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#INSIGHT

**INSIDE UK
GROCERY RETAIL**

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INSIGHTS: Bis Henderson Consulting

SUMMARY

Over the last 18 months the **UK Grocery Market** has experienced the unprecedented impact of the direct and indirect consequences of both the Covid pandemic and Brexit. As a result, the industry is widely anticipating one of the most challenging seasonal peak quarters ever.

The intensity of the barrage continues, and activity remains understandably very tactical, with singular focus on trying to protect the peak trading period from the impact of labour shortage, inbound failures and low inventory in the supply chain. With the risk of a winter Covid resurgence, any consumer panic buying or disastrous failures of key lines like turkeys would push some operations to their absolute limits.

Bis Henderson Consulting have conducted a number of confidential interviews with senior professionals who are representative of the UK Grocery Retail and Logistics sectors, to gain an insight into what's happening behind the scenes. The purpose of the research is to better understand the impact of lockdown and re-opening of the UK on the Grocery Retail and Logistics sectors, and to hear from the industry about their key issues and opportunities, their perspective on the cause of these, and plans to respond.

CONSUMER BEHAVIOUR

Channel Switch, Format Switch and Shopping Patterns

Public adherence to the 'stay home, stay safe' message from Government created a big switch to the online Grocery channel as consumers either chose to not go to the supermarket or were forced to switch as a result of personal vulnerability.

Those choosing to go out to the shops did so less often and bought a bigger basket when they did, topped up by a trip to the local convenience store for essentials. This had a negative impact on the limited choice discount Retailer sector, who were also impacted by their lack of home delivery capability. Retailers with either local convenience, Grocery home delivery capability or both, fared best during the early stages of the pandemic in 2020.

Older customers, supported by younger family members, started to utilise Grocery home shopping for the first time. This opened up a segment of the market that, until the pandemic, had proved difficult to crack. Initially, slot availability was immediately saturated as Retailers struggled to meet demand. By the summer of 2020 this had been resolved with many of the mature online grocers doubling their slot capacity and newer entrants accelerating their capability. Consumers were driven by slot availability and not Retailer loyalty.

The onset of lockdown fatigue, the gradual return of consumer confidence post vaccination and the re-opening of the economy, have triggered the steady reversal of the Grocery online behaviour as consumers start to go back out to shops. Despite this, Grocery home shopping still remains between **50%** and **75%** ahead of pre pandemic rates in some Retailers.

Profitability Impact

As the pandemic took hold, absence levels in stores and the supply chain created capacity challenges at some stage for all Retailers, not to mention the cost impact. Furthermore, adhering to covid safety restrictions has required not only operational changes but created a huge bill for Retailers.

Whilst Grocers with online fulfilment capability have benefited from a sales perspective during lockdown the online P&L remains very challenging. The cost to pick, pack and deliver an order erodes margin and the increasing mix of online vs. shop sales dilutes overall profitability. Retailers are looking at different ways to fulfil the increased demand, as well as service the growing consumer pull for faster, practically on-demand deliveries.

Location, Location, Location

As offices and universities closed and the nation worked and studied virtually, city centres have been badly affected. Retailers with city centre outlets have seen a significant impact in sales and some were forced to mothball stores during the lockdown. It's still unclear what the future of office working and academia will look like and how this will impact Retailers.

Retailers with stores in holiday hot spots have clearly seen an unprecedented sales increase driven by 'staycation'. There is a view that this will continue for up to two to three years until greater confidence returns for overseas travel and the connected restrictions and administrative burden reduces.

Eating In Is The New Eating Out

The closure of hospitality and the natural move to home cooking had a positive impact on Grocery sector sales. The re-opening of non-essential Retail and hospitality has generally softened sales in the UK Grocery sector and the 'share of stomach' is now re-balancing, but the hospitality sector is still capacity restricted in the short term, driven predominantly by supply issues and resource shortages.

SUPPLY CHAIN DISRUPTION

Warehouse Cost And Availability

UK supply chains have become very efficient over time and traditionally carry very little safety stock. Lean supply chains were exposed by the impacts of the pandemic, and this has forced business to rethink and has resulted in some stockpiling. When you combine this impact with the reduced availability of commercial warehouse space because of Brexit stock builds across industry, the accelerated switching of consumers from shop to online and shortage of development land, the price of commercial warehousing has increased significantly, and the view from logistics professionals is that this is unlikely to reverse.

