After a landmark year for the retail sector, what does 2015 hold? On Monday 26 January 2015, an EY panel with retail expertise discussed the evolution of the sector and asked webcast participants for their views on UK retailers’ principal challenges and priorities for the year ahead.

**Retailers’ to do list:**

*Balancing the need to invest, protect margins and meet growing consumer expectations.*

1. Plan for Black Friday 2015
2. Review infrastructure investment priorities
3. Ask questions about supplier relationships
4. Build resilience to rising challenges & rapid change

**A year of profound change**

Retail is inherently a dynamic sector, but by any standard 2014 was a milestone year. Immense promotional and pricing pressures - epitomised by ‘Black Friday’, increasing infrastructure challenges and the consequent challenge of protecting brand and margin - were already familiar themes. However, the last year has crystallised significant changes within the retail sector, with profound and lasting consequences.

Nowhere felt promotional and pricing pressures more keenly than the UK grocery sector. Christmas sales figures confirmed that UK supermarkets’ long era of era like-for-like sales improvements is over. After a breakthrough year for the European discount grocers, the UK’s big-four supermarkets have been compelled to make radical changes to price and business models. The price war continues and falling food prices will further bear down on sales figures in 2015. The focus is now also firmly on convenience, with the UK’s major supermarkets rethinking property portfolio use and location, mothballing out of town expansion plans and even closing stores.

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If we strip out food, Christmas sales look much healthier, although this doesn't tell us much about margins - and there is every reason to believe that these came under significant pressure in 2014, especially in the final quarter. ‘Black Friday’ arrived in the UK in 2010, but in 2014 media promotion and intense competition created a behemoth that now appears indelibly inked into the retail calendar. It’s hard to overstate its impact. Retailers’ verdict on its benefits is mixed, but most agree that it has radically changed trading patterns, creating a ‘two humped camel’, with a struggle to maintain momentum in December without further discounts.

The peak of demand also created immense infrastructure challenges, toppling IT systems at the front and back end and clogging up fulfilment and logistics networks. However, the pressure on infrastructure came not only from the exaggerated peaks of Black Friday, but also the increasing expectations of consumers. The upside for physical retailers in 2014 was the coming of age of ‘Click & Collect’, which has put them back in the box seat. Consumers’ shift from ‘wait-in’ to ‘pick-up’ eliminates the expensive final mile and brings shoppers into stores. Without a doubt, the ability to offer ‘Click & Collect’ has gone beyond a ‘nice to have’ to become a critical part of the retail offering, providing the best practitioners with a distinct commercial advantage. However, this does entail further investment and the challenges are the same for all multi-channel offerings: to provide an excellent and fully integrated experience and to protect and enhance brand and margin - an increasingly difficult proposition in this demanding climate.

Customer boost mitigated by margin pressure in 2015

The fight to maintain and improve margins will be the main challenge for retailers in 2015, according to our webcast polls. It’s an interesting turnaround from the previous years’ focus on disposable income and reflects just how much the consumer outlook has improved. Not only do we now have rising employment to provide a collective boost to spending, but rising wages and low inflation are providing an individual fillip. According to the EY ITEM Club, disposable income is forecast to rise by 3.8% in 2015, up from 3.3% in 2014. In 2015 consumers should have more to spend and we believe they’ll have the confidence to spend it. Consumer spending is forecast to increase by 2.9% in 2015, a significant improvement from autumn’s forecast of 2.25% growth - with electrical, fashion and restaurants and leisure sectors amongst the winners.

What do you think will be the key challenges for retailers in 2015?

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Ability to maintain and improve margin</td>
<td>45%</td>
</tr>
<tr>
<td>Pressure on consumer disposable income</td>
<td>27%</td>
</tr>
<tr>
<td>Ability to manage multi-channel and fulfilment</td>
<td>25%</td>
</tr>
<tr>
<td>Property and other capex priorities</td>
<td>3%</td>
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</tbody>
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Increased margin pressure means this good news comes with a large caveat. Our poll shows 86% of our respondents expect pricing pressures to hit the top and bottom line. Again this represents a significant switch in concerns. In 2013, 60% believed property costs would provide the biggest drag. Many retailers have taken action to rationalise their portfolio, but property costs perhaps now appear more controllable when compared to trying to capture and retain consumer interest.

