



Retail Agility: The Long Game

COUNTING THE COST OF THE GLOBAL SUPPLY CHAIN CRISIS

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Introduction

The triple effect of Brexit, the pandemic and the war in Ukraine has driven supply chain costs to new heights and revealed areas of over-reliance and inefficiency in global supply networks.

However, while some may have hoped the supply chain crisis was a short-term issue, our latest research among the UK's top 100 retailers reveals that 87% believe things will not go back to how they were before the crisis began. Retailers also believe higher costs are here to stay.

Given the concurrent cost of living crisis in the UK and the need to keep making progress with ESG commitments – including reducing their carbon footprint – retailers face the difficult challenge of managing costs when consumers are demanding higher availability, quicker deliveries and more ethical shopping, but also tightening their belts. While seller and buyer must both adapt to this new landscape, competition remains high.

Our research also reveals a great disparity in retailers' responses to the crisis. While the majority are doing something, this ranges from small, incremental changes to restructuring – suggesting many retailers are undecided or working through some fundamental constraints, such as cost barriers.

Our report takes a closer look at the areas where retailers are being forced to adapt, including:

- Cost management
- Supplier management
- Transport and near-shoring
- Staffing, robotics and automation
- Warehouse and logistics

We hope you find this report useful and look forward to discussing it with you further.

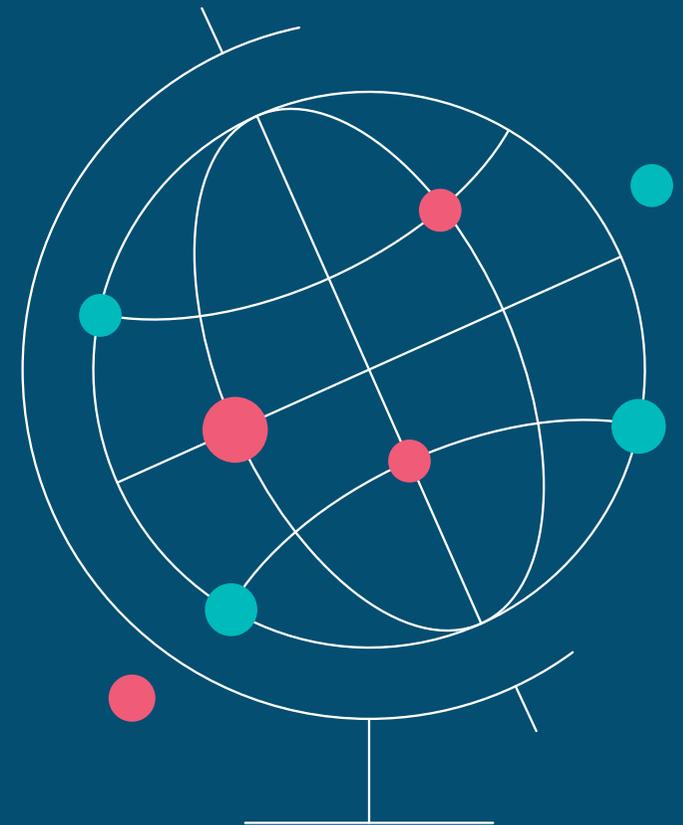


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Playing the long game

The supply chain crisis is a long-term issue requiring long-term solutions

Far from seeing the global supply chain crisis as a short-term issue, 87% of retailers say things will not go back to how they were before the crisis began. Two thirds (63%) say it will go back in some ways but not others, while a quarter (24%) believe things will never be the same.



