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Retail Hits Back: How Retailers are Fighting the Online Threat

As demand for online retailing continues to expand strongly, traditional high-street retailers have faced increasingly difficult conditions.

The UK high street faced a difficult year in 2018, with the likes of Toys R Us and Maplin entering into administration, Mothercare and Marks and Spencer announcing store closures as profits tumbled, and House of Fraser being restructured and sold to Sports Direct for £90 million. Although revenue is expected to rise by 1.4% across the retail sector as a whole in 2018-19, this figure has been boosted by strong growth in a number of online industries, and the picture has been considerably less rosy for traditional enterprises.

IBISWorld estimates that purely online retailers will grow by 8.8% over the current year, compared with 0.3% for bricks-and-mortar counterparts. As e-commerce continues to absorb a greater share of total retail expenditure, more and more stores have disappeared from the high street. According to The Centre for Retail Research, 2,594 stores closed on the British high street in 2018, with fashion and electrical stores bearing the brunt of tightening consumer spending, rising overheads and the popularity of online shopping. The situation is such that Mike Ashley, founder of Sports Direct, has called for a drastic measure - a tax on retailers that make more than 20% of their sales online - to save high-street shopping.

However, not all bricks-and-mortar firms are rolling over. In this Sector Snapshot, IBISWorld explores three companies defying the high-street downturn and the strategies behind their success as they tackle competitive threats, supply chain concerns and consumer-driven trends such as fast fashion.

Reasons for high-street closures

1. Weakening consumer confidence

- GfK's UK consumer confidence index fell to -14 in December 2018, the lowest level in five years.
- Consumer expenditure fell 1 % in December 2018, following a 0.7 % fall in November and a 0.2 % fall in October. - Despite UK unemployment dropping to a record low of 4 % and rising real wages, households remain cautious and are withholding expenditure.

2. Rising overheads

- Gradual increases in the National Minimum Wage and National Living Wage are pushing up employment costs, which total an estimated £1.5 billion to £3 billion across the sector.
- Retailers are expected to pay an additional £2 billion in business rates over the next three years compared with the past three years.

3.Online competition

- Almost £1 in every £5 is spent online.
- Non-food online expenditure has increased by 9.3 % over the past year.
- Online giants offer consumers greater and easier access to a range of goods at more competitive prices.

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Omnichannel

Not every retailer is suffering in the age of online shopping. Some notable high-street names have embraced digital distribution channels and capitalised on the uptake of e-commerce to combine the traditional store experience with the convenience of shopping online. Click-and-collect services in particular have been paving the way for high-street success. Under this model, physical outlets can act as showrooms, as well as click-and-collect and product return points, supporting demand from time-poor customers whilst maintaining a physical location that can be deployed in support of impulse purchases.

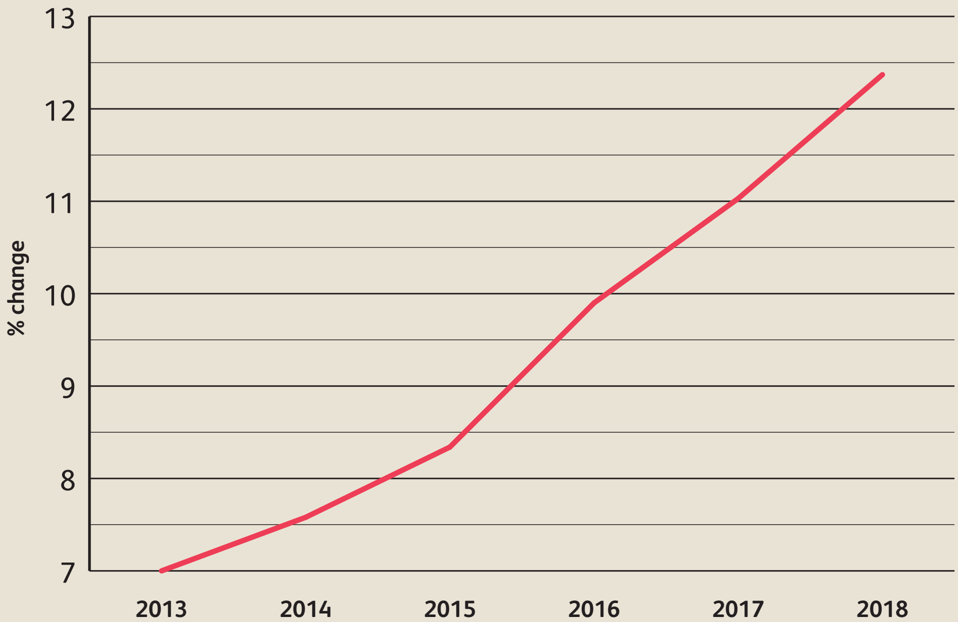
The UK's largest clothing retailer, Next, is a notable example of a company that has embraced and subsequently succeeded in developing a multi-channel presence. According to the company's July 2018 half-year trading results, a booming click-and-collect service, alongside an increased range of product offers and an improvement in stock availability, helped buoy revenue expectations. Approximately 50% of all Next's UK online orders are fulfilled through retail locations, representing 38% of the company's UK online sales. Next also currently serves 4% of its online sales from retail store stock. Although this trend is not contained solely within the fashion sphere, numerous other industries such as homeware retailers have also started to employ a show-and-shop strategy, such as IKEA.

