KANTAR

Whitepaper

The Impact of Brexit on UK Grocery Industry and Shoppers

The present, the near future, and scenarios for what may happen over the next 18 months

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Unsurprisingly, the foods and nutritional supplements that Britain consumes have diversified in the past 30 years, both in terms of where they originate from but also in how they are organised and supplied by retailers and distributors across the food chain.

To satisfy British consumers' global taste buds, every major supermarket provides either a dedicated World Foods section in-store or lists World Foods ranges throughout the year. Therefore, it should come as no surprise that grocery retailers have major concerns when it comes to what type of Brexit is negotiated over the coming weeks.

Consumers will still want to enjoy the 'Tapas of Spain', the 'Kitchens of Italy' and 'France's award-winning wines' even after Brexit. Grocery retailers will need do their best to satisfy these desires, but surely Brexit will change some, if not most, of the ways they deliver to the public.

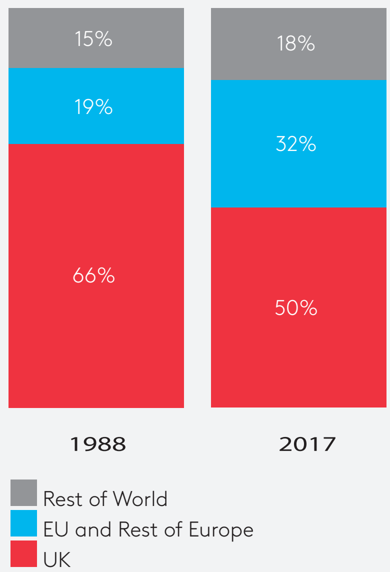
According to the Department for Environment, Food & Rural Affairs in 1988 domestic foods accounted for 66%, or two-thirds, of all foods in Britain. Today, that figure has fallen to 50%, or half. Much of the new consumption has arrived from the European Union. However, it would be wrong to ignore the gains made in food sourced from the four corners of the globe, which has expanded from 15% to 18% of all food by origin.

When looking specifically at Europe, 32%, or approximately one-third, of all food in Britain arrives under EU guidelines. Some of this is non-perishable imports, such as wine, which can be safely stored and shipped for long periods of time. Equally, much of the imports from the European Union are perishable, like fresh fruit, vegetables and flowers, where time is of the essence. Distributors and retailers need to get the produce from their origins onto grocery shelves as quickly as possible to guarantee quality, food safety and avoid wastage.

A quick look at fresh foods provides a stunning picture. 62% of all fresh foods in Britain are imported, much from the EU, and almost half of those goods (46%) originate from Spain with an additional 22% from the Netherlands.

The result is that grocery retailers, especially those providing fresh fruit, vegetables, and flowers, will need to take precautionary measures as uncertainty around the type of Brexit that will be negotiated increases and the remaining preparation time begins being measured in days. Nothing looks more frightening than grocery shelf signage stating: "Due to sourcing challenges this shelf is empty".

