The future of the grocery sector in the UK

- Price wars are a “race to the bottom” and could deter future investors
- Shift to convenience store shopping has been driven by retailers - not consumers
- But convenience stores sales are now so significant they risk rendering hypermarkets obsolete in their current form
- ‘Drive through’ supermarkets and free doorstep delivery would offer consumers the ultimate in convenience and choice

Introduction
The UK’s grocery sector is one of the most competitive and cutthroat in retail. It also risks being one of the unhealthiest, with demand flat lining and over capacity eroding the big players’ profitability. Against this backdrop of multi million pound price wars and investor concern, the KPMG/Ipsos Retail Think Tank (the RTT) met in April to discuss what may play out in the future.

What impact are the discounters really having on the UK’s grocery sector?
The rise of the discount grocers has been heavily analysed, with some commentators portraying them as playing a leading role in reshaping the grocery sector, tempting cash conscious consumers away from the established brands of the British market.

However, while there is no doubt these discount brands have eroded the edges of the big four’s market share and continue to do so, the RTT questioned how significant their effect has really been. Despite recessionary-induced changes in shopping behaviour, the RTT believes it is difficult to see the big four’s hold on the main grocery market being seriously challenged, simply because of their commanding (75%+) store network market penetration – a market share which has existed for almost ten years.

Mark Teale, Head of Retail Research at CBRE, said: “Kantar Worldpanel figures do indeed show Aldi and Lidl gaining market share while both Tesco and Morrisons have sustained significant market share losses. But the Kantar figures also show that the cumulative market share of the big four (Tesco, Sainsbury’s, Asda and Morrisons) has changed little since 2008 with the market share losses of Tesco and Morrisons largely offset by gains achieved by Sainsbury’s. Waitrose has also gained. Whatever switching is occurring, it is happening at both ends of the value spectrum (quality and discount).
“Tesco and Morrisons are suffering because they are caught in the squeezed middle; discounters (not just Aldi and Lidl) are chipping away from below and Sainsbury’s, Waitrose et al are digging down from above, albeit post-Christmas figures suggest Sainsbury’s is now beginning to suffer too. The underlying problem ultimately is the continuing household income squeeze. And the danger that the new-found consumer parsimony will become a permanent feature of the market even if economic growth is sustained.”

The price war is damaging the sector and putting off potential investors

The price war between the grocers has been well trailed in the press, with Morrisons announcing in May that the average price of their everyday essentials will fall by 17%.

The RTT believes that the price war between the major grocers may offer some short term gains for consumers, but it won’t deliver the shift the average shopper actually wants in terms of service levels and convenience. The latest discounting also fails to give the big four grocers a competitive edge over the discounters, who offer low prices all year round. Indeed, it could play into their hands as consumers may not trust a spate of lower prices than offered yesterday.

The RTT warns that the price war could damage the sector’s prospects for attracting investment in the future. Nick Bubb, Retail Consultant to Zeus Capital, said: “The big UK supermarkets have been dismal investments on the stockmarket for some time now and share prices remain under pressure, despite the attractive dividend yields now available on Tesco, Morrisons and Sainsbury’s. Equity investors are clearly worried about the impact of declining industry sales volumes and declining gross margins on near-term profitability.”

Tim Denison, Director of Retail Intelligence at Ipsos, added: “The immediate threat to three of the big four is their potential inability to invest in the changes needed to move with the marketplace. With profit levels falling, the declared price cutting schemes and low volume sales, these grocers are becoming less attractive to investors, witnessed by the £2.8 billion wiped off their market value amidst fears of full-blown price wars. Retailers need to compete on their own strengths, not those of their competitors. The promise to consumers of lower prices will prove to be nothing more than a race to the bottom of the premier league.”

Changing consumer behaviour

The RTT believes that the real danger to the grocers is the steady decline of the weekly shop, which could render out of town hypermarkets, a significant chunk of retailers’ real estate operations, obsolete.
Nick Bubb of Zeus Capital said: “The way we buy our groceries has changed, with many consumers favouring a bulk online order for key staples and supplementing this with visits to convenience stores during the week for fresh goods. This has shifted the emphasis away from hypermarkets and spells trouble for the mainstream grocers.”

