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Taking Stock

The outlook for Consumer & Retail



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UK Economic Outlook

The UK faces an unprecedented crisis. Never has a single event had such a widespread impact on financial markets, companies and households. The International Monetary Fund (IMF) expects the global economy to contract sharply by 3% in 2020 – significantly worse than during the financial crisis of 2008. The Euro Area is expected to report much weaker growth, with output falling 7.1% in 2020, while advanced economies are predicted to suffer a 6.1% fall before bouncing back in 2021.

In the UK, Government measures to control the spread of Covid-19 caused significant disruption, paralysing the economy and uprooting societal norms. Response from the Bank of England and the Government was swift, but the hit to the UK economy will be inevitable. Support measures such as the Coronavirus Job Retention Scheme¹, business rates holiday and deferral of VAT have been a lifeline for many businesses and will help cushion the blow, but deep scars are likely to be left across various sectors.

Consumer spending has fallen significantly. In the second quarter, it is expected to be 30% lower than in the final quarter of 2019². Although the Coronavirus Job Retention Scheme assisted firms in retaining staff, household incomes have declined and will come under further pressure following a projected rise in unemployment.

Indeed, the Bank of England's forecast of a 25% fall in GDP in the second quarter of 2020 – leading to the deepest recession in over 300 years – lays out the scale of the challenge ahead. As the Government begins to reduce its unprecedented levels of support, unemployment is expected to reach 8% by the end of the year as business failures increase.

From a business perspective, tighter financial conditions and heightened uncertainty about the outlook for the economy have decimated investment. In the second quarter of 2020, almost 85% of firms reported that their level of uncertainty was 'high' or 'very high', up from 40% in February³ – Covid-19 being the primary reason for uncertainty for the vast majority. As such, business investment is expected to be around 40% lower in the second quarter of 2020 than at the end of 2019.

The speed of economic recovery heavily depends on: the trajectory of the virus (case numbers), duration of social distancing measures in place, the return of consumer confidence, supply chain efficacy, and further out, the extent to which short-term disruption damages the economy.

The stakes are high and the UK Government will continue to run a significant fiscal deficit to avoid high levels of structural unemployment, protracted disruption to supply chains and waves of business failures. The benefit of large deficits today will be seen as far outweighing any eventual costs. As the UK emerges from lockdown, policy makers will cautiously explore ways to enable societies to manage the interconnected realms of public health and economic wellbeing.



¹ Covers 80% of the income of employees up to £2,500 per month

² Bank of England

³ Bank of England

Consumer and Retail

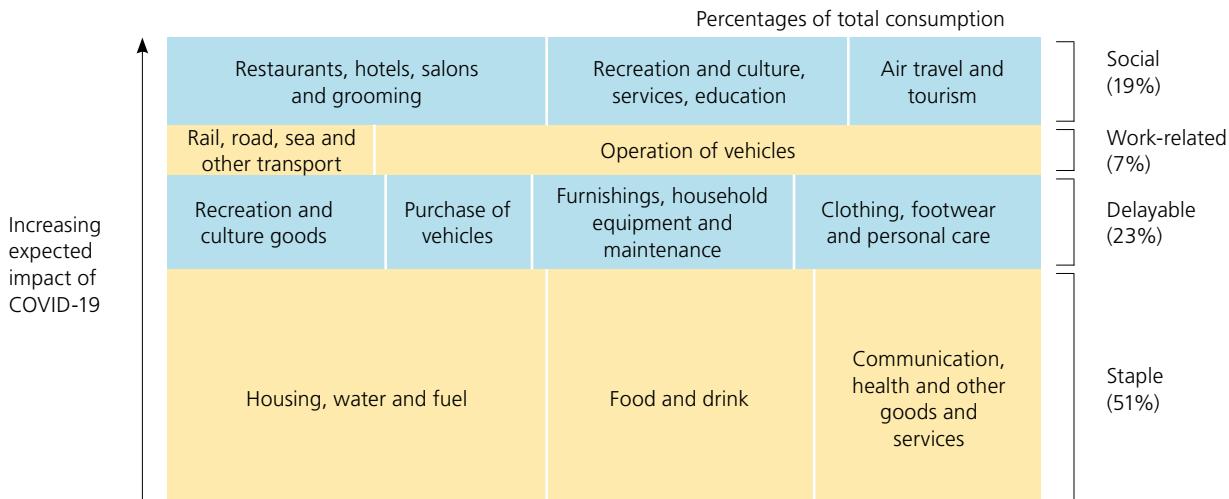
– what's in store?