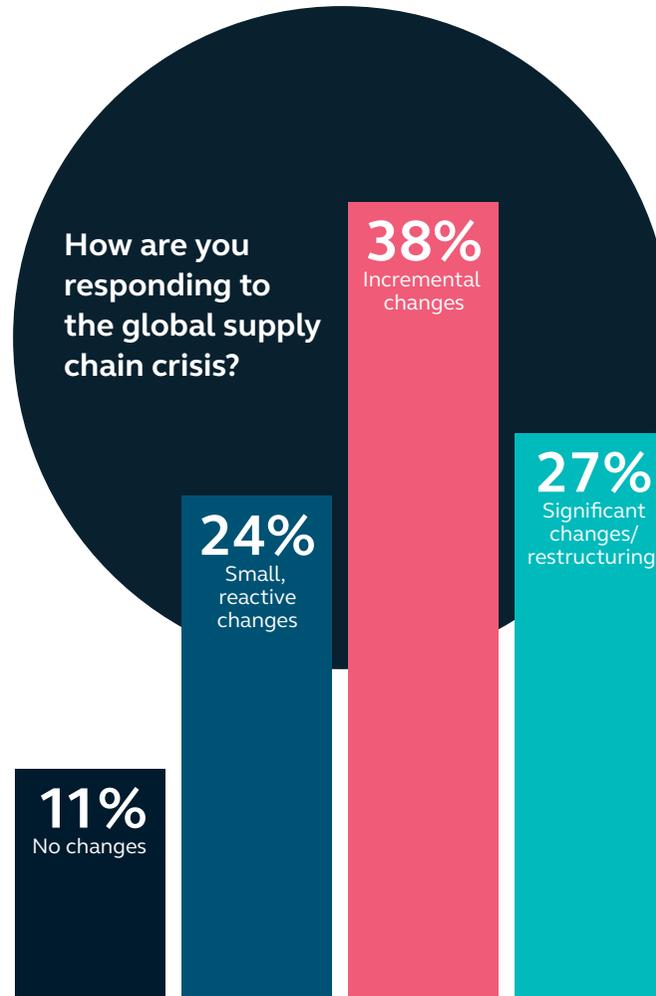
87%

of retailers say supply chains will not go back to how they were before the crisis

Retailers are overall doubtful that supply chain costs will return to pre-crisis levels, with 37% saying this is “unlikely” or “very unlikely”, and only 31% saying it is “likely” or “very likely”.

What’s more, despite the many widely-publicised issues with supply chains, two thirds (62%) of retailers say consumers are demanding higher availability and quicker deliveries.

As a result, the majority (57%) of retailers say the supply chain crisis is one of their top priorities at the moment, rising to 70% of grocers. However, while the vast majority (89%) of retailers are making some changes as opposed to waiting to see what happens, responses vary (see right).





Home retailers are the most likely to not be making any changes (19%), perhaps due to the strength of the current market for home improvement coupled with less flexibility in supply options, while grocers are the most likely to be making significant changes (30%) as they grapple with significant fluctuations in commodity prices.

Clearly, long-term issues require long-term solutions. Retailers are less confident now than they were three years ago about their supply chain's ability to cope with the demands placed on it over the next five years, suggesting the need for significant transformation.

Perran Jervis, head of retail and consumer goods at TLT, says: "This is no longer about managing short-term peaks in demand. Our research clearly shows a fundamental

shift in global supply chains, and retailers will need to recalibrate around the issues – from global commodity shortages, to interdependency on international trade routes and, increasingly, environmental concerns.

"The preference for incremental changes isn't surprising when you consider the financial and other difficulties with wholesale change, especially in the current economic climate. All retailers will have to find more financially and environmentally sustainable ways to manage their supply chains moving forward, looking at all options including sharing infrastructure, and consumers will need to come to terms with higher product and delivery costs. The government may well need to provide further support with this."



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Counting the cost

Managing the financial and environmental cost of change

Rising costs are retailers' greatest concern with regard to managing their supply chains (82%), with the biggest increases seen in fuel (86%), shipping containers (68%), raw materials (66%), supplier costs (65%) and technology (51%).

Environmental impact is also a top-five concern, which is significant given that retailers' environmental performance is under increasing regulatory scrutiny and with the regulators making it clear that allowances will not be made for extenuating circumstances such as the supply chain crisis.

The most common response to rising costs is the search for new efficiencies (68%), closely followed by passing costs onto customers via products (67%) and deliveries (55%), which is often seen as a last resort. Perran Jervis says: "Passing costs onto customers is never a preferred option, so this shows just how few alternatives retailers have been left with, and why so many are offsetting costs elsewhere – for example through steps like better staff rostering, warehouse automation, reducing wastage and reducing returns. Until now, many retailers have been avoiding investing too heavily in these other areas, but these are now becoming essential to their survival."