Where do you see the highest pressure on margins for UK retailers in 2015

<table>
<thead>
<tr>
<th>Pressure on Pricing</th>
<th>Percentage</th>
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</thead>
<tbody>
<tr>
<td>Everyday pressure on pricing</td>
<td>56%</td>
</tr>
<tr>
<td>Promotional tactics adopted</td>
<td>30%</td>
</tr>
<tr>
<td>Labour and input costs</td>
<td>8%</td>
</tr>
<tr>
<td>Logistics/supply chain</td>
<td>4%</td>
</tr>
<tr>
<td>Property costs</td>
<td>2%</td>
</tr>
</tbody>
</table>

To do: Plan for Black Friday 2015

The intensity of ‘Black Friday’ competition and demand took some of the sector by surprise in 2014, but there’s no excuse for 2015 and preparations are already underway. Detailed planning for peak season is always critical, but extreme changes in trading and discounting patterns make thorough preparation even more vital. Some retailers are taking a more analytical approach, focusing on their key demographic and narrowing their proposition. Whatever the tactics, retailers will need to work hard to be heard: this year looks set to be ‘noisier’ than the last.

Priorities for ‘Black Friday’ 2015:

- Merchandise planning: critical to ensure that as much as possible is ‘bought and planned for’.
- Involving suppliers early: to help protect the top and bottom line.
- Building in flexibility: to deal with any stock overhangs or sudden changes in trading patterns.
- Investing in infrastructure: to deal with vastly increased peaks in store and online demand, leveraging ‘Click & Collect’ advantages where possible.
These challenges highlight the importance of strategic discounting and protecting and enhancing brand values across all markets and channels. Retailers can also take control by balancing their investment priorities, asking the right questions about their supply chain and building resilience against rapid change. It's these elements that will mark out the winners in difficult and dynamic times.

Confidence drives deals in 2015

Three themes dominated retail deal making in 2014: IPOs, increasing M&A confidence and rising inbound investment. We expect to see broadly more of the same in 2015, but with less emphasis on IPOs and a strong second-half weighting.

The IPO market was certainly red-hot in 2014, and therein lies the source of investor caution. After just two listings in 2013, last year started with a bang with 12 retailers coming to the market in the first six months. However, mixed share price performances - particularly for online retailers - meant investors grew more cautious and just one further retailer listed in the second half of 2014.

Thus, while it should be another good year for IPOs, with a number already announced, we also expect more cautious valuations and consequently more dual-track processes. Improving sector fundamentals will continue to drive deals, particularly amongst overseas buyers attracted by strong UK comparatives. This is reflected in the answer to our polling question, where the number of respondents picking overseas investors as a buyer of UK assets has doubled year-on-year.

In fact, the broad spread of our polling vote highlights the breadth of options open to sellers. One deterrent, particularly for private equity purchasers, could be high multiples. The uncertainties surrounding the outcome of the General Election may also encourage investors to delay to the second half. However, with fundamentals improving and a fair wind, deal volumes as a whole should remain robust overall in 2015.

Who will be the buyers of retail assets in 2015?

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Private equity/other funds</td>
<td>43%</td>
</tr>
<tr>
<td>Overseas investors</td>
<td>21%</td>
</tr>
<tr>
<td>Exit through IPO</td>
<td>19%</td>
</tr>
<tr>
<td>Trade buyers</td>
<td>17%</td>
</tr>
</tbody>
</table>
Recent events have pushed the appropriate management of supply chain relationships rapidly up the agenda, with well-publicised issues raising questions from stakeholders around commerciality, governance, accounting and risk. Retailers’ values are under an intense spotlight. Retail executives are now being asked more searching questions, from concerns about supplier terms to contract compliance and their governance framework. However, there is an opportunity for those who take definitive action to gain an advantage by demonstrating ‘best practice’.

To do: Ask questions about supplier relationships

To do: Build resilience to rising challenges & rapid change

There’s no doubt that 2015 will bring further challenges. Retailers will need to show resilience to increasing demands placed on infrastructure and the pressures on margins from intense competition and promotional activity.

However, building resilience isn’t just about preparing for difficult times, but also demonstrating the ability to understand the changing dynamics of the retail sector, to meet new challenges and to provide a clear vision for stakeholders. Retailers will need to constantly reassess their approach, anticipate and adapt quickly to events in order to preserve value.
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