Consumer spending has been dealt a significant blow. The initial closure of non-essential physical retail (e.g. non-food, entertainment and leisure, bars, pubs and restaurants) crippled demand in large parts of the economy.

Clearly, the most impacted areas involve spending on goods and services with close social contact such as

footwear and beauty salons for instance. Consumer confidence remains extremely fragile, heightened by fears around job security, health and overall prospects for the economy. Consumers are prioritising their spending on essentials over discretionary purchases and increasing precautionary saving.

Spending on good and services that involve social contact will be most affected by the pandemic



Source: ONS and Bank calculations

The crisis is also driving changes in consumer behaviour. A larger proportion of spending is shifting online as people become more conscious about shopping and socialising in physical locations. Evidence from Germany, Italy, Spain and China shows that even after social distancing measures are relaxed, many customers continue to social distance voluntarily, being reluctant to dine out or attend events involving large crowds.

The long-term implications for the consumer and retail sector will be vast. Around a third of British consumers think that the way they shop will change permanently – greater than changes in the way they will travel, communicate or work. Additionally, almost half (45%) of

consumers have now purchased an item online that they had only ever previously purchased in-store, since the outbreak. This has exposed them to new customer journeys. Undoubtedly, some behavioural changes will endure and will remain after the crisis.

It is inevitable that the UK consumer sector will emerge from the crisis in a very different form. Unfortunately, further administrations, job losses and store closures can be expected. However, a more resilient sector will emerge, characterised by nimble and adaptable businesses that are better placed to form the cornerstone of the economic recovery.

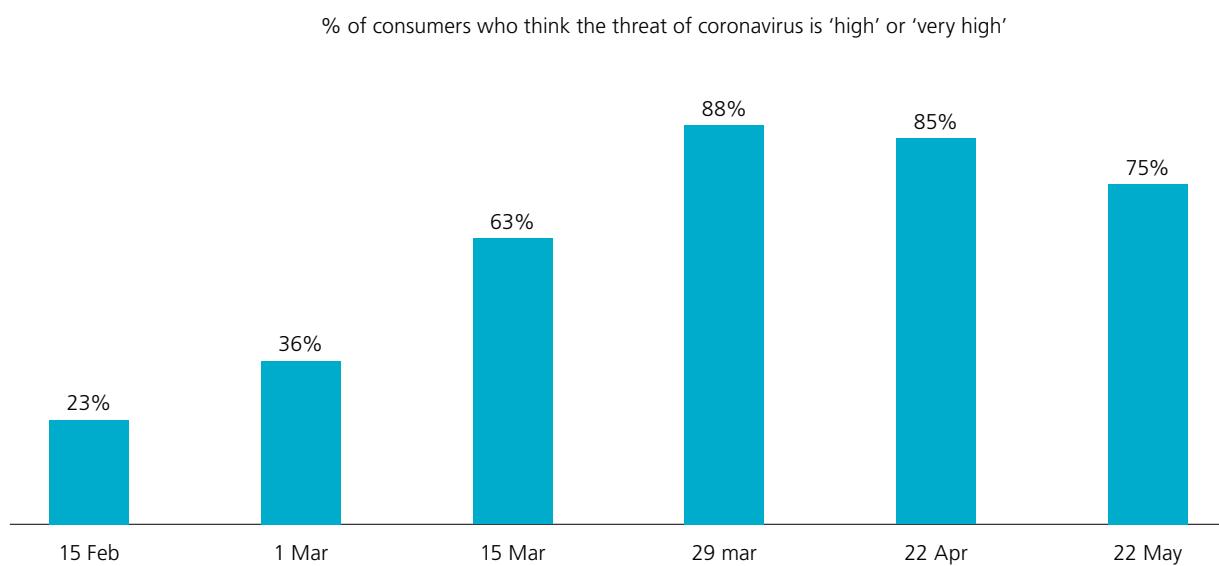
This transition will cause a 'shake-out' across the sector as consumers migrate towards businesses that are more aligned to a new set of needs and values. Retailers and consumer brands who fail to pivot their business models fast enough are likely to fail, with the voids filled by those with nimbler strategies and by new brands altogether.



