

FROM THE SQUEEZE TO THE CRUNCH

What Really Matters in Retail

IF 2022 WAS THE YEAR OF THE 'SQUEEZE'...

In 2022 the cost-of-living crisis hit hard for many households, particularly those in lower income brackets:

- The Bank of England steadily increased interest rates from 0.1% to 3.5%¹ from November 2021 to November 2022, increasing mortgage repayments for those coming off historically lower rate fixed-term deals
- Private rents rose by almost 4% in the 12 months to October 2022²
- Inflation rose sharply by 9.3% in the 12 months to November 2022³, increasing the price of essential food and non-food items (including some of the lowest-cost grocery essentials, such as 30%+ increases in vegetable oil, pasta and bread)⁴
- Household energy prices increased significantly (by 54% in April), and were set for a further 80% rise in October, prior to the introduction of the Energy Price Guarantee (EPG), which limited the increase to 27%⁵

"In 2022 we began to see discretionary spending on major items such as furniture and consumer electricals take a hit, as consumers shunned significant spending on big ticket non-essentials. Retailers that focused on value generally faring better in the run-up to Christmas."⁶

...2023 IS ALMOST CERTAINLY GOING TO BE THE YEAR OF THE 'CRUNCH'

- Household incomes and discretionary spend will continue to be under severe pressure throughout 2023
- According to the ONS, 9 in 10 adults reported that they were experiencing an increase in the cost of living in December 2022 compared to the same period last year⁷
- 2022's squeeze will become the 2023 crunch as many households face into trying to balance budgets on the back of an already tough 2022
- The Resolution Foundation estimates that the average household will be £800 worse off in 2023⁸.

What is driving challenges for households in 2023?

Real disposable household incomes (RDHI) will continue to fall (the OBR is predicting a 7% cumulative fall in RDHI per person between 2021-22 and 2023-24⁹). There are significant inflationary impacts across major spend categories underpinning this fall in real income:

- The typical energy bill for a household is set to rise by £900 (or well over half) to £2,450 in 2023, up from £1,550 in 2022, and £1,170 in 2019¹⁰
- Food inflation accelerated to 13.3% in December 2022, up from 12.4% in November. This is the highest inflation rate in the food category on record¹¹
- Non-food inflation remains close to record highs at 4.4% in December 2022¹²

1. Trading Economics, Bank of England, 2022; 2. ONS, Oct 2022; 3. ONS, Nov 2022; 4. ONS, Rising cost of pasta, bread and other everyday foods leaves most vulnerable the worst off, Dec 2022; 5. House of Commons Library, Nov 2022; 6. BRC, Financial Times, May 2022; 7. ONS, Dec 2022; 8. Resolution Foundation, New Year's Outlook 2023, Dec 2022; 9. ONS, OBR – Economic and Fiscal Outlook, Nov 2022; 10. Resolution Foundation analysis, 2022; 11. BRC - NielsenIQ Shop Price Index, Dec 2022; 12. BRC - NielsenIQ Shop Price Index, Dec 2022

FURTHER STRAINS ON CONSUMER SPENDING

The majority of the indicators below point to a tough 2023, as the cost-of-living crisis continues to impact real incomes. We expect many consumers to delay spending on big ticket items, and further adapt their spending behaviour across other categories as they become more price conscious and value-orientated.

- **Declining wages** in real terms as wage increases fail to keep up with inflation (between August to October 2022, the [ONS](#) reported that growth in total pay adjusted for inflation fell by 2.7% year-on-year, one of the largest falls since records began two decades ago)¹³
- **Declining house prices** (and the emerging threat of negative equity for some), with forecasts predicting a [5% drop](#) in prices in 2023¹⁴
- **A sharp increase in mortgage payments** for many, as lower fixed rates continue to roll off. The Bank of England estimates that average monthly repayment increases will be around £250, with monthly payments growing to c.£1,000, or 17% of average pre-tax income¹⁵
- **Savings will continue to be depleted**, with the savings ratio (i.e., the proportion of disposable income that is not spent on consumption) set to fall to zero in 2023¹⁶
- **Unemployment set to increase.** The Bank of England has projected a [rise in unemployment](#) to 4.9% by the end of 2023, rising again to 5.9% by 2024¹⁷

“Whilst Christmas yielded many positives for retailers, we expect 2023 to be a tough year as the UK enters one of its worst recessions and household incomes come under significant pressure.”

13. ONS, Dec 2022; 14. Reuters, Nationwide, Financial Times, 2022; 15. Bank of England, Financial Stability Report, Dec 2022; 16. OBR, Outlook for household income and consumption, Nov 2022; 17. Bank of England Monetary Policy Report, Nov 2022

In 2023 retailers will continue to

BATTLE COST PRESSURES AND THE FALLOUT OF SUPPLY CHAIN DISRUPTIONS



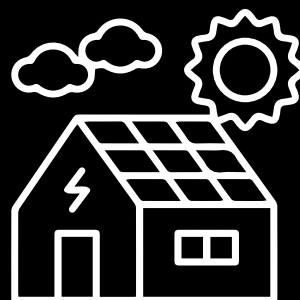
£10.42

National living wage set to increase in April 2023¹⁸



**TOTAL RETAIL
CLOSURES 50%
HIGHER IN 2022**

vs. 2021, hitting a five-year high¹⁹, but the high street is arguably still over-congested, so we expect more closures to come