These changes in our shopping habits mean that the grocers’ property portfolios risk becoming no longer fit for purpose, as consumer trends outpace their long term development plans.

“Grocers need to question how much space they need to keep pace with online growth,” said Richard Lowe, Head of Retail and Wholesale at Barclays. “If more consumers switch from visiting bricks and mortar stores to the virtual world, grocers must consider how fast or slow this rate of growth is when planning their expansion strategies. As convenience stores and online shopping continue to grow, the question grocers will be asking is what do they do with the footprint they have in the larger stores.”

David McCorquodale, Head of Retail at KPMG added: “Many large stores could be refitted to become click and collect or home delivery hubs. This could prompt the rise of ‘drive through shopping’, the ultimate choice for the time constrained consumer.

“However, it’s not as simple as moving some shelves around and re-designating use. Omni-channel grocery can dilute margins if not done effectively. It is a service enhancement for the consumer, but won’t necessarily benefit the retailer unless the consumers using the service buy more than those just choosing to shop in store.”

The RTT believes that the shift to convenience shopping has been driven by the industry itself, rather than consumer demand, after grocers opted to open smaller high street sites to quickly gain a foothold in towns where they were underrepresented. Consumers have embraced convenience stores and ‘top up shopping’ so enthusiastically that the grocers have seen sales in their large format stores decline, cannibalised by smaller stores on the high street.

Yet despite these headwinds, expansion continues unabated. The big four supermarkets have full development pipelines, backed by eager property investors, who view grocery stores as almost rock solid investments. Nick Bubb of Zeus Capital said: “Property investors seem very relaxed about long-term prospects, as rental yields remain quite firm, implying that there is no doubt about the future cash flows from well-located supermarkets and their ability to pay market rents.”
But is this untrammelled expansion sensible? Neil Saunders, Managing Director of Conlumino, warned: "In the future it is unlikely that demand will pick up in any meaningful way. It is also unlikely that capacity will moderate or decline. Although from a sector point of view it makes little sense to bring on more space, from an individual retailer point of view it is eminently logical to expand and grow in areas where a chain is underrepresented. What this means is that the long-term financials of the sector are and will remain less healthy than they were ten years ago. This is an economic shift in the model of the industry."

**What’s next for the sector?**

The modern consumer wants a cheap, ideally free, online shopping service, with long sell-by dates and no substitutions. This is the golden chalice of grocery, but the cost of delivery is a major barrier to grocers and consumers. Whether grocers with significant property estates will ever strive to provide this level of service is debateable. However, the RTT believes consumers may embrace ‘drive through’ shopping, where consumers can quickly pick up their preordered shopping at a location convenient to them.

James Knightley, senior UK economist at ING, said: "The cost of home delivery still puts many potential consumers off along with worries about the products selected by the packers. Greater emphasis on quality may help, but for higher value meat/fish products we could see individual photos or more specific information to allow customers to get better choice."

However, the economic reality is that it’s not in the interests of the big four to move quicker towards on-line sales and home delivery, irrespective of whether the demand is there. The costs of the online sales and homes delivery model remain fiercely prohibitive.

The arrival of the online rival The RTT believes that price alone or a competitive environment will not reshape the grocery sector whilst all the players keep using similar formats. Instead, a new entrant could change the balance. This could take the form of a new online only retailer like Amazon entering the fray, or price comparison websites playing a greater role in the market. It is inevitable that this change will be greatly accelerated if a big grocer fails. This would leave room for new market entrants to come in and offer consumers something different.

"It’s possible we could see third party companies like price comparison websites providing services to pick products from different grocers to guarantee the cheapest weekly shop,"
said James Knightley of ING. “As a result, we may see grocers focus more on their own branded products, which are more difficult to compare.

"Such third party organisations could boost opportunities for smaller retailers offering locally sourced food or ethically produced items. Conceivably, we could see the manufacturer of the product or the farmer sell through Amazon, further diminishing the need for a traditional supermarket. All in all, advancing technology will offer greater choice for customers, but present huge challenges for the established sector leaders.”