Top five concerns regarding supply chains



82%

Rising costs



64%

Product availability



64%

Recruitment and retention



60%

Environmental impact



52%

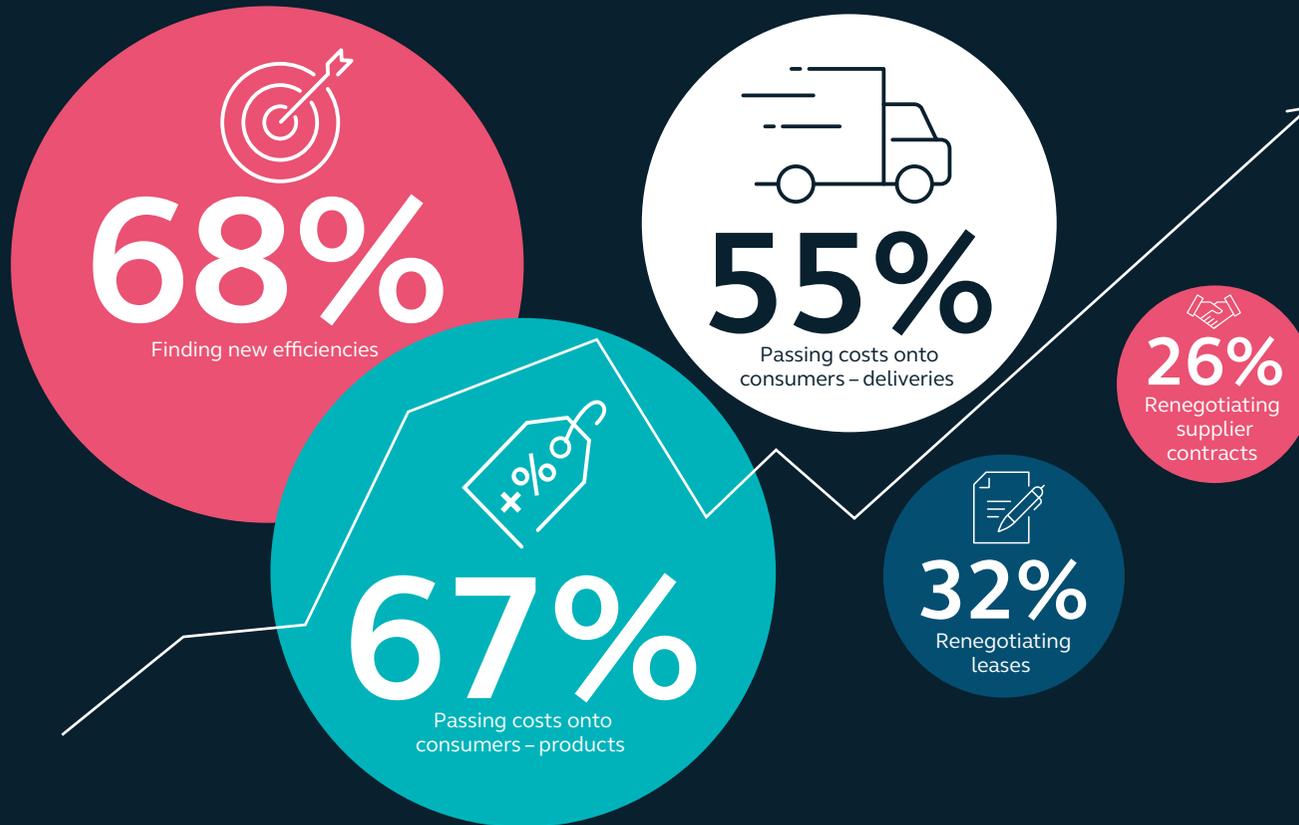
Workers' rights



Passing costs onto customers is never a preferred option...



Response to rising supply chain costs



Grocers (40%) and fashion & beauty (30%) retailers are more likely to be renegotiating existing supplier contracts than home (26%) and lifestyle & leisure (17%).

Home (37%) and fashion & beauty (36%) retailers are more likely to be renegotiating leases than lifestyle & leisure (27%) and grocers (20%), for example to reduce or forward-fix costs.

When asked about measures that have not previously been feasible but are now becoming more urgent, almost half (47%) of retailers say this includes fuel bunkering/hedging, 44% say closer stock management, two fifths (39%) say labour-saving technology and more than a third say near-shoring (36%) and using UK manufacturing and suppliers (34%).

Dan Read, technology partner at TLT, says: "Technology is vital in enabling closer stock management; retailers cannot afford to hold excess stock or for that stock to be in the wrong place at the wrong time as they rise to the challenge of meeting customer demands for higher availability and quicker deliveries.

"We are seeing increased investment in and deployment of warehouse and stock management solutions, which are becoming crucial in giving retailers live data on their inventory. A key pillar of these solutions is speeding up the move to the cloud, allowing the convergence of silos of existing data and the use of newer tracking, automation and RFID technology to provide valuable and real-time insights."

More than half (56%) of retailers say there is a risk of retailers cutting corners to save costs as a result of the supply chain crisis, with 26% saying they strongly agree this is the case.



A key pillar of [new warehouse and stock management] solutions is speeding up the move to the cloud...

Planes, trains and automobiles

The majority (78%) of retailers say changes to modes of transport is one of the longer-term issues affecting supply chains.

After sea freight became less feasible during the pandemic – due to port closures, delays, a lack of workers, a lack of shipping containers and, therefore, rising costs – air and road transport have seen the biggest increases in retailers relying on them more (20% and 17% of retailers respectively).

Which modes of transport are you using more due to the supply chain crisis?



20%
Road



17%
Air



9%
Rail



9%
Sea

While air and road circumnavigate the issues at sea ports, they are the most financially and environmentally costly ways to move goods, making them unsustainable in the long term. Rail remains more difficult due to reduced flexibility and over-dependence on unreliable infrastructure together with the additional cost of onward transportation from rail heads, which are seldom conveniently located.