Diversity of Food in Britain by Origin



Source: Department of Environment, Food & Rural Affairs, 31 May 2018

Figure 1. Food in Britain, by Origin, 1988 & 2017

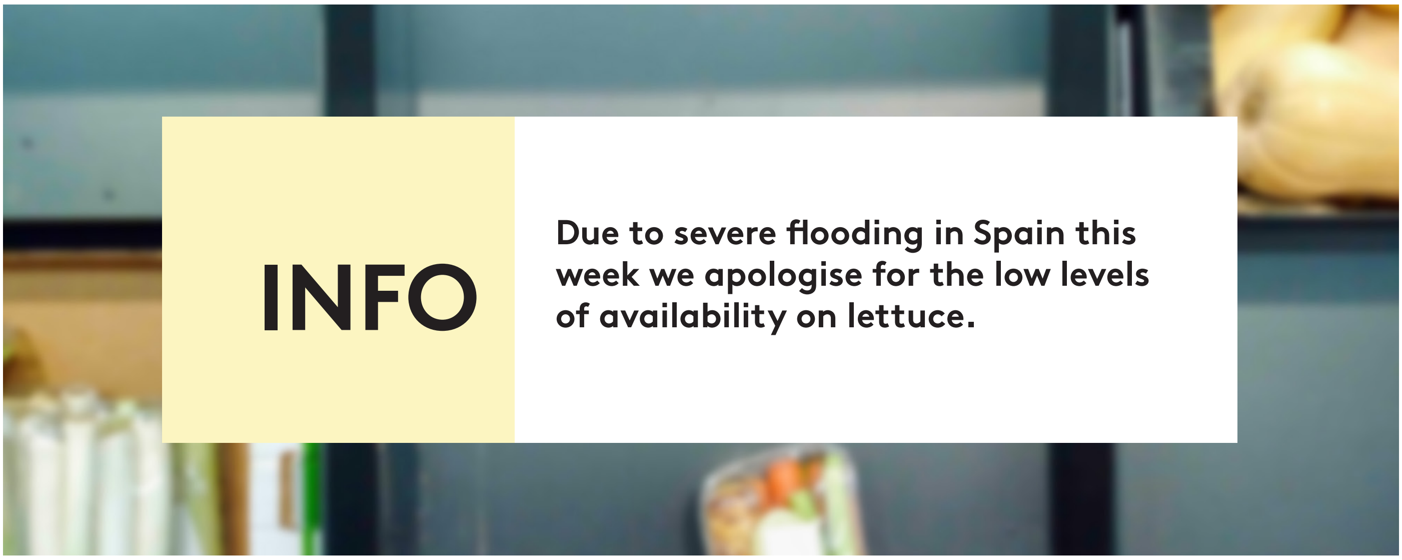
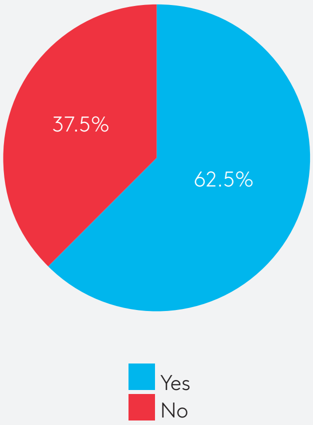


Figure 2. (Above) Fresh vegetable shortage, in-store signage 2017

In this paper, we look at the precautions grocery retailers operating in Britain have taken prior to February 2019, the measures they will take between now and the current scheduled Article 50 deadline of 29 March 2019, and identify the permanent or long-term changes many grocers will implement post-Brexit.

Are you worried about the prospect of a no-deal Brexit?



Kantar Worldpanel Plus survey of 7,008 respondents undertaken 1 Feb 2019

How Will Britain's Shoppers Respond To Brexit?

The 'B' word is never far from the British consciousness, but the perils of more difficult trading relationships for UK brands, suppliers and retailers are not exactly the same as those faced by FMCG shoppers and consumers. On the whole, people are unaware of sourcing or the logistics behind goods getting to supermarket shelves.

What shoppers do notice is range, availability and price. Fresh fruit and vegetables are at the most immediate risk of reduced choice and stocks in the event of a disruptive Brexit. While UK consumers may seek provenance from their products, and want to buy locally and seasonally, the facts suggest that in reality they shop differently.

For example, only 41% of the strawberries bought in Britain are consumed in June, July and August. Supply during much of the rest of the year depends on Europe and North Africa. Tracking the national source of such foods is surprisingly difficult as, for example, retailers change suppliers from Morocco to Spain to England as the season progresses.

One

The Present - grocery retailers and extraordinary measures taken to prepare for Brexit up until February 2019

Unlike clothing, medicines, alcoholic beverages and electronics, it is very difficult to stockpile foods in a pack size designed for family consumption. Grocery retailers have been stockpiling but mainly at the wholesale level and primarily in the ingredients categories they use to produce own-label goods. Examples would be dried milk powder, wheats and grains, raw and refined sugar, and other commodities bought by the tonne.

Rather than stockpiling perishable goods, retailers have instead invested in several changes to how they source and merchandise fresh products. Kantar has identified six ways grocery retailers have prepared themselves up to February 2019, and what it means for consumers.

1. **Buying varieties of products that have longer shelf life.** One way to guarantee consumers have their fill of fresh product is to ensure the product can withstand travel and storage. Grocers are testing which varieties of tomatoes, avocados, and oranges can stay fresh the longest and then contracting with suppliers to guarantee availability. Impact on consumers: Different varieties have different tastes – so consumers may want to try before they buy to be sure of getting the most for their pound spent.

2. **Investing in Local.** The 'Buy British' campaign has been around for a long time, with a heavy focus on proteins such as beef and fish. In 2019, many retailers will encourage consumers to buy locally, with Easter flowers the first potentially post-Brexit opportunity for retailers to demonstrate just how well they can source from Britain. Still, surely Britain would never really dent Dutch Pride when it comes to flowers. In some categories, local varieties will be an ideal substitute for European-grown versions, yet in others the European version will still be consumed, but perhaps at a higher cost and lower frequency or quantity.