David McCorquodale of KPMG added: “We may see the demise or disappearance of one of the majors over the coming years but, unless there’s a change in approach, I would expect them to be quickly replaced by new entrants with ambitious expansion plans. We could end up with a Big Six or Seven occupying the market with more evenly spread market shares. However, if there is a seismic shift, caused by a new online player or a market failure, then brand will become the decider in this battle.”

Tim Denison of Ipsos said: “The competitive advantage Amazon has is that they know a lot more about their customers than the traditional grocers. If they can find the right local partner and target just the top 5% of customers in the UK who could deliver the majority of their sales, then this could be a game changer. Despite the widespread use of patronage and loyalty cards by consumers, supermarkets have failed to reap the benefits of the data and insight these offer to them.”

**Conclusion**

New market entrants and changing consumer buying habits have left the UK grocery market in a state of flux, and the RTT warns that the majority need to reconsider their long term strategy and assess if it is still fit for purpose.

The rising popularity of buying staple goods online and topping up at the nearest convenience store risks rendering the average out of town hypermarket obsolete in its current form, and these need to be reconfigured to reflect the rise of click and collect and the falling sales of non food items.

The discounters aren’t the slayer of the big four, but they have piqued the interest of a UK consumer bored with the middle ground brands and keen to make their money go further, whilst buying food and products they can enjoy.
However, the current status quo would only be at risk if one of the big four were to disappear: in order to gain significant market share the discounters will require a stratospheric store opening programme or the failure of a competitor. The RTT believes the answer to securing sales doesn’t lie on a price tag, but in strong product ranges tailored to the local market’s tastes alongside delivery options, charges and times to suit the consumer. If a grocer can work out how to offer free home delivery, with no substitutions, products with a long shelf life and exact delivery times then they will pull ahead of the pack.

If a well-financed player can find the right supply chain model and partner in the UK to deliver its online grocery model service then this could be a pivotal moment in the history of UK grocery, and completely change the face of UK retail.

Either way, the old blueprint for a UK grocer is out of date and radical investment in store infrastructure, online delivery and click and collect is urgently needed if the grocery sector is to deliver the service the modern consumer demands.

**Part II: In detail – Individual views of the RTT members Richard Lowe, Head of Retail and Wholesale at Barclays**

The grocery market in the UK remains a highly competitive landscape, with food inflation and price wars adding on-going pressure. Whilst challenges persist, growth does continue and we’ve seen a significant rise in trading square footage as grocers increase their retail store footprint both in terms of additional convenience stores and online capacity.

This expansion drive is a trend we’ll likely see continue, but in a slightly different guise. The space race isn’t over; grocers will carry on increasing the space they have but they won’t look for the large supermarket formats. The focus will be on convenience stores – it’s the c-stores they want. This is largely being driven by a change in consumer shopping habits. People are shopping with greater frequency, choosing to “top up” shop in addition to the weekly visit to the supermarket or online shopping. Therefore as grocers look to cater for changing consumer needs we’ll in turn see an increase in their c-store footprint.

This convenience approach to shopping is also influencing online growth. All the major grocers have now embraced the need to have an online offering, with the last of these being the Morrisons/Ocado collaboration. This does bring about however a challenge to the grocers as to how much space they need to keep pace with online growth. If more consumers switch from visiting bricks and mortar stores to the virtual world, grocers have to
consider how fast or slow this rate of growth is when planning their expansion strategies. As c-stores and online shopping continue to grow, the question grocers will be asking is what they do with the footprint they have in the larger stores.

Value will also continue to play a significant part in the future of grocery. Whilst there is segmentation in the market around price points and offering within the good, better, best architecture, the value players are growing significantly. They certainly present a very real and current challenge, which can be seen from the significant growth they've had over recent years, and I predict we'll see these particular grocers take greater market share as their growth trajectory continues.

**Mark Teale, Head of Retail Research, CBRE**

Two to three years ago it was High Street administrations and vacancy proliferation that dominated the headlines. Over the last year or so attention has turned to the grocery sector. A lot of column inches have been devoted to the disappointing trading performance of Tesco and Morrisons in particular, with the finger commonly pointed at Aldi and Lidl. Hard-pressed consumers, so the story goes, are swapping allegiance to Aldi and Lidl because they are cheaper.