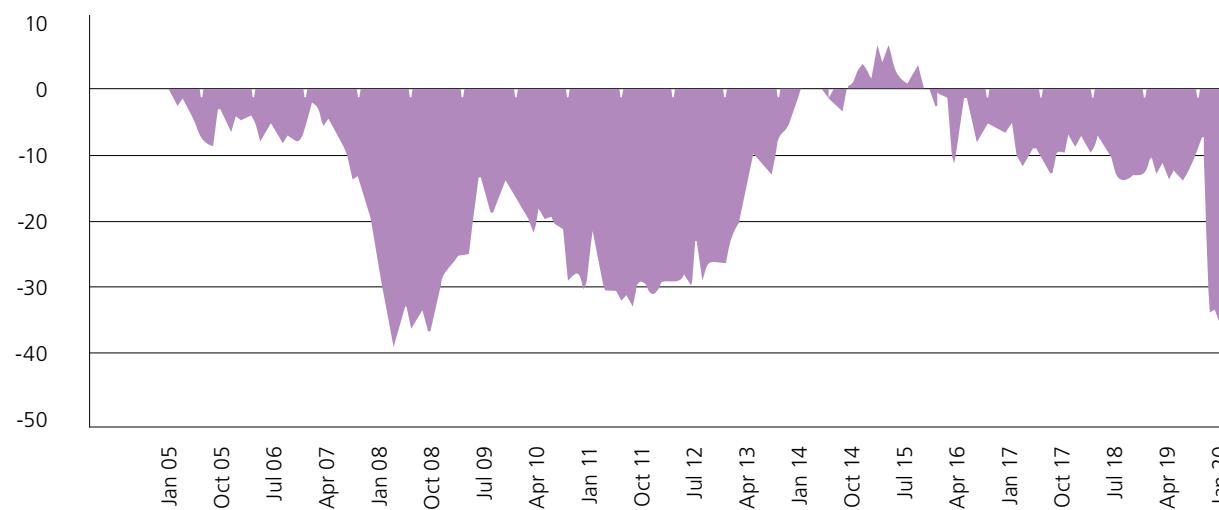


The long-lasting impact of Covid-19 on consumer behaviours in six charts

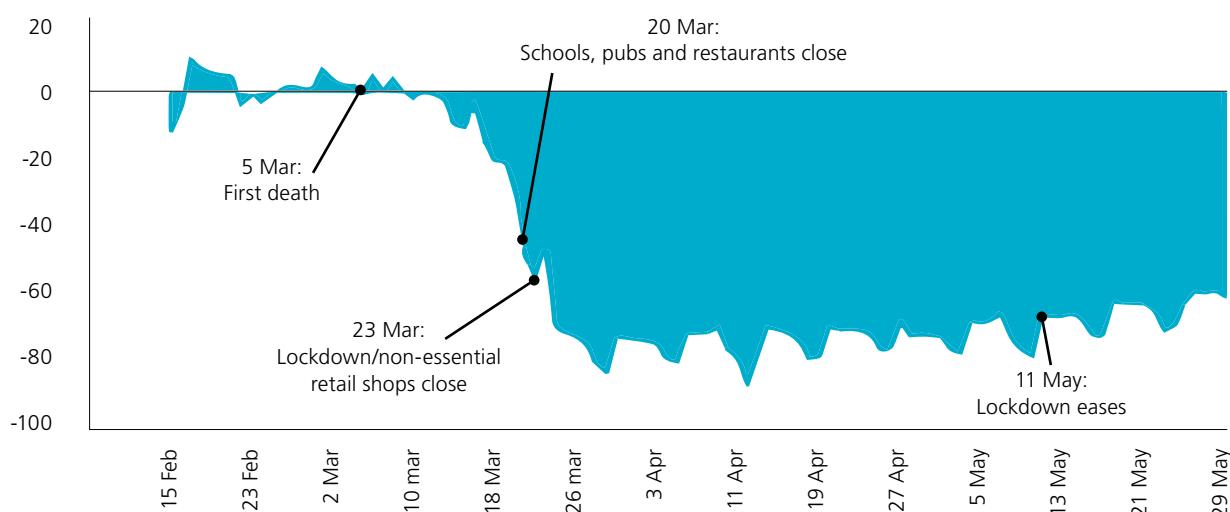
(1) Fears about the seriousness of the virus rose quickly in the UK...