3. **Delisting Products.** Unknown by many consumers, retailers conduct regular range reviews with leading suppliers to decide which products can fit on a supermarket shelf and which cannot. This year, many retailers are simplifying their imported ranges and maximising where the before-and-after Brexit situation is confirmed. Consumers may see some changes in what is available every week through the year with more space for offers where retailers can respond quickly to opportunities and deliver surprise. This should make shopping more exciting for consumers that like to try new items and experiment with ingredients. Those that prefer to buy the same items each week may find the situation more complicated.

Categories at risk

Some consumer trends show how high prices can be ignored when the need or desire is strong enough. For example, craft gin and associated premium tonics or 'free-from' dairy alternatives have grown strongly despite costing much more.

Categories without such tailwinds should be alert to the dangers of shoppers trading down. A strong private label presence and a large price gap below mainstream brands gives shoppers an easy way to save money post-Brexit. Where there is a large choice of rival brands in repertoire markets consumers have ample opportunity to shop around for cheaper prices.

Widespread availability in discount retailers and a reliance on less affluent shoppers are likely to amplify the risk.

4. **Rejecting Fewer Items.** Historically, retailers have had very strong rules related to the size, shape and colour of fresh produce items. There are two reasons for this. First, they know shoppers will 'buy automatically' when everything looks perfect and ready to go, encouraging a speedy shop, benefiting both retailer and shopper. Secondly, over time, consumers have become very picky when it comes to what they'll buy, so retailers have a wastage problem if a fresh item goes unsold due to appearance. In recent years, retailers have introduced 'wonky' ranges to re-educate consumers and eliminate waste. As Brexit draws near, retailers will be rejecting less than ever. Ultimately, this means many shoppers will need to spend extra time learning how to pick their own. Overall, this may help retailers accelerate the war on packaging/plastics, on food waste, and on obesity. The only downside is that shopping will take just a little bit longer than before, unless you ask the retailer to pick for you.

5. **Providing 'Eat Seasonally' Educational Materials.** Yet another method retailers use to get consumers to buy British is educating them on the best products at different times of the year. Consumers that eat freshly farmed courgettes and switch to another choice when courgettes go out of season are far more likely to buy mostly from Britain than consumers demanding courgettes on their plates 52 weeks of the year.

6. **Merchandising Stores Differently.** Finally, a small group of retailers are working hard to identify stores that possess different requirements based on consumer switching data. They are testing how consumers respond when faced with a difficult choice such as having to buy imported vegetables when domestic varieties are out of stock or vice versa. Likewise, they are testing to see how behaviour changes when something that can only be sourced overseas goes out-of-stock. Consequently, these retailers have identified certain stores with 'sensitive' consumers – those unwilling to switch buying habits when confronted by such a dilemma. In these stores, the retailer will plan to stock imported products in a post-Brexit environment the same as usual. Other stores, where consumers will change according to availability and price, will have more agile assortments in future. The good news for shoppers is that two supermarkets under the same fascia might have different varieties available, meaning shopping online and shopping around may well provide greater satisfaction for consumers that can spare the time.

Kantar believes that most of the measures being enacted right now are both sustainable for retailers and better for consumers. In total, the investments being made to ensure a smooth Brexit are those required under any circumstances to help make the UK a healthier, more environmentally friendly nation. In some ways, we should be thankful that Brexit has injected more urgency into these initiatives.

Lessons from past recessions

If Brexit does trigger an economic slowdown, there is no guarantee this will hit overall grocery sales. The sector as a whole has shown itself remarkably inelastic to financial ups and downs. This is due to the non-discretionary nature of most FMCG purchasing.