Kantar Worldpanel figures do indeed show Aldi and Lidl gaining market share while both Tesco and Morrisons have sustained significant market share losses. But the Kantar figures also show that the cumulative market share of the big four (Tesco, Sainsbury’s, Asda and Morrisons) has changed little since 2008 with the market share losses of Tesco and Morrisons offset by gains achieved by Sainsbury’s. Waitrose has also gained. Whatever switching is occurring, it is happening at both ends of the value spectrum (quality and discount).

Tesco and Morrisons are suffering because they are caught in the squeezed middle; discounter (not just Aldi and Lidl) are chipping away from below and Sainsbury’s, Waitrose estate dig down from above, albeit post-Christmas figures suggest Sainsbury’s is now beginning to suffer too. The underlying problem ultimately is the continuing household income squeeze. Economic growth might well be strengthening but there is little evidence of cost pressures easing for households.

It was feared, following the onset of 2008 downturn that if the income squeeze lasted indefinitely – as effectively it has – frugality would become so ingrained that it would become a permanent feature of consumer behaviour. Survey results from FIM suggest that
this is occurring in the US with over 70% of households reporting that they intend living on less in the future. The same is clearly happening in the UK too. Internet price comparison is accelerating the process. A sustained surge in prosperity might, in time, undermine the new-found thriftiness (albeit evidence from Japan suggests that it might not), but there appears little likelihood at the moment of the downward pressures on grocery price easing in the medium term. Market share battles look set to intensify as a result.

Grocery market share remains a function of branch network penetration. Tesco has by far the biggest market share (circa 29%) because it has the largest main grocery network. Because of that it also has by far the largest click and collect platform (and reportedly circa 50% of online grocery sales). Tesco is meanwhile rapidly growing its convenience store portfolio, chipping-away at market shares on the convenience side. So are Sainsbury’s and Morrisons. Whatever the recessionary-induced changes in shopping behaviour (including trade diversion to discounters and shopping frequency/spend reductions) it is difficult to see the big four’s hold on main grocery market share being seriously challenged, simply because of their commanding (75%+) network market penetration. The performance wobble is another issue. The big four are having difficulty adapting to the new pricing realities. Unhappily for investors, it does now look as though the sector is in for protracted price wars. Factor in the margin dilution caused by multi-channel investment (the bulk of it invested by the big four) and things look set to remain ‘challenging’ for grocery majors.

James Knightley, Senior UK Economist, ING

Two big trends in recent years have been online shopping and greater competition for the big four from the likes of Aldi and Lidl. In terms of the latter, it will be interesting to see whether consumers stick with these “discounters” or choose “quality” as real incomes start to rise and consumer confidence improves. As for the former, the cost of home delivery still puts many potential consumers off along with worries about the products selected by the packers. Greater emphasis on quality may help, but for higher value meat/fish products we could see individual photos or more specific information to allow customers to get better choice. For those not willing to pay the delivery costs there is click and collect, with the option of not even leaving your vehicle. We could also see a wider range of collection points such as lockers at petrol stations, giving customers more options.

With supermarkets gradually turning into local distribution warehouses and with more options on collection points, it could mean many supermarket sites are no longer needed. This could free up large amounts of land that could be used for residential property, which
would be particularly helpful in the likes of London. Another avenue is price comparison sites. Could we see third party companies providing services to pick products from different grocers to guarantee the cheapest weekly shop? As a result, we may see grocers focus more on their own branded products, which are more difficult to compare. Already we see the likes of Amazon breaking into the US grocery market with Amazon fresh. Such third party organisations could boost opportunities for smaller retailers offering locally sourced food or ethically produced items. Conceivably, we could see the manufacturer of the product or the farmer sell through Amazon, further diminishing the need for a traditional supermarket. The move towards convenience stores may also be brought into question should Amazon’s dream of drone delivery come to fruition. All in all, advancing technology will offer greater choice for customers, but present huge challenges for the established sector leaders.