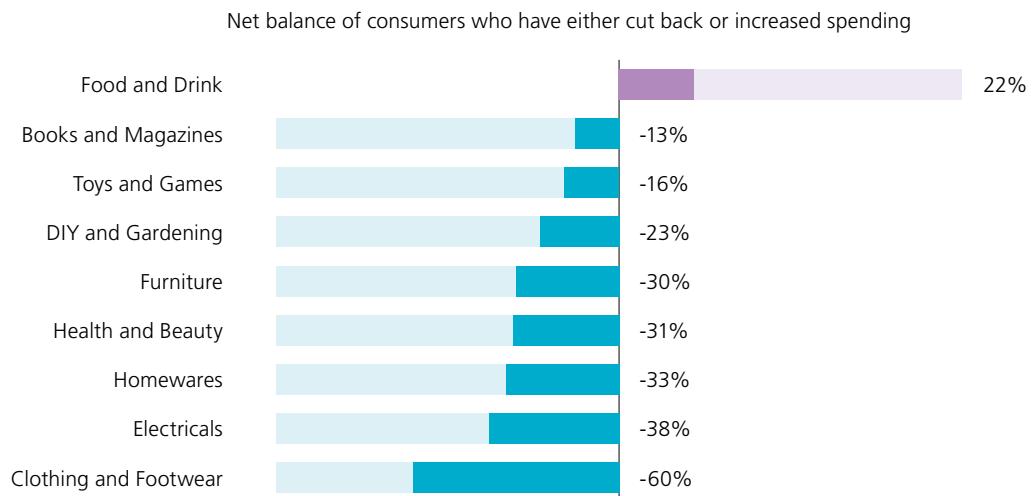
(2) ... rocking consumer confidence which plunged to levels not seen since the financial crisis in 2008...



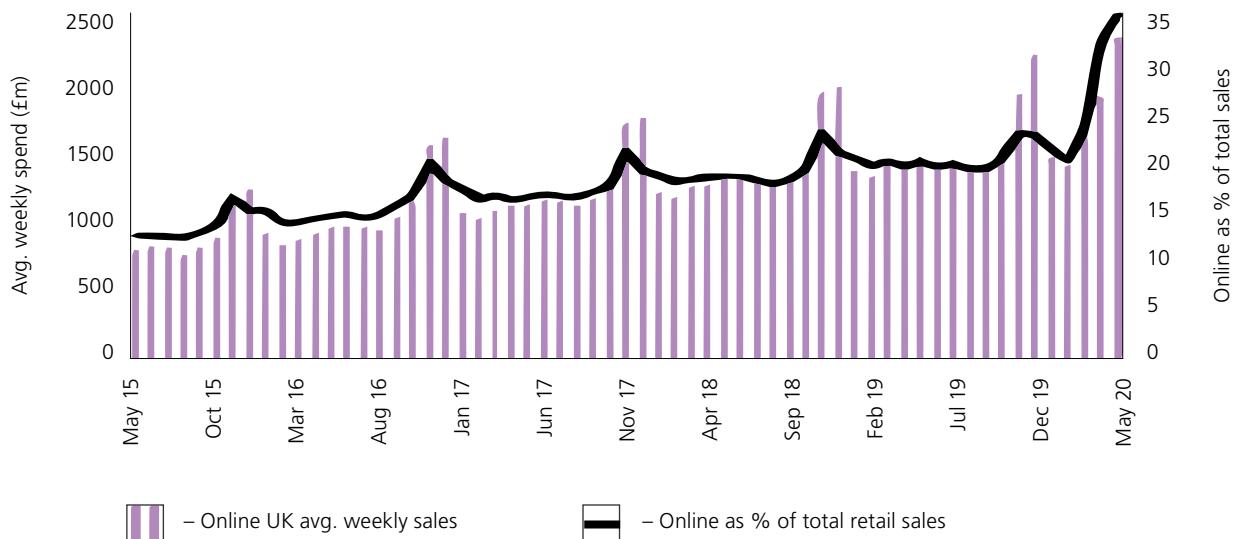
(3) Even prior to lockdown measures, footfall began declining sharply...