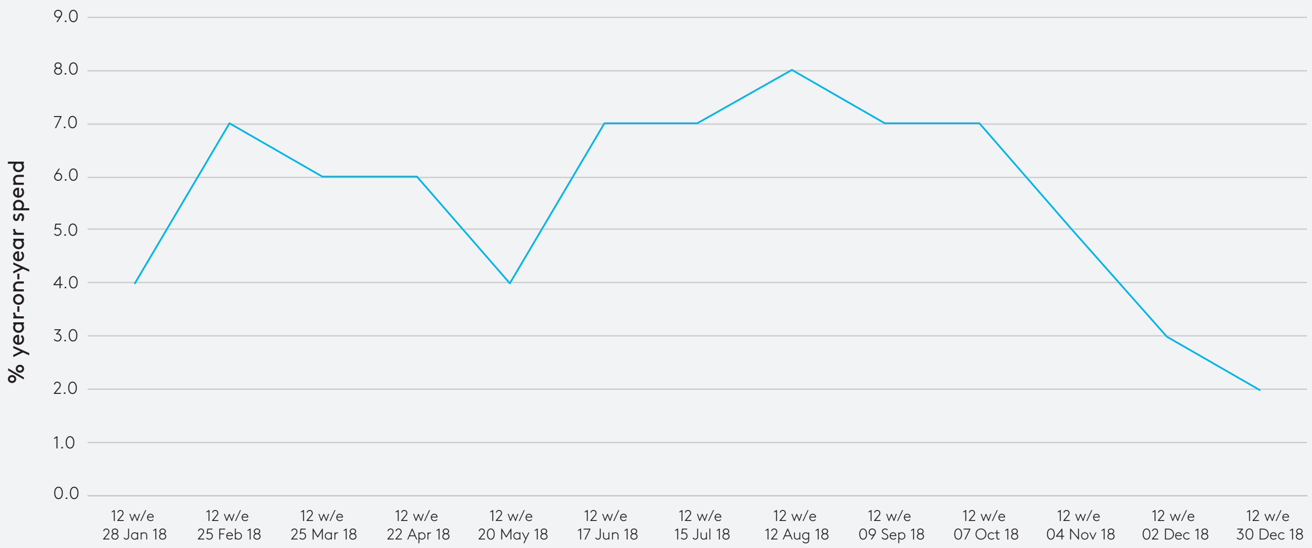
In fact, attempts to correlate macroeconomic indicators such as confidence, wage growth or GDP with supermarket sales are highly unsatisfactory. The one measure reliably influencing shopper behaviour is the rate of grocery inflation. Put simply, to escape higher prices shoppers will find ways to moderate their spending.

If tariffs are imposed or there is a further decline in the value of sterling, prices at the tills will inevitably rise. It is by looking back to previous periods of weaker growth and higher inflation that we can gauge the likely consumer response to Brexit.

By the end of 2018 we had already observed several recessionary behaviours, which look familiar from the post-2008 recession. The long-term trend of choosing foods for health reasons has plateaued. At the same time, levels of snacking has increased.

The number of lunch-boxes taken to work by adults has risen, a sure way to save money compared to buying from a sandwich shop or canteen. Overall out-of-home food and drink growth has also slowed, after booming in recent years.

Pre-recessionary behaviour: Out-of-home food and drink growth is slowing



Kantar Worldpanel out-of-home purchase

Two

The Near Future - grocery retailers and extraordinary measures to prepare for Brexit from 1 February to 29 March

At time of publication, neither the UK government nor the EU have moved to extend the Article 50 deadline from 29 March to some other date. Consequently, most retailers have established special crisis management teams to make sure that, in the event of a no-deal Brexit, they can continue operating.

Most of the initiatives being planned will have no direct consumer impact while the one-off additional costs of these preparations will not result in any price increases on individual lines. Retailers will need to fund these costs but will do so using existing budgets. This means they will do fewer things this year with their budgets compared to years where certainty over import/export trading arrangements was assured.

For most retailers, the three key areas of concern of a no-deal Brexit are sterling-euro and sterling-dollar exchange rates; import inspections and processing procedures, and general security. In this section we look at what retailers have done and will do to be crisis-ready should a no-deal scenario become a reality.

1. **Currency Exchange Rates.** The finance departments of every large retailer will work in three ways to lay the sturdiest foundations possible should sterling be devalued in the near future.

    a. **Currency and Contract Hedging.** They will work with suppliers and banks to create currency hedges. These will have been explored generally leading up to 1 February but will intensify and become more specific leading up to 29 March. More forward purchasing will occur than is normal.

    b. **Cash Reserves.** Each major retailer will set aside additional cash to insure against unexpected scenarios related to wild swings in currency rates or in prices.

