Retail 2020
A Perfect Storm?
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Demand: Worse to Come?

The backdrop to this entire Report is the very sober economic situation. The recession has left its mark – both in consumers’ psychologies and on the retail landscape. We’ve lost many stores (one in eight units is empty on Britain’s High Streets at the time of writing) and several chains (e.g. Pier Import in France, Woolworths in Britain). We have even seen Shopping Centres go bust.

The view ahead is challenging. Economics experts from Experian and HSBC explain that the worst is not over. Taxpayers and/or public sector workers across Europe are going to be suffering over the next several years, added to the pain already being felt by savers, construction/industrial workers and those reliant on housing and stock assets for their retirements. Added to this are structural issues that were pushed off the agenda during the Credit Crunch. The pensions crisis has not gone away, it has just been talked about less recently. The inverted age pyramid means fewer workers’ contributions to support those in retirement and this situation will worsen substantially over the next decade as the Boomers become pensioners.

Meanwhile, greying populations mean over-burdened national welfare states. Set up at a time when many people died within a few years of retirement, and when life-saving technologies were still a distant dream, very few European States will be able to continue to fund their health and social security systems. Indeed, looking at the deficits, few can pay for their commitments today, let alone the increasing liabilities over the coming decade.

To these structural problems could be added the costs associated with climate change, energy supply and security, water and food provision – the list is long. All require solutions to be embarked upon over the coming decade and all will come with hard choices. For consumers this will obviously translate to increasing demands for public taxes and for private provision. For example, the French government announced in April 2010 that it is planning a new tax to pay for future French pension liabilities.
The forecasts, then, are sobering:

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Once again, the picture looks brighter in Central and Eastern Europe but overall, to use a term coined by investment management company Pimco, we are looking at a ‘new normal’ of low inflation and low growth. Consumers are maxed out and deleveraging as fast as possible. Neither the engine of house asset price inflation nor access to consumer debt will be available going forwards. This is a radically different backdrop to the last ten years of debt-fuelled, house-as-cash-machine retail partying. Add to this the fact that public spending is maxed out too and this suggests trouble ahead.

Not only will consumer demand be lower over the entire decade, but it will be increasingly subject to substitution. As we have said throughout Retail 2020, online shopping is key going forwards and, whilst projections are notoriously unreliable in this area, we could realistically expect online sales to jump from around 10% today (Source: CRR/Kelkoo, Jan 2010) to around 20% by 2020. Meanwhile, we have seen that the mobile internet is a true game changer which will provoke price deflation and could even stimulate an end to fixed pricing.

Finally, it is reasonable to expect heightened competition as retail continues to go global. The very best of international retailers will continue to eye European markets as opportunities and we can expect new entrants – not only from America but also from Asia and Latin America.
Supply: Squeezed?

If demand will be down, prices down and substitution and competition up, will there be better news on the cost front?

Partially, yes. Retailers and Shopping Centre Managers can expect further savings to come through the use of technologies despite having harvested many of the biggest supply chain gains already over the past 15 years or so. Costs will also come down at Head Office as more companies decide to outsource skills which are not core to their business. Furthermore, we have mentioned elsewhere that some operational costs, inflated in the good times, could now be squeezed as the economic context tightens.

Two other movements will be unfavourable to retailers. Firstly, and most importantly, we will see a slow but inexorable rise in prices from China. Raw materials will be more costly across the decade, the yuan will be allowed to rise against the dollar and Chinese workers will want higher standards of living. Meanwhile, China is being asked to be greener and more ethical. All this comes at a cost and manufactured products from China will become gradually more expensive. Again, a very different scenario to the last decade or so where Europe imported deflation from China.

Secondly, retailers themselves will feel the cost of going green – in new build and running costs. And whilst some greening will lead to lower operational costs, returns on green investment are often long-term leaving an impact on free cash flows.

Finally, some pressures on the financial ecosystem come from inside the retail industry. For example, more new space is coming through the pipeline for delivery in 2010 and beyond.

This is good news for the owners of the newest Centres as consumers are always hungry for the next best shopping experience, easier parking, luxurious designs etc. In Eastern Europe, as we have seen, new centres will be, by and large, expansionary; but in Western Europe new space will typically replace old, and not all old space will be given a facelift. Creative destruction is good for consumers, but not so good for those further down the real estate ‘food chain’ as the a concentration of spending will be in the hands of the very best asset portfolios.

In its way then, this is a perfect storm. Over the next decade retail turnovers will see only modest increases on average, and profitability is set to decline, despite operational improvements.

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For retailers, the hard work will likely have to come sooner rather than later and over the next five years we will start to see the contours of the winners and losers. Clearly, the winners will be those exemplary operators able to take advantage of new lands of opportunity by rejuvenating and retargeting their offers, communicating better with fans and launching radical, entrepreneurial online formats. For Shopping Centres, who have perhaps not had to work as hard today as they will in the future, the major impact may come more in the middle of the decade and beyond.

In conclusion, the consumer is changing, the world is changing and retail will change. To that extent, nothing changes.

What does change is the pace of progress. Six months is now a long time in retail, time for an innovative website to scoop up part of a retailer’s business. Forty eight hours is an eternity for a consumer to wait for a delivery. Five minutes is simply too long in a queue.

The last decade was one where physical expansion was high and innovation relatively low; the next decade is profiling itself as one where space expansion will be lower but innovation will be higher.

The barriers against change are weakening, everywhere. Take the internet. Speeds are increasing, kit is ever more universal, network costs are coming down and governments and Google are training the reticent. Little stands in the way of ecommerce increasing.

Paradoxically, success in the future may go to those retailers and shopping locations that know how to help consumers savour time – to experience the art of living, to be enchanted by a great in-store demonstration, to escape from stress in a relaxed eatery, to find friends and laugh together in a coffee bar.

And some things never change. As always, the winners will be the most deserving; those that know how to read the future and are prepared to take the tough decisions to align themselves with the opportunities. The losers will, as always, be those companies trading on former glories, with their eyes firmly in the rear view mirror. Retail 2020 is here to offer you some guiding lights as to the right decisions to make along the way.