However, over a third (35%) of retailers say it is becoming easier to justify decisions based on environmental concerns, while a quarter (26%) disagree, 16% are neutral and 23% are unsure, suggesting this is increasingly front of mind when deciding how to manage supply chains.



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Viewpoint



John Foster,
Director of CBI Policy Unit

Our retail members see the challenges arising from the global supply chain crisis as having medium to-long term implications, so it goes without saying that the industry is thinking about how to deliver long-term change. At the moment, the approach is often to make smaller, incremental changes, but this may become more substantial – for example, some retailers may need to change their focus – to reflect what consumers are looking for.

In terms of retailers' current priorities, the labour market has been severely affected by the displacement of jobs, especially in warehouses, leading to hyper-competitive recruitment between competitors, wage spirals and other incentives. The seasonality of the sector means we can expect these issues to intensify ahead of the Christmas period.

Input costs have also significantly eaten into retailers' margins, as they continue to work hard to minimise price increases for consumers. As a result, many retailers will

have had to delay or cancel major capital expenditure projects, even though this could have delivered long-term cost savings. There is some recognition that digital investments are necessary to realise the kinds of efficiencies that this "new normal" of supply chain economics requires, but it is important to also have the right supply chain infrastructure in place around that, and to invest in the right kinds of technology.

We are also seeing shifts in consumer behaviours – as a direct result of the cost of living crisis – such as switching to cheaper versions and foregoing what might be considered luxury items. As ever, retailers are having to stay alive to this and respond quickly, with a particular focus on maintaining the price point for 'essential' items.

In addition, retailers operate on low margins so even the smallest changes by the government – for example, national insurance increases – can have a big impact.

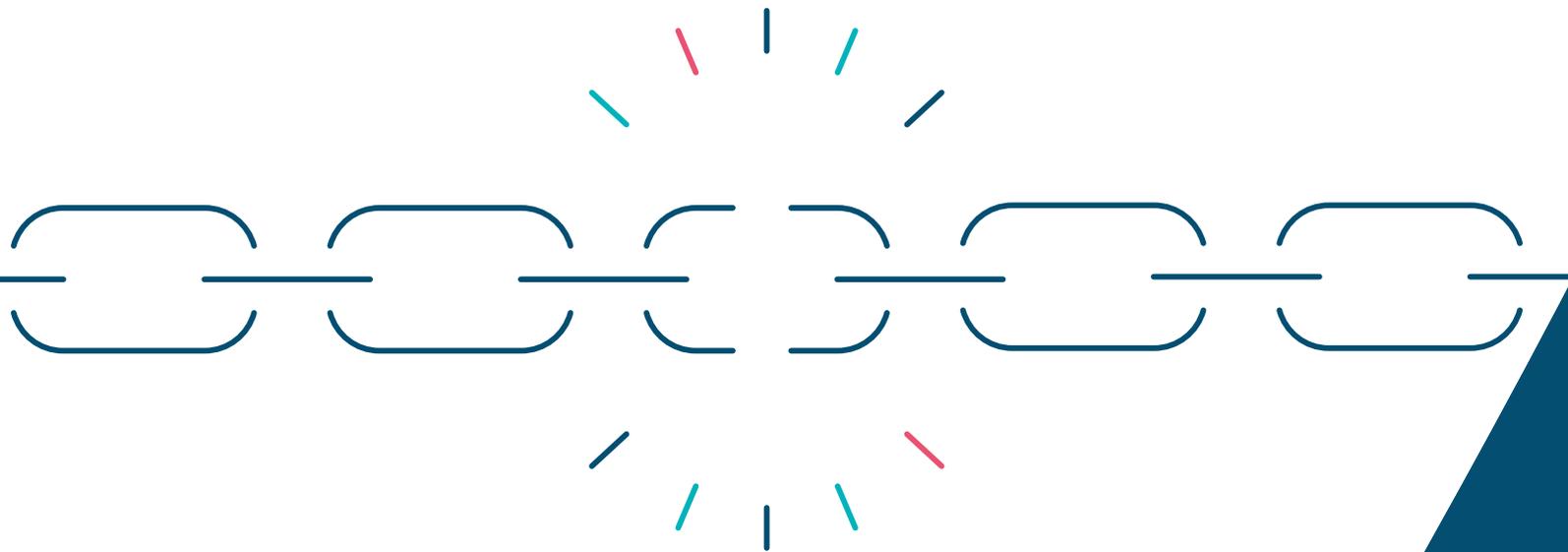
In terms of policy levers, business rates remain the biggest burden to investment for the sector. With the sector well positioned to support the government's levelling-up agenda through its employment and supply chain footprint, a fairer system would enable the sector to channel even more investment into local communities.

Guaranteeing supply

Retailers are building more flexibility into