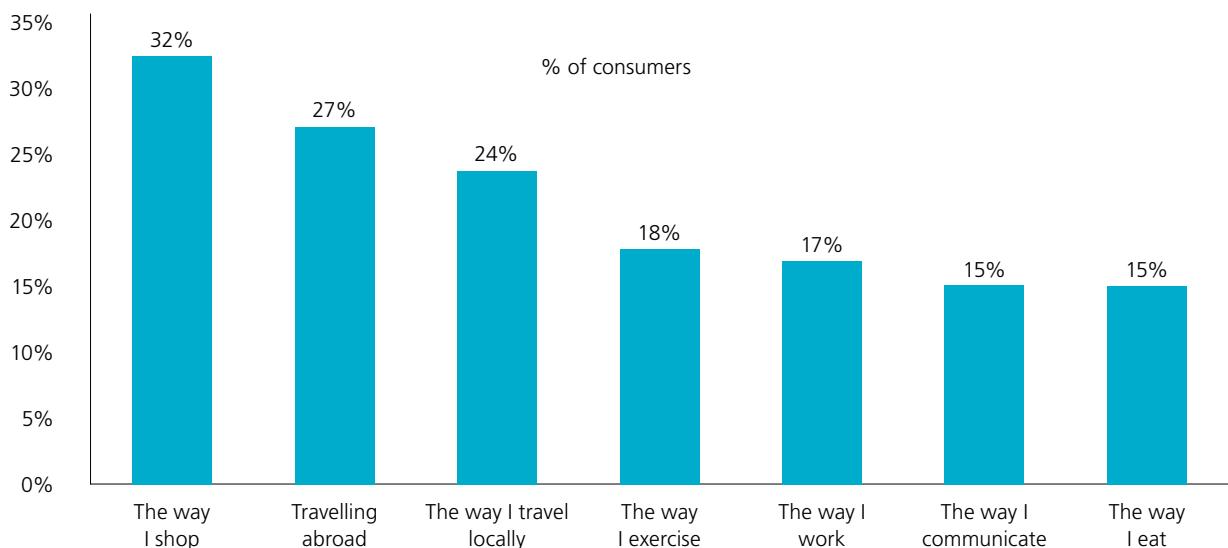
(4) ...and consumers cut back on non-essentials and focused on necessities.



(5) A significant proportion of spending moved online, and in May accounted for a third of retail spending...



(6) ...with many consumers intending to change the way they shop on a permanent basis.





Subsector outlooks

| Sector | Summary | Original forecast 2020 | Revised Forecast 2020 |
|---|--|------------------------|-----------------------|
| Food and Grocery  | <p>The food and grocery sector will remain a clear winner in the second half of 2020. The closure of food services (e.g. cafes, restaurants and bars) resulted in on-going transference of spending while encouraging more cooking from scratch and online ordering.</p> <p>Online is expected to account for 9.3% of total grocery spending in 2020, up from 7.8% in 2019, as retailers ramp up capacity for picking, packing and distribution.</p> | +2.6% | +6.8 |
| Apparel  | <p>Apparel is expected to be the hardest hit sector given lockdown and social distancing measures significantly undermine demand for new outfits. Although online clothing and footwear is one of the most widely used sectors online, the shift towards this channel did very little to insulate against the overall decline in the market.</p> <p>Spring/Summer ranges have been piled up in closed stores for most retailers during the lockdown, leading to excess levels of stock which are being heavily discounted. Many retailers will be desperate to turn inventory into cash as quickly as possible to shore-up balance sheets.</p> | +0.5% | -36.7% |
| Electricals  | <p>Electrical retailers have benefited significantly as companies set up home working systems requiring laptops, software and accessories. Home schooling has also led to increased uptake of educational products and budget laptops as parents looked to occupy their children and assisted with teaching. Notably, businesses with mature online propositions helped ease the transition towards online for many retailers and households.</p> <p>With a greater focus on health, fitness equipment and smart fitness devices experienced a boost. White goods are also in higher demand as consumers spending more time indoors improve their living environments.</p> | +1.0% | -2.6% |

Source: Retail Economics



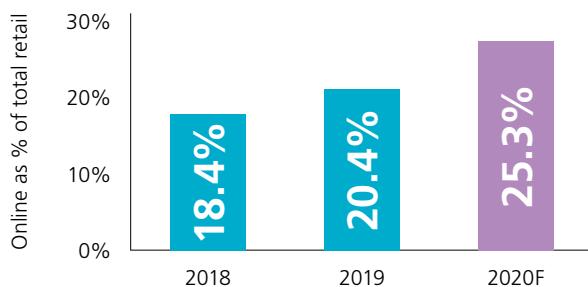
| Sector | Summary | Original forecast 2020 | Revised Forecast 2020 |
|---|--|------------------------|-----------------------|
| Home, Furniture and Flooring  | <p>Homewares and furniture retailers have seen sales tumble in the immediate aftermath of the lockdown. The Furniture and Flooring sector fell significantly in April (-77.9%) and May (-64.7%) while Homewares also plunged in April (-42.2%) before showing signs of improvement in May (-15.8%).</p> <p>Housing market activity (a key driver for furniture sales) remains under pressure with the collapse in housing transactions expected to continue throughout 2020. In fact, the housing market is expected to suffer significantly in coming months from restricted home viewings and mortgage providers applying more stringent lending criteria. However, Homewares is predicted to rebound more quickly as consumers adopt an "improve, not move" mentality from potential movers deciding to remain longer in their current homes.</p> | +1.2% | -24.2% |
| DIY and Gardening  | <p>The DIY and Gardening category is also likely to suffer less than other non-food sectors as home-bound consumers continue to focus on home improvement projects throughout the staycation summer. Increased gardening-related activity in coming months will undoubtedly support gardening equipment sales.</p> <p>Importantly, this category had just 12.2% of sales occur online in 2019. This is expected to rise to 16.3% in 2020 which will benefit retailers with attractive online propositions.</p> | +1.8% | -14.1% |
| Health and Beauty  | <p>The initial boost in bathroom toiletries, paper products and over-the-counter medicines stimulated sales growth in the short-run. However, it will now take time for consumers to deplete stockpiles, softening demand for later in the year.</p> <p>Categories such as cosmetics will come under intense pressure as consumers continue to self-isolate and home working systems remain in place. Also, social distancing measures have been challenging for beauty retailers to adhere to, further undermining recovery efforts.</p> | +2.1% | -11.4 % |