Global Sourcing And Shipping

The build-up of full containers in domestic ports during the economic slow-down of 2020 has created a global imbalance and shortage in countries of origin. The continued restriction of shipping capacity has multiplied the cost of containers tenfold. Port congestion and new Brexit administration is slowing down the processing time of containers through UK ports. Overseas manufacturers have also felt the full force of the pandemic with the impact of factory closures or restrictions forced by employee absence or covid outbreaks still to be felt by the UK consumer for some time to come.

Food Manufacturing And Agriculture

Closer to home, UK food manufacturers and processors have faced many of the same absence and plant closure challenges, have been affected by the same global shipping issues, and now more recently the shortage of production employees and HGV drivers. Retailers are quoting inbound service levels currently at c. **75%** to **80%** compared to the normal level of **90%+**. This is having a direct impact on availability in Grocery and is evident in stores across the UK.

Some Retailers feel better placed than others to protect elements of their supply chain and those who have greater vertical integration feel they have more control over their own destiny and will be competing less for stock with their competitors.

Brexit

Moving product in to Northern Ireland appears to be the most troublesome issue in the supply chain. Post Brexit customs procedures caused initial issues with many Retailers temporarily unable to deliver to NI. Gaps started to

appear on supermarket shelves as the extensive administration required for customs clearance and advanced shipping notification very quickly overwhelmed supply chains.

The government suspended the new rules to allow time for Retailers to develop the necessary IT systems to automate what is cited in the industry as “an unworkable administrative nightmare”. These rules start to be re-instated from the beginning of October, and the sense is that many UK businesses don't feel ready to implement the complex procedures required in a cost-effective way.

RECRUITMENT AND RETENTION - THE WORLD OF WORK HAS TURNED

Eastern European Workforce

In the early stages of the pandemic, resource was simply not a problem as complete sectors closed down and travel restrictions prevented Europeans from returning home. However, as the economy has re-opened the landscape has changed dramatically. Lifting of travel restrictions after a long period of lockdown in the UK has seen the return home of most of the UK eastern European workforce at the same time as demand for resources surged. With the introduction of tighter immigration rules because of Brexit, this workforce is not coming back. This workforce has been propping up Agriculture, Construction, Manufacturing, Logistics and Hospitality for many years and its sudden removal has revealed some serious shortfalls.

HGV Drivers

This European exodus has been most keenly felt in the lack of HGV drivers. In addition, the introduction of IR35 regulations in 2021 contributed significantly to the driver shortage.

Retailers are very motivated to train and convert warehouse staff into drivers and will invest what it takes to protect their business, but the issue is more complex to resolve than this including examiners and test facilities.

The immediate reaction to this very real issue has been to push wage rates up by between **5%** and **30%**, alongside hefty ‘golden hello’s’ and financial schemes to attract, recruit and retain drivers. However, all this serves to achieve is moving the problem from one place to another - ultimately someone loses out as not enough new resource is being added. Contractors and manufacturers are feeling the most pain and are being supported by Retailers protecting their own inbound volumes and availability as much as possible. Wherever supply and demand finally falls, the expectation amongst logistics professionals is that this is likely to be a significant and lasting re-basing of UK transport costs.

Warehouse Resource

Many Retailers have reported up to a third of their workforce were absent during the Covid peak because of a combination of isolation, ‘pingdemic’ and holiday period. Whilst generally still above pre-pandemic levels, absence has now improved significantly to circa **5%** to **10%** but new issues are now in play.

Retail Logistics networks with a traditional reliance upon an eastern European workforce or high agency usage are now feeling the same pain in their warehouses across the UK. For some Retailers this has resulted in volume caps in line with available capacity, and wage rates are starting to increase significantly to support the retention and recruitment of the necessary resources for peak.

Non-Food online businesses are already increasing wage rates and offering large joining incentives to attract warehouse workers to cover their seasonal peak during October and November. Given the size of some of these companies and the gravitational pull they have on the labour market, this will suck a disproportionate amount of resource out of the remaining labour pool.