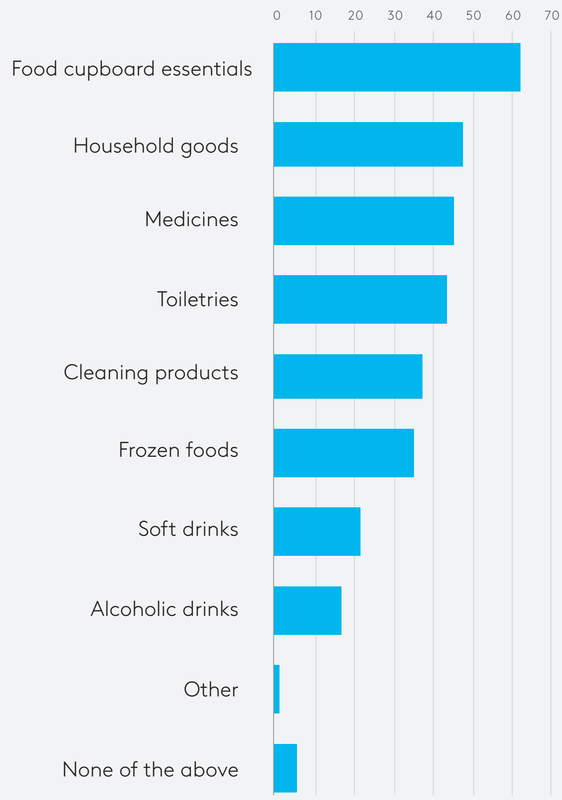
    c. **Direct Sourcing.** Finally, many finance leaders have temporary sourcing arrangements in place which will go into effect only in the case of a no-deal Brexit, oftentimes using owned warehouse facilities in European Union locations, including the Republic of Ireland. These sourcing agreements would cut out elements of the supply chain where suppliers typically pass on higher exchanges directly into the Cost-of-Goods.

Shopper stockpiling

'Prepping' for a logistical Armageddon has moved swiftly from the fringes to the front pages. While only 10% of consumers claim to have created a stockpile by early February, another 25% are considering it. The already-hoarding rate is twice as high among those preferring to remain in the EU compared to those happy to leave.

Non-perishable food cupboard essentials are the most popular category to stockpile, followed by household goods and then medicines. As yet, there has been no evidence in take-home sales data of a stockpiling boom, and nor are we likely to see anything until the very last weeks leading up to 29 March in the event of no satisfactory withdrawal agreement being signed.

Of the 10% already stockpiling, and the 25% considering stockpiling, these are the categories chosen



Kantar Worldpanel Plus survey of 7,008 respondents undertaken 1 Feb 2019

2. **Import Inspections and Processing Procedures.** The supply chain teams at every major retailer will begin temporarily stockpiling substitution items in readiness for a no-deal Brexit but will also make additional contingencies, including but not limited to:

    a. **Temporary Container Units.** Tesco has publicly stated that it did not return temporary freezer containers rented during the Christmas period to the hire company to guarantee their availability in the event of a no-deal or disorderly Brexit.

    b. **Additional Border Inspectors.** Lidl, like Tesco, announced it would be hiring additional border and customs officials to fast-track their own imported goods.

    c. **Electronic and Software Investments.** Many retailers will be upgrading and investing in electronic ordering and new software to speed up processing times in the event of having to file more applications and obtain more approvals.

    d. **RO-RO Logistics Changes.** Standard English Channel shipping uses 'Roll on, Roll off' (RO-RO) ferries. Many companies are investing in boosting capacity for these vessels by, for example, switching to double deckers. Others are moving away from the highest frequency/highest traffic routes to new ports and new routes. Some are even moving away from RO-RO shipping altogether in favour of more operations that are more complex but less likely to face disruption.

    e. **Plan B Procedures.** Several other retailers are developing Plan B operational procedures in the event that their container fails to pass inspection or that contracted supplies are no longer economically viable in the UK. This is made easier in strategic purchasing alliances such as the relationship Tesco has forged with French retailer Carrefour. Should one of Tesco's orders be prevented from reaching the UK in a timely or cost-effective manner, Tesco now has a direct relationship with Carrefour which opens up options previously unavailable to the company.

3. **General Security.** Retailers are implementing new security measures and working with local police forces on additional protection should protests, looting or rioting erupt that would compromise the safety of the retailer's goods or the safety of its workers and supply chain partners. These measures primarily relate to additional staff availability should an unexpected need arise. The wider expectation is that on the whole the public will behave in a peaceful and law-abiding manner.

Kantar views most measures being undertaken between 1 February to 29 March as temporary activities that will mostly disappear once the confusion over Brexit lifts and business returns to normal. From a consumer perspective, they will go unnoticed and have no direct impact on how grocery retailers communicate with shoppers.

However, we also believe two types of retailers will emerge. One will be cautious – a retailer investing heavily in putting all precautions in place ahead of its competitors, and ready to capitalise should Brexit proceed in a disorderly or no-deal fashion. Its counterpart is the 'it will never happen to me' retailer that blithely assumes politicians will come up with a last-minute solution to maintain the trade flow status quo.