What's popping: trends to watch in 2020/21

Forgot the shop floor, bring it to my front door - digital barriers are crumbling

The closure of non-essential retail stores necessitated a clear shift towards online. Almost half (45%) of consumers claim to have purchased something online that they had only previously ever purchased in-store, exposing them to new customer journeys. Many of these consumers would have overcome the initial barriers of setting up online accounts, entering payment details and gaining trust.



While a proportion of consumers will inevitably revert to their old shopping habits once 'normality' returns, a significant proportion will embrace a permanent change in the way they shop.

Indeed, forecasts suggest that online will account for more than a quarter of total retail spending in 2020, reaching almost £90 billion – an increase of c.£12 billion on the previous year. The transition towards digital channels has effectively been fast-tracked. Specific stages within the overall shift that would have otherwise taken years to complete, may now have been accomplished in a mere matter of months.

A key consideration for retailers will be trying to identify which behaviours will endure and how they will develop in the interim. These permanent shifts will impact the market unevenly, depending on various factors such as online sector penetration, online retail capacity, market concentration, socio-demographics and others.

Successful brands and retailers will be implementing innovative ways to engage previously 'hard-to-capture' online shoppers to create and add value. These new cohorts may become more valuable targets as they reassess what aspects of the retailer relationship are most important to them.

Mind the (gender) gap

Following the rise of mass equal pay claims in 2019, gender equality remains in the spotlight this year. From the outset of lockdown, the headlines have focussed on the significant progress being made as regards flexible working and gender equality in the (virtual) workplace. However, the picture is in reality much more nuanced. For many, working from home has meant juggling work and childcare responsibilities; for others, particularly in the retail sector, working from home has simply not been feasible due to the nature of the work. It's clear that women have borne the brunt of these challenges, with a recent IFS study finding that mothers are more likely than fathers to have been furloughed, been made redundant or resigned, or reduced their hours during lockdown.

Although non-essential shops can now open, ongoing social distancing requirements and customers' health concerns are inevitably impacting footfall in shops. Given this, and with the Job Retention Scheme set to close at the end of October and a recession looming, further redundancies and pay cuts unfortunately appear inevitable.

There is a strong business imperative in keeping diversity and inclusion on the agenda during these challenging times: it is well-established that gender diversity improves profitability and reduces "group think", leading to more innovation. Employers would be well advised to update their diversity and inclusion strategies to respond to the changing landscape and monitor the impact COVID-19 has had on the diversity of their workforces to date.

Let's get physical... (at a sensible, safe distance) - the new in-store experience

The customer experience will be 'turned on its head' as the industry transitions to a new normal. In-store experiences that were previously built around entertainment, escapism and product interaction will be put on pause as consumers prioritise safety and retailers enforce social distancing and hygiene measures.

Difficulties arising from the transition will vary widely across the industry and individual sectors will face their own sector-specific challenges across the customer journey. Some of these difficulties will include characteristics such as:

Some other example measures in the EU:

 **Density of products in-store**

 **Frequency of product contact**

 **Customer service proximity**

 **Average dwell times**

 **Footfall levels**

As consumers become acclimatised to events, the entire customer experience is being put at risk (e.g. being greeted by face-masked assistants, asked to wait outside stores, following one-way systems restricting browsing opportunities etc.).

After the initial boost for digital channels due to necessity, any additional friction in-store within the customer journey could further propel online shopping. Customers are likely to assign physical shopping missions towards the purchase of necessities over leisurely trips out to retail destinations.