Dr Tim Denison, Director of Retail Intelligence, Ipsos Retail Performance

The RTT has referred to the structural changes underway in retailing on more than one occasion in past white papers and grocery retailers are just as exposed to the shifting sands as others. Tesco’s stealthy land bank strategy was considered a stroke of genius at the time, if a little underhand, making provision for its unstoppable expansion into every neighbourhood across the land. Big box was unquestionably the format for success and the way to go. Who would have foreseen that in less than a decade, Britain’s number one retailer would be caught flat-footed, failing to sell sufficient merchandise through its Extra stores and needing to embark on a re-engineering/re-invention programme to turn these mega-stores into mini-high streets under one roof? Who could have predicted the re-emergence of convenience as a popular format or the irrepressible advance of online food shopping?

Retailing is a complex business, moving at an unprecedented speed. The recipe for today’s success will become the left-over scrapings on the plate tomorrow. The immediate threat to three of the big four is their potential inability to invest in the changes needed to move with the marketplace. With profit levels falling, the declared price cutting schemes and low volume sales, these grocers are becoming less attractive to investors, witnessed by the £2.8 billion wiped off their market value amidst fears of full-blown price wars. Retailers need to compete on their own strengths, not those of their competitors. The promise to consumers of lower prices will prove to be nothing more than a race to the bottom of the premier league.

The two key battlegrounds for grocery retailers to advance their causes lie around logistics and patronage. There is nothing more frustrating than when items on the shopping list are
absent from the store shelf, or when substitutes have been made to home deliveries which are not perceived as like-for-like. Creating an engine room that delivers better and more efficient fulfilment is something one immediately associates with Amazon, so it will be interesting to see how the Amazon Fresh trials go.

Most important of all though remains, and always will remain, the ability to understand one’s customers and act on their needs. All too quickly and easily customers vote with their feet, if they begin to feel disenchanted and ignored. Some retailers have been quicker to react than others at embracing the community power of social networking to tune in and respond to today’s messages. The trick is in knowing to whom to listen and how quickly one can act. In a recent talk Sir Charlie Mayfield shared the fact that 50% of John Lewis and Waitrose sales are made by 5% of its customers, however, the composition of those 5% are different every year. Therein lies the real challenge of grocery retailing, past, present and future.

**David McCorquodale, Head of Retail, KPMG**

The key themes in the grocery sector are format, capacity, innovation and internationalisation. In twenty years time will ‘millennials’ really drive their offspring to a ‘shed’, push a trolley up and down aisles for an hour or so and pick items off shelves filled to capacity? Time will be too precious and grocers will have perfected delivery to a location of choice. The last two decades have been focussed on a dash for growth, but little evidence has emerged to demonstrate that national coverage from a big store network will actually meet the future consumer’s demands. By 2034, the now popular convenience store may have become dated but the large format shed almost certainly will have – people won’t want to combine their entertainment time with their ‘weekly shop’.

In a market which, in total, is already operating at over capacity, it would be quite normal for the sector to consolidate into three or four giants with clear brands – notice the tobacco, beer and soft drinks industries. However, in the grocery sector in the UK we have flat to negative growth in volume terms, more than enough retail space devoted to grocery and yet still have new entrants, all with ambitious individual growth plans across a number of formats. This cannot be sustainable. We may see the demise or disappearance of one of the majors over the coming years but could end up with a Big Six or Seven occupying the market with more evenly spread market shares. These players will have a clear brand proposition and physical retail space operated may be less of a determinant of market share.
Fierce competition drives innovation and we're already seeing that in terms of offering, price promotion and customer service. This will increase as the grocers invest more in technology and supply chain than in property: all of which will be good news for the consumer.

International expansion is more challenging in grocery – the supply of fresh produce – than in any other sector because of the short supply chains and local tastes. This makes international expansion all the more risky. Yet, some of the new entrants to the UK grocery market are international players and, as they take market share from our grocers, the demand for growth from investors will put pressure on our grocers to either drive new verticals or expand overseas. Foreign shores can provide a new stimulus for growth but investors ought to be prepared for higher costs and lower profitability as the price of growth.

Nick Bubb, Retail Consultant to Zeus Capital

The big UK supermarkets have been dismal investments on the stockmarket for some time now and share prices remain under pressure, despite the attractive dividend yields now available on Tesco, Morrisons and Sainsbury’s. Equity investors are clearly worried about the impact of declining industry sales volumes and declining gross margins on near-term profitability.