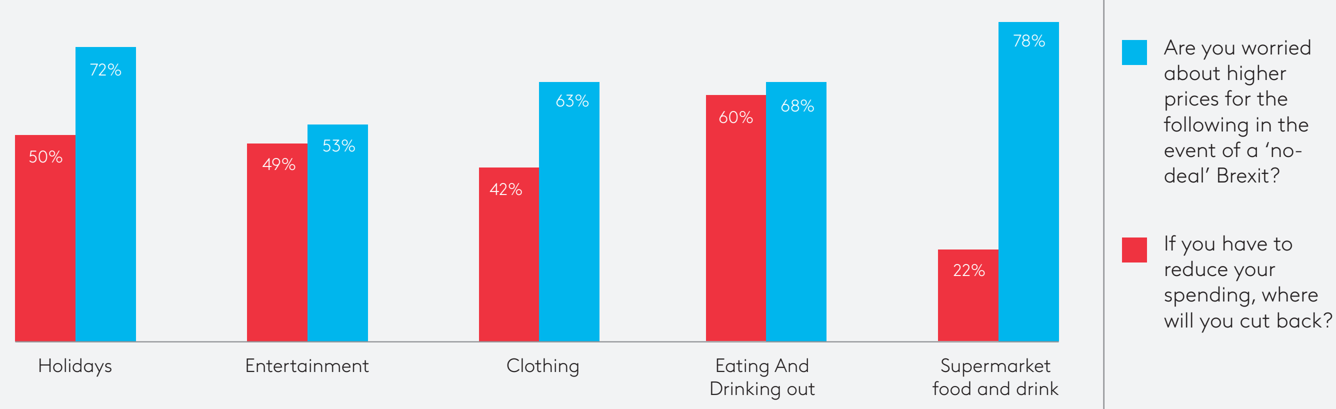
No one can say for sure which will be best-placed come 30 March. However, it is clear the 'Extreme Caution' type is using Brexit as motivation to engage in top-to-bottom spring cleaning of their business. Therefore, Kantar views this group as the most likely winners in any scenario.

Cutting back on groceries

Grocery bills are top of mind for many. Nearly 80% of people are worried about the price of supermarket food and drink in the event of a no-deal Brexit. These concerns diminish with age, but remain a worry for two-thirds of the over 65s.

Despite being the most worried about slice of household expenditure, groceries are, in fact, the least popular piece of spending on which to cut back. Only 22% claim they will actively cut back on their supermarket spend, well behind eating and drinking out (60%), holidays (50%) and entertainment (49%).

Shoppers are worried about higher grocery prices but don't see much room to cut back



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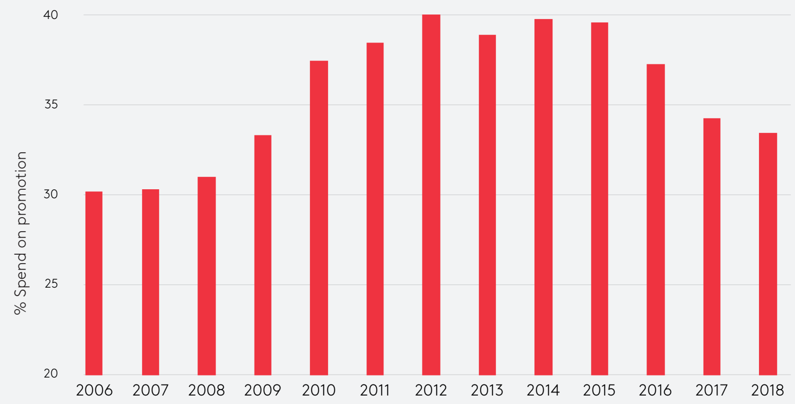
This reinforces the notion that the grocery industry will be insulated from the worst effects of a Brexit-induced spending squeeze. That isn't to say totally immune, as we have previously observed sharp changes in shopping patterns, such as the reaction to grocery inflation reaching 9% in 2009.

In the face of higher prices, shoppers can economise in four ways:

1. Buying less volume is the first option, but cutting back overall grocery purchasing is rare. During the post-2008 recession, UK take-home volumes continued to grow. Individual discretionary categories are more at volume risk, but if this happens it is more likely to be triggered by other consumer trends than prices alone.