The integration of in-store technology could play an important role, from chatbots that greet people as they enter stores, to digital touchpoints that can fulfil store purchases by offering home delivery via online channels.

Open(ish) for business – rethinking retail property

In the context of seismic shifts in consumer behaviour, there will be an urgency to repurpose physical retail space. Retail landlords are under intense pressure as retail asset values, rental demands and investor sentiment have tumbled in recent years.

More innovative use of space such as pop-up shops and white box spaces can create a healthy churn of independent retailers who are relevant to the local communities they serve. This shift may be supported by

consumers choosing to shop more locally in support of independent businesses with sustainable consumption also being a key consideration.

The landlord and retailer relationship will become more collaborative, involving shorter and more flexible lease terms and a higher proportion of turnover based rents.

Elsewhere, oversized or redundant stores will be shared using innovative partnerships or repurposed for online fulfilment, city centre hubs for consolidating deliveries or convenient click-and-collect destinations.

Don't get thrown under the Omnibus – GDPR-sized fines on the horizon for consumer facing businesses

Throughout the EU, changes to consumer-facing law over the next 24 months will require businesses to reset their approach towards their consumers, moving away from a lax or minimal compliance approach (which may represent a commercially acceptable approach now), to a more stringent, consumer-friendly outlook.

November 2019 saw the adoption of the Omnibus Directive (or, more formally, the Enforcement and Modernisation Directive). One of the key changes under the Directive is the introduction of turnover-based fines for EU consumer-facing businesses which fail to comply with existing EU consumer law. By 28 May 2022 EU member states will have to provide for maximum fines of at least 4% of the infringing trader's annual turnover in the relevant member state(s), while other penalties can also be imposed by courts and regulators (instead of, or in addition to, fines). Penalties will of course depend on factors such as the nature, gravity, scale and duration of the infringement and the financial benefits gained or losses avoided by the trader due to the infringement. But these are potentially GDPR-sized fines!

The Omnibus Directive is just one example of a raft of recent enhancements to consumer protections in the EU. The freshly replaced Consumer Protection Cooperation Regulation gives more powers to national authorities and the European Commission to require authorities in other EU Member States to take enforcement action (i.e. authorities in Germany could require authorities in France to take action against a French retailer for example). In the future, European consumers may also be able to bring class action style claims under the Directive on Representative Actions.

The advent of fines and possibly class actions, together with enhanced enforcement action, significantly changes the risk profile of consumer protection law compliance in Europe. In practice, this means consumer-facing businesses will have to review the terms and conditions on which they deal with consumers, as well

as related policies, processes, notices, advertising materials and other communications, and will need to be prepared for more, and increasingly aggressive, regulator investigations and enforcement actions.

From a UK perspective, Brexit means that the UK is unlikely to be required to adopt domestic laws which comply with the Directive. Similar fines could be introduced anyway given that the Government and Competition and Markets Authority have historically supported the introduction of fines for consumer law breaches. However, we currently have no clarity on what will happen next.

When 2 become 1 – consolidation and partnerships will increase

Further business failures and retail administrations can unfortunately be expected. This will lead to market consolidation and acquisition opportunities for companies looking to build scale, reposition brands and drive value.

The shift towards simpler and more nimble business models will encourage more strategic partnerships as retail brands outsource deep specialisms such as artificial intelligence (AI) and logistics.

Here, partnerships and collaborations will be formed by mutually beneficial tie-ups that cut across previously untraversed paths.

Complementary partnerships can offer:

- 1 Enhanced propositions (e.g. Next and Amazon)
- 2 Improved logistics (e.g. Clipper Logistics that can house, distribute and manage returns)
- 3 Efficient final mile delivery (e.g. Deliveroo, Uber)
- 4 Big-data driven insights (e.g. Google cloud computing, Amazon Web Services, Microsoft Artificial Intelligence)
- 5 Intelligent use of retail space (e.g. flexible landlords facilitating innovative solutions)

Indeed, many strategic alliances arising from the Covid-19 impact are likely to strengthen further in the future as new ones arise (e.g. M&S and Deliveroo, WH Smiths and Sainsbury's).

The other crisis...remember the environment?

For those consumers who have managed to maintain their household income throughout this crisis, there will be renewed concern about the environmental impact of their buying decisions and greater importance placed on brands' sustainability commitments. Many homebound consumers are re-evaluating their priorities, with health & wellness, community and a focus on quality over quantity leading to more ethical consumption.