And yet property investors seem very relaxed about long-term prospects, as rental yields remain quite firm, implying that there is no doubt about the future cash flows from well-located supermarkets and their ability to pay market rents. This apparent disconnect may simply be a difference of timescale, but, although nobody thinks that Tesco will go bust, everybody probably agrees that Tesco’s UK operating profit margins are heading downwards. Behind the problems of the big supermarkets is an increasing change in the way we shop for groceries. Time-poor consumers can now avoid the chore of supermarket shopping by getting most of their groceries delivered to their door for only a modest extra fee, via online ordering, whilst a plethora of well-located and well-ranged convenience stores now offer plenty of opportunities for easy top up shopping.

More affluent consumers can certainly access the Marks & Spencer fresh food range in more and more convenient locations, but the extraordinary growth of the grocery discounters, Aldi and Lidl, as well as the cheap confectionery and toiletries now easily available in “pound stores” and other discount chains, make it increasingly possible for the canny shopper to make big savings in their weekly grocery spending. The joint success of premium retailers like Waitrose and Marks & Spencer, as well as the discounters like Aldi and Lidl certainly
shows that the grocery market is polarising, but the steady decline of "the weekly shop" spells trouble for the mainstream supermarkets.

A few years ago an increasing presence in Non-Food looked to be the answer for supermarkets, but the growth of Amazon and the renaissance of Argos, as well as the decline of the physical market for entertainment products, has meant that there are no easy pickings here anymore either, so the day of the big hypermarket looks to be over.

Morrisons’ CEO Dalton Philips was surely right when he said in March 2012 that General Merchandise is not going to be about “big box” retailing but about goods being delivered in a “cardboard box”. But this will be of little comfort to investors watching Morrison’s efforts to catch up lost ground in the key growth areas of online grocery and convenience stores, while the discounters eat more and more of Morrisons’ lunch in their Northern heartlands.

Morrisons has tried to mollify shareholders by slashing its capital expenditure to cut its financial gearing, but the stockmarket is worried about its operational gearing, via the much-vaunted vertical integration of its fresh food supply chain. As its market share continues to fall, what once seemed like a competitive edge may turn out to be a millstone around Morrisons’ neck, as it struggles to keep its head above the water in the increasingly choppy seas of grocery retailing.

Neil Saunders, Managing Director of Conlumino
It was not all that long ago when the grocery industry used to be accused of being an oligopoly. That charge could not be made today! If anything the grocery industry, despite the limited number of players, is one of the most competitive and cutthroat in retail.

This arises from a situation where, relative to a very flat demand environment, there is a high and increasing amount of capacity. The numbers from the industry demonstrate this fact: every winner in the market creates a loser; like-for-like sales are flat or falling across the sector; and, profitability is being steadily eroded. These are the classic symptoms of a saturated and mature market.

Yet is this all such a bad thing? From the point of view of the consumer it probably isn’t. Competition is driving down prices, it is forcing retailers to up the service they provide, and it is making them create more attractive and interesting store environments. These are all positive and healthy outcomes. However, in order to balance the books they must also be met with efficiency gains at the back end of the operation; something that will be hard to achieve given the leanness of the industry.
Going forward, it is unlikely that demand will pick up in any meaningful way. It is also unlikely that capacity will moderate or decline. Although from a sector point of view it makes little sense to bring on more space, from an individual retailer point of view it is eminently logical to expand and grow in areas where a chain is underrepresented. What this means is that the long-term financials of the sector are and will remain less healthy than they were ten years ago. This is an economic shift in the model of the industry.

The other issue, of course, is that of online. In grocery online is critical in terms of securing sales. However, due to logistical complexities and the low margins involved it is far less good at delivering profits. Again, over the medium term this has a corrosive effect on profits. There are also a few wildcards on the horizon that could shake things up further. Amazon is one. It has a long held ambition to be big in grocery but has never managed to quite make it work. What if it did? What if it bought, say, Ocado? While not necessarily the stuff of nightmares, the prospect should give the big grocers cause for contemplation.

The bottom line is that over the next ten years the big players are going to have to work increasingly hard just to stand still.

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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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