2x TO 4x

Despite predictions that energy costs are set to stabilise, supermarkets and convenience retailers have seen energy costs double, and in some cases even quadruple over the past year²¹

**£18BN
TO £5BN**

Government energy support to fall as Government cuts its Energy Bills Discount Scheme²²



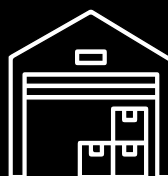
UK retail sector volumes up but spending down on 2021, with

**SMALLER BASKET SIZES
REPORTED²⁰**



**SIGNIFICANT BUILD-UP OF
INVENTORY TO UNWIND**

particularly in fashion as lead times from Asia unexpectedly fell in 2022 bringing product in earlier than expected²³



**RISING WAREHOUSE
COSTS**

compounded by energy costs and excess inventory in overspill locations²⁴

18. Financial Times, Jan 2023; 19. Centre for Retail Research, Jan 2023; 20. Barclaycard, Dec 2022; 21. Grocery Gazette, July 2022; Talking Retail, Jan 2023; 22. Gov.uk, Jan 2023; 23. Retail Week, Nov 2022; 24. New Statesman, Jan 2023

WHAT REALLY MATTERS

Whilst there are early signs that retailers who shifted early to a focus on affordability in time for Christmas 2022 fared well²⁵, many are in for another challenging year as consumers reprioritise spending and cut back on non-essentials. Cost pressures, while easing in some areas, will require significant focus.

- Energy costs will continue to pose a challenge, with some retailers reporting bills doubling year-on-year. Many have already instigated energy saving measures, including replacing equipment (e.g., upgrading fridges and freezers, installing heat pumps and switching to LEDs in stores) and lowering the temperature in shops and distribution facilities²⁶
- There is also the looming threat of further geopolitical instability, with the tensions between China and Taiwan causing concern for those whose supply chains have a reliance on the region²⁷. The fallout from Russia and Ukraine demonstrated what can happen as a result of regional instability with rocketing prices in some food categories²⁸. Supply chain resilience, as highlighted in the latest AlixPartners Disruption Index research, will be a key focus for retail executives²⁹
- Labour challenges continue to impact operations. Labour costs have increased, with a rise in the UK's minimum wage in 2022 and further increases expected from April 2023. Skills shortages also persist, with the ONS estimating there were 91,000 vacancies in the retail sector in the three months to November 2022³⁰
- There have been some positives, for example falling costs in some areas (e.g. freight, although it still remains materially higher than pre-pandemic levels³¹)
- The overall picture remains challenging with bellwether retailers such as Next cautious on the outlook for next year³²

25. BRC – KPMG Retail Sales Monitor, Dec 2022; 26. Retail Gazette, Dec 2022; 27. Chartered Institute of Procurement and Supply Chain, Aug 2022; 28. USDA, April 2022; 29. 2023 AlixPartners Disruption Index, Dec 2022; 30. Financial Times, Jan 2023; 31. Investors Chronicle, Dec 2022; 32. Reuters, Jan 2023

OUR TEN PREDICTIONS FOR 2023

Against the background of an increasingly challenging macro environment, retailers will need to be more disciplined in their management of operating costs. Reading and reacting to changing demand, and being clear on the customer value proposition will be key to winning in 2023.

- 1** Margins will be under intense pressure as retailers run the gauntlet of managing markdowns and promotional activity to shift inventory against the need to hold / increase prices to battle inflation, from wage and other operating cost increases.
- 2** Cash protection will be sharply in focus as retailers hunker down to ride out the crunch and look to bolster liquidity measures. Working capital initiatives must be built into company plans³³.
- 3** More focus on providing perceived value for money and emphasising affordability will be key messages to consumers in the mass market – discounters are likely to continue to perform well.
- 4** Post-Brexit labour pressures will continue and there will be more emphasis on labour productivity as wages increase.
- 5** A continued rebalancing of the post-pandemic surge to online as consumers return to stores, but also a continuation of the store rationalisation programmes we saw in 2022, as retailers re-evaluate their bricks and mortar portfolios.
- 6** Returns management, particularly in fashion, will be a key area to address in order to improve net margins. Expect more charging for returns in addition to other interventions.
- 7** Sustainability, fuelled in part by continuing energy price challenges, will be a big focus as energy efficiency garners more attention, both from the consumer and as part of retail operations.
- 8** A rethink of sourcing strategy and locations, as evolving geopolitical scenarios threaten supply chains in Asia and the ongoing disruption in Eastern Europe.
- 9** Digital investments that focus more acutely on practical initiatives that deliver a clear return on investment, with margin expansion and cost optimisation high priorities.
- 10** Established retailers will emulate digital natives and build smaller, simpler, and nimbler approaches to technology solutions, driven by the business proposition, the budget and the pursuit of getting to value faster than the typical multi-year 'ERP-type' transformation.

“2023 will force retailers to take a forensic look at their business and operating models. Whilst some of 2022’s supply chain issues will ease, we expect consumer spending to be significantly impacted, and cost pressures to bite harder. As a result, a laser focus on margins and profitability will be required.”

³³ 2023 AlixPartners Disruption Index, Dec 2022

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These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.

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