments are coming on-stream, thus many short term lets will inevitably be in sub prime locations. Mark Teale noted: "The sharp turndown in development activity is resulting in the familiar primary/secondary demand polarisation, with stock shortages continuing in the former and un-usable supply growing in the latter. The current shakeout is highlighting, once again, the deep-rooted stock obsolescence problem afflicting UK shop markets."

The RTT agrees that there will be the usual rash of insolvencies in the retail sector. However it does not predict this will be the "Armageddon" forecast by some commentators and is more likely to involve smaller businesses, not big names. Predictions that many major retailers would be forced into administration during 2009 proved well wide of the mark with a relatively small number of significant players falling victim, with many of these on the "danger list" well before the onset of recession, in any event.

Nevertheless, January is the peak time for retail failures – even in a buoyant year businesses go into administration. It was noted that the banks' attitude to failing businesses is shaped more by the changing appetite to risk than the lack of credit availability and that there has been something of a shift in attitude from company directors who are flagging up problems in failing businesses earlier for fears of wrongful trading.

Christmas and beyond – the implications for retail in 2010

This year has been a period of adjustment and change and this will undoubtedly be reflected in this year's Christmas trading. According to Professor John Dawson: "Having had a full year of doom and gloom, retailers and consumers have adjusted to some extent. Last Christmas it was all unknown – and it has turned out not to have been apocalyptic."

The RTT's latest Retail Health Index provides reason to be more upbeat about Christmas trading and although retailers face challenges in the next quarter, such as the rise in VAT, they approach the season with benefit of their experience of last year's festive period.

The new retail environment which has become the norm throughout 2009 – tightly managed stock, adjustment to the level of demand and emphasis on cost control – sets the tone for

Christmas 2009. Those who get this challenge right should be in good shape to face the year ahead.

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Note to Editors:

The RTT panellists rely on their depth of personal experience, sector knowledge and review an exhaustive bank of industry and government datasets including the following:

Members of the RTT are:

- Nick Bubb – Independent Retail Analyst
- Dr. Tim Denison – Ipsos Retail Performance
- Jonathan De Mello – Harper Dennis Hobbs
- Martin Hayward – Hayward Strategy and Futures
- Maureen Hinton – Conlumino
- James Knightley – ING
- Richard Lowe – Barclays Retail & Wholesale Sectors
- David McCorquodale – KPMG
- Martin Newman – Practicology
- Mike Watkins – Nielsen

The intellectual property within the RTT is jointly owned by KPMG (www.kpmg.co.uk) and Ipsos Retail Performance (www.ipsos-retailperformance.com).

First mentions of the Retail Think Tank should be as follows: the KPMG/Ipsos Retail Think Tank. The abbreviations Retail Think Tank and RTT are acceptable thereafter.

The RTT was founded in February 2006. It now meets quarterly to provide authoritative 'thought leadership' on matters affecting the retail industry. All outputs are consensual and arrived at by simple majority vote and moderated discussion. Quotes are individually credited. The Retail Think Tank has been created because it is widely accepted that there are so many mixed messages from different data sources that it is difficult to establish with any certainty the true health and status of the sector. The aim of the RTT is to provide the authoritative, credible and most trusted window on what is really happening in retail and to develop thought leadership on the key areas influencing the future of retailing in the UK. Its executive members have been rigorously selected from non-aligned disciplines to highlight issues, propose solutions, learn from the past, signpost the road ahead and put retail into its rightful context within the British social/economic matrix.

Definitions: The RTT assesses the state of health of the UK retail sector by considering the factors which influence its three key drivers.

1. **Demand** – Demand for retail goods and services. From a retro-perspective, retail sales, volumes and prices are the primary indicators. When considering future prospects, economic factors such as interest rates, employment levels and house prices as well as others such as consumer confidence, footfall and preferences are used
2. **Margin** (Gross) – Sales less cost of sales; the buying margin less markdowns and shrinkage. Cost of sales include product purchase costs, associated costs of indirect taxes and duty and discounts
3. **Costs** – All other costs associated with the retail operations, including freight and logistics, marketing, property and people

The Retail Health Index – how is it assessed?

Every quarter each member of the RTT makes quantitative assessments of the impact on retail health of demand, margins and costs for the quarter just completed and a forecast of the quarter ahead. These scores are submitted individually, collated and aggregated in time for the RTT's quarterly meeting. The individual judgements on what to score are ultimately a combination of objective and subjective ones, drawing upon a wide range of hard datasets and softer qualitative material available to each member. The framework follows the example of The Bank of England Agents' scoring system on economic intelligence provided to the Monetary Policy Committee.

The aggregate scores are combined to form the **Retail Health Index ('RHI')** which is reviewed at that meeting and occasionally revised after debate if members feel it appropriate. The RHI tracks quarter on quarter changes in the health of the UK retail sector and as such provides a useful and unique measured indicator of retail health. The index 'base' of 100 was set on 1 April 2006. Each quarter, it assesses whether the state of health has improved or deteriorated since the previous quarter. An improvement will lead to a higher RHI score than that recorded in the previous quarter, and with a deterioration leading to a lower score. The larger the index movement, the more marked the shift in the state of health. The RHI has two main benefits. Firstly, it aims to quantify the knowledge of the RTT members in a systematic way. Secondly, it assesses the overall state of health of the UK retail sector for which there is no official data.

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