Sustainable growth and achieving a transition to a circular economy also remain high on the agenda for law and policy makers in both EU and the UK. In the EU, the recently adopted European Green Deal and the New Circular Economy Action Plan form the backbone of the EU's ambition to achieve climate neutrality by 2050, mainstream sustainability and promote "nature-based solutions". Whilst in the UK, the Environment Bill sets a new direction for resources and waste management, with measures proposed to move the economy away from the traditional linear pattern of 'take, make, use, dispose' towards a more circular economic model.

The push of new regulation and the pull of changing consumer behaviour will require all businesses to adapt their current and future strategies on product design, the reduction of waste and carbon emission measures.

Some other example measures in the EU:



Sustainable Product Policy Framework:

introduction of measures to establish a new "right to repair", the expansion of eco-design requirements and the empowering of consumers in the green transition.



Farm to Fork Strategy: aims to accelerate the transition to a sustainable food system that is fair, healthy and "environmentally-friendly".



EU Plastics Strategy: all plastic packaging on the EU market to be recyclable or reusable by 2030.



"Single Use Plastics" ("SuP") Directive: prohibitions on certain SuP products and the reduction of others; extended producer responsibility; product design changes; product labelling and information campaigns.



Possible **prohibition on intentionally added microplastics** to certain products.



Proposals for policy framework on the sourcing, labelling and use of bio-based plastics and the use of biodegradable plastics.



Proposal for a new EU Strategy for Textiles: which may include eco-design requirements and measures to encourage the re-use and recycling of textiles.

Other example measures in the UK:

-  Legal requirement for the UK to **reduce greenhouse gas emissions** to net zero by 2050.
-  **Reform of the packaging producer responsibility regime** requiring producers to meet the full net cost of managing their packaging waste.
-  **Proposal for extended producer responsibility regimes** for other waste streams, including textiles.
-  **Deposit return schemes.**
-  **Tax on certain plastic packaging** produced in, or imported into, the UK which contains less than 30% recycled plastic.
-  **Prohibition of plastic straws, drinks stirrers and plastic stemmed cotton buds** from October 2020 (England).
-  **Possible new charging schemes**, including for other single-use plastic items.
-  **Increased non-financial reporting.**

Supply chains under the microscope

The Covid-19 crisis has highlighted the need for many consumer organisations to develop more resilient supply chains and distribution platforms focussed on agile planning, balancing costs and managing risk.

Organisations with the best chance of thriving will be those that can quickly adapt to new consumer and retail trends, being flexible, nimble and responsive. In some cases, shorter supply chains to maintain faster reaction times for operating models will be required. Near-shoring may be commercially viable for some, but this will not be feasible at scale for many parts of the market.

Nevertheless, a broader diversification of supply chains will help to mitigate some risk, but multiple suppliers may just be part of the solution where retailers consider leaner inventory, pull ordering and just-in-time manufacturing. Many parts of the fast fashion industry are already operating with these agile sourcing models. Others are likely to follow suit, mirroring similar strategies where profitability allows.

Advertising in a time of crisis

With the events of 2020, we have seen the advertising industry as a whole struggle to adjust as the market came to a grinding halt. Some brands erred on the side of caution, at least initially, and paused advertising activities altogether but others have looked to be more agile, quickly responding to the crisis and changing engagement channels for consumers.

As companies look to tighten their belts, advertising budgets have been one of the first casualties, in many cases seen as superfluous to critical business requirements at this time. This has resulted in a shift in spend to new channels, and in particular, to social advertising. To succeed, brands will need to follow this movement to alternative channels going forward.

It is important however to remember that the opportunities presented by influencer marketing and social media content are not without their challenges. Advertising is ultimately a creative exercise – the same advertising content simply distributed through a different channel is unlikely to be as successful as a purpose-built campaign specifically designed around that channel.

And of course, the central principle for all marketing communications still remains that they should be legal, decent, honest and truthful. In a time of a crisis these principles are just as important and brands should prepare advertisements responsibly for consumers and society. We have already seen the ASA consider and rule in relation to numerous examples of misleading, irresponsible advertising during the current crisis. This follows a longer term trend where the rise and prevalence of influencers in particular in recent years has been accompanied with higher scrutiny from the industry and the ASA. In 2019, online media was responsible for almost half, at 48%, of all ads complained about. Of that, influencer advertising was responsible for a quarter of online adverts complained about in the same year. Brands must therefore combine flexibility in their marketing strategies with a degree of caution.

We examine the impact of the current crisis on the advertising sector as a whole, across all channels, in more detail in our report "Advertising in a time of crisis" available at www.adtekr.com.







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