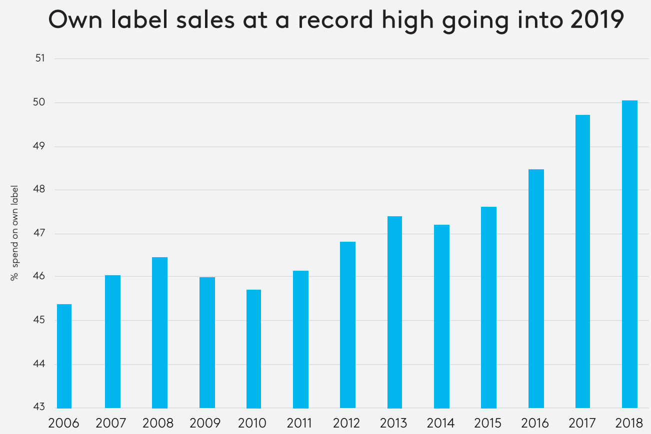
2. Buying more on promotion was certainly an option in the last recession, and deal levels rose sharply to 37% by 2010. Promotional levels are currently falling as retailers find new ways to communicate value through some form of Everyday Low Pricing (EDLP) or revamped private label ranges.

Rapid promotional de-escalation in last 3 years



Kantar Worldpanel take home purchase

3. Choosing cheaper products has been a theme from the last few years, facilitated by increased own-label presence and focus from retailers across the price spectrum. Own-label sales now account for half of all UK grocery sales, up from 47% five years ago. It remains to be seen if the British consumer still has an appetite to buy ever more own-label goods.



4. From 2010 onwards, discounter market share in the UK took off, showcasing the fourth money-saving tactic – shopping at a cheaper retailer. If published store opening plans by Aldi and Lidl are executed, the retailers would be set to grow regardless in the next five years, but any Brexit-fuelled financial shock would only help their cause.

What people say and what they actually do should not be regarded as the same thing, but nevertheless 72% of people say they would shop around retailers other than their usual supermarket in the event of higher prices. Unsurprisingly for a question of that nature, Aldi and Lidl are the most popular destinations, but the cheaper price perceptions of Asda and Iceland are evident too.

Three

The Post-Brexit Landscape - grocery retailers and extraordinary measures taken to prepare for Brexit after 29 March (or an extension date)

A post-Brexit world is difficult to comprehend without an agreement of some kind in place. Still, when speaking with retailers about how they will do business once Britain leaves the EU four big issues arise. We can briefly summarise retailer concerns as centred around these four topics:

1. **Immigration Policies - Staff/Workers.** Many jobs in retail are considered entry-level, with candidates for positions not requiring many prior qualifications to be hired and most training provided on the job. For these reasons, retail jobs often attract candidates just arrived in the country and lacking language fluency or other skills that long-term foreign residents possess. The Office of National Statistics organises the labour market into nine industry sectors. Within these, retail, classified as 'distribution, hotels, and restaurants', boasts 9.7% of all workers holding EU passports. This is the second-highest rate of EU employment in Britain behind manufacturing. The 9.7% average hides a strong regionality within the data. Among the reporting 12 regions reported by the ONS only two are higher than the national average – London at a whopping 22.5%, followed by Northern Ireland at 10.5%. The North-East of England and Wales have much lower rates of EU staff in the distributive and service trades with 4.5% and 4.4% respectively.

2. **The Irish Border.** Likewise, many retailers are concerned as to how the Irish Border will be managed, particularly if it becomes an opportunity for small-scale operators to create price disruption by listing items for sale on websites or classifieds using peer-to-peer exchanges.

3. **Tariffs and Accounting.** No matter what kind of Brexit is agreed, retailers are aware that many changes will take place demanding new rules around applications, product labelling, shipping labels and procedures, tax filings and all manner of back-office functions. Right now, retailers are working flat out to recruit, reward and retain the best talent in these functions and increase staffing levels for the next three years at least in readiness for the substantial workload this will entail.

4. **New Opportunities.** A small group of retailers, anticipating the possibility of closer free trade arrangements with countries considered UK allies, but outside the EU, are sending buyers and representatives on exploratory missions to Canada, the USA, Australia, New Zealand and other large food-exporting countries.

Case Study – Kantar talks Brexit with a Major High Street Retailer

When most people think about their local high street shop, they do not think sourced from the Netherlands or imported from Sweden. Nor, when that same shop is 'British-owned' do they imagine a multi-continental retail giant. However, Kantar had an opportunity to discuss Brexit planning with just such a retailer – a staple of the British High Street, British-owned and British-operated – but with investments and sourcing relationships all over the world. We checked in with them to see how retailers are dealing with Brexit in the run-up to the 29 March Article 50 deadline.

The first thing the high street chain's management is eager to point out is that they are both a strong British and European business. While the company's #2 and #3 overseas markets by number of locations are India and Hong Kong, the European Union qualifies as its #2 market if all countries are considered a single market. The company also has hundreds of stores in EU countries, and has major import/export warehouse investments in the Netherlands and the Republic of Ireland. Practically speaking, this allows the retailer to spot hit products being sold in Scandinavia and rapidly bring them to British consumers and vice versa. The new product innovation pipeline is essential in catering to fast-changing consumer tastes.