THE RUN UP TO CHRISTMAS

Essentially last year Christmas was cancelled, and the general view is that this year will be one of the biggest Christmas peaks for many years as consumers make up for 2020. The shape of Christmas may however not be in its traditional form and there are some significant concerns about how trading will materialise.

There is widespread and fully justified apprehension about the sector's ability to cope through the non-food peak of October/November and the Grocery peak in December. Supply chain disruption has been felt throughout the summer and volumes are about to increase significantly with no more resource available to process and deliver volume.

The Consumer And The Fragile Supply Chain

Visible gaps on the shelves because of resource shortages and inbound service levels, general global stock scarcity and range rationalisation, the well-publicised lack of CO2 and its impact on food production and delivery, reports coming from industry of shortages and delays of key seasonal lines such as turkeys and toys. As these issues build through the next few months, the current fragility of the Retail Grocery sector could quite easily be exposed.

Whilst we have not seen consumer panic to the same extent as the beginning of the pandemic, public reaction to the first signs of fuel shortages at UK forecourts recently is a very strong reminder that it doesn't take much to trigger panic buying.

Brexit

With the exception of Retailers who service stores in Northern Ireland from mainland distribution centres, Brexit has so far not had too big an impact on the supply of goods moving across European borders. There are concerns that this will however become more challenging in the run up to Christmas because of the seasonal switching of produce supply as the UK moves into the Autumn / Winter season. This increase in Southern European produce volume will further test the resilience of post Brexit supply chains.

Consumer Spending Power

The domestic economy is starting to reveal the longer lasting implications of the pandemic and Brexit, and prices everywhere are on the increase. Wages, raw materials, energy, fuel, shipping, road transport, warehouse space and Brexit related administration costs are all increasing significantly and at the same time. These cost increases are already hitting the front-line and the impact on consumer spending power is set to continue for the foreseeable future.

IMMEDIATE PRIORITIES

Understandably at the moment, the priorities for UK Grocery Retail are very tactical. Putting aside the distractions of recent ownership changes for a couple of Retailers and existing network re-engineering projects in others, the focus is generally on three things in the run up to Christmas:

- 1. Post lockdown trading patterns** – establishing the 'new normal' trading patterns across multiple formats and channels
- 2. Short term supply chain resilience** – securing the inventory to protect availability
- 3. Resourcing for peak** – recruiting and retaining enough labour with the right skills to process seasonal volumes

LOOKING AHEAD

When Retailers sit back and consider the seismic, and in many cases permanent, impact of the Pandemic and Brexit, their focus is already looking towards four strategic areas:

- 1. Cost reduction** - The economy is turbulent; cost of goods and Retail prices are on the increase and disposable income is under threat. Discounter relevance will return and the need to take cost out of stores and the supply chain to invest in price has always been a priority for the highly competitive Grocery sector. The rapid acceleration of Grocery home shopping participation will further fuel the need to find efficiency and limit the impact on the P&L.
- 2. Format and Channel participation and profitability** - What does the new normal look like, where should a Retailer expand or contract, how do we make it profitable? Supply chains will need to respond to this to accommodate the needs of their customers in a more efficient way.
- 3. Supply Chain re-engineering to create greater control and security** – Including sourcing resilience, low carbon, servicing Northern Island under Brexit, and the adoption of automation and technology within the supply chain and operations.
- 4. Recruitment and retention** – Businesses are now having to look urgently at moving away from the use of agency workers in favour of own employees, improved working conditions, shift systems with greater work-life balance and wider benefits. Without doubt, the pandemic has accelerated the change of attitude towards work and companies are starting to recognise this and are acting upon it.

BIS HENDERSON SUPPORTING GROCERY RETAIL

Shaping the future to secure resilience, performance and profitability for 2022 will be both an exciting and a challenging time for Retailers.

Here at Bis Henderson we're poised ready to take that change journey with you.

In our work with Retailers, we navigate the myriad of options for automation, to drive productivities and accuracy, deliver capacity and operational resilience, and enable sales growth with improved customer service. We design new processes and space layouts to 'sweat the assets' and to lower cost to serve. We find the right partners for Retailers to work with and benchmark KPIs and costs to ensure commercial value for money in contracts. We are at the forefront of micro-fulfilment and urban logistics thinking with a range of Retailers. **Success depends on expertise.**

For further information please visit www.bis-hendersonconsulting.com