The click-and-collect market is expected to grow at a compound annual rate of 45.8% over the five years through 2023-24 according to analytics firm, GlobalData. The report found clothing and footwear segments were the most popular category in 2018, accounting for 59.9% of click-and-collect expenditure, emphasising the growing importance of click-and-collect to high-street retailers.

Price competition and marketing

Whilst many high-street retailers are coming under pressure from falling footfall and reduced sales, discount retailers are going from strength to strength, despite operating only from physical stores. Primark is perhaps the most notable of these retailers, with the firm succeeding

Order of the day
Online share of the retail market



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thanks to low prices and engaging digital marketing to drive footfall to stores, rather than operating e-commerce operations alongside establishments.

With Primark's physical operations relying on high volumes and low prices, online operations would only cannibalise the company's margins. According to auditing firm, KPMG, the cost of picking and delivering an order costs between £3 and £10, and the cost of handling a return from transport, processing and repackaging or folding can be as much as three times the cost of delivery. For a company that operates with slim margins and sells clothing for as little as £2, online operations are simply not feasible.

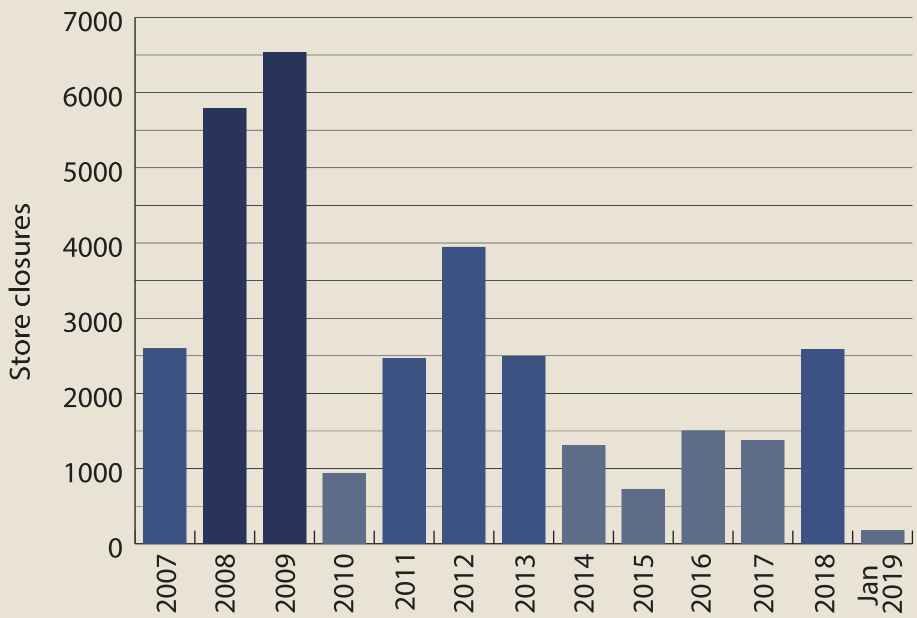
Rather than selling goods online, Primark's website includes a magazine-style features section detailing the latest products and trends, and a social media 'primania' function, which encourages engagement with the brand and helps drive the consumer back to the high street. The company's unconventional marketing campaigns celebrating diversity have also garnered much positive attention for the brand.

On-trend fashion and vertical integration

The secret to some high-street successes has simply been the ability to keep up with rapidly changing fashion trends and meeting consumer demand with very little delay. The fast fashion trend has been exacerbated by social media, enabling both consumers and designers to save and share in-trend styles. Take Zara, for example; the company has a vertically integrated supply chain, and its decision to keep manufacturing operations in close proximity to key markets, rather than offshoring to take advantage of cheaper production, means it is able to take new designs from catwalk to shop floor in an average of three weeks. Vertical integration also eliminates the need for warehouses, lowering costs and helping to reduce the impact of demand fluctuations.

On the retail side, the company ships products to its store twice a week in small quantities and creates a sense of artificial scarcity to ensure stock levels are low and encourage impulse purchases. This method also ensures that more space is dedicated to the selling floor. Items also do not stay

Number of store closures on the UK high street



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on the floor longer than four weeks to keep up within changing consumer tastes. Furthermore, sales data is fed back to head office on a daily basis and if a product has not sold well within a week, it is then pulled. This tight operational control offers consumers the latest fashion trends that are also of reasonable quality and at affordable prices, allowing the company to thrive on the high street.

Tackling fast fashion

One of the key issues facing the retail sector is fast fashion and its contribution to emissions, pollution and wastage. The UK population consumes the most new clothing per capita in Europe per year at 26.7 kilograms. According to the Environmental Audit Committee and the United Nations Economic Commission for Europe, in 2018, 235 million items of clothing were sent to the landfill; 700,000 fibres are released per domestic wash finding their way into the ocean; and the global fashion industry produces more than 20% of global wastewater and 10% of global carbon emissions – more than all international flights and maritime shipping combined. Yet, less than 1% of material used to produce clothing is recycled into new garments in the United Kingdom. As result, green advocates and parliamentary members are calling to incentivise companies to offer sustainable designs and repair services, much like outdoor clothing manufacturer, Patagonia. Others are asking for a 1p levy on every garment they sell to fund a £35 million annual recycling scheme.

Brexit and supply chain concerns

Although some firms have bucked trends and seized opportunities, even successful high-street retailers still face challenges posed by the UK's exit from the European Union. With little over four weeks until 29 March 2019 and no deal in place, UK businesses are facing immense uncertainty regarding the ability to trade and the impact on supply chains.

At present, the United Kingdom is a member of the EU customs union and benefits from the ability to freely trade with EU nations. However, following the UK's exit, high-street retailers are likely to face rising costs with the imposition of additional tariffs, time delays and the possibility of inventory stockpiling.

Upon exit and assuming a no-deal scenario, all goods imported from the European Union will be subject to World Trade Organisation tariffs. Unless retailers increase prices, the additional tariffs are likely to result in a 4.2% drop in profit for a general merchandise retailer with an annual revenue of approximately £1.5 billion, according to sensitivity analysis conducted by consultancy firm, Oliver Wyman. Households are likely to feel the brunt of these tariffs, with the annual cost totalling £27 billion, or nearly £1,000 per household.

Meanwhile, additional 60 second custom checks are likely to result six- to eight-hour queues at Dover. A 70 second delay is expected to lead to a six-day queue, while 80 seconds would result in a gridlock scenario, according to research by University College London. For those relying on low prices and operational excellence like Primark and Zara, significant red tape will lead to supply chain disruptions and falling consumer fulfilment numbers, adding to retail pressures and putting numerous operators out of business.

Ultimately, the threat to traditional retail from e- and m-commerce is not going anywhere. Whilst Mike Ashley's call for an e-commerce tax has made the headlines, the incremental and innovatory changes embraced by the operators discussed above provide a platform for effective competition, if not an ability to reverse the effects of the e-retail boom.

IBISWorld Industry reports used in this special report:

G47.190	Department Stores in the UK
G47.599	Furniture, Lighting & Homeware Retailers in the UK
G47.710	Clothing Retailing in the UK
G47.910	E-Commerce & Online Auctions in the UK

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