Management further states that, due to their extensive high street presence, employment of EU staff and operations in many EU countries, the company serves as a barometer for the UK government when judging how retailers are feeling about Brexit. Despite headlines to the contrary, both Brussels and Westminster are eager to know what companies like this are doing to prepare for Brexit.

Its approach to Brexit was clearly formulated once the leave vote was delivered and has not wavered since. "We were faced with a high-risk scenario and a medium-risk scenario," management states, "The medium-risk scenario – proactive investment at affordable levels to guarantee as smooth a Brexit as possible - made the most sense for our business, our customers and our staff. The alternative would be to risk crisis."

This approach appears to be paying off. Management says investments the business made in warehouses has given it more flexibility and ultimately has helped with its overall mission of maintaining a high pace of new product innovation, with products sourced worldwide, not just from the UK or EU. Still, the company is not sitting back and waiting for Westminster and Brussels. Its strategy encompasses five areas of risk mitigation, which include:

1. Debt restructuring to balance sterling and euro cash flows
2. Changes to sourcing with new logistics, higher levels of local purchasing and stockpiling
3. A new employment policy to help manage the 10% of their workforce in the UK that are EU nationals
4. A new set of accounting policies and procedures to manage tariffs
5. Flexibility in supplying Ireland, both North and South

Conclusions

While a definitive overview of the post-Brexit grocery landscape remains unknowable, with British employment levels at an all-time high and unemployment the lowest in living memory, it can be said that the sector faces medium-term challenges around sourcing adequate levels of staff, particularly in London and potentially also in Northern Ireland. This will disproportionately affect grocery retailers with large portions of their estate in London but may yet be relieved to some extent if UK immigration remains open to EU nationals and even expands to allow easier employment of overseas nationals hailing from beyond the EU.

The net effect of these changes in the medium to long-term will be added incremental indirect costs to doing business as a grocery retailer in Britain. The first of these relates to higher wages, as a labour shortage encourages retailers to raise starting and long-term wages to attract talent. Further costs relate to a need for extra back office staff, thereby inflating head office wage bills.

All these costs can be pro-actively offset by retailers investing in new technologies like robotics, Artificial Intelligence (AI), Blockchain ledgers and accounting, pricing and sourcing algorithms and more. These technologies will not reduce the need for staff but will make the work of existing employees more efficient, helping retailers keep cost rises in check.

Kantar's view is that, as a result of Brexit, many of Britain's grocers will find themselves at the global forefront of exploring new retail technologies. This can only be a positive for Britain's labour force, British consumers, and the country's ability to attract investment and partnership.

About the Authors

Fraser McKevitt
Head of Retail and Consumer

In over a decade at Kantar Worldpanel, Fraser McKevitt, Head of Retail and Consumer Insight, has helped advise some of the country's biggest brands and supermarkets.

He is an expert in ever changing consumer and shopping behaviours, explaining how and why these trends influence and impact both manufacturers and retailers. He closely watches and describes as the grocers battle competitively for market share each month. Fraser's opinions are regularly sought by the industry, broadcast media, national newspapers and the business press.

Ray Gaul
Senior Vice President of Research and Analytics

Based in London, Ray is an expert in global retail trends, working with clients looking to understand how retail is changing across multiple countries and continents.

He currently focuses on pan-European retail topics, such as the expansion of grocery discounters, the rise of European buying groups and M&A activities among big retailers. Ray leads Kantar Consulting's dedicated forecasting teams that provide clients with future views to aid in key channel/account planning and also sits on Kantar Consulting's global centre of excellence for eCommerce. Ray joined Kantar Consulting in 2000 and holds a B.A. in economics and an M.A. in international relations with a focus on international economic policy.

KANTAR WORLDPANEL

Kantar Worldpanel is the global expert in shoppers' behaviour. Through continuous monitoring, advanced analytics and tailored solutions, Kantar Worldpanel inspires successful decisions by brand owners, retailers, market analysts and government organisations globally.

With over 60 years' experience, a team of 3,500, and services covering 60 countries directly or through partners, Kantar Worldpanel turns purchase behaviour into competitive advantage in markets as diverse as FMCG, impulse products, fashion, baby, telecommunications and entertainment.

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We track 1200 retailers globally, have purchase data on over 200 million shoppers and forecast social, cultural and consumer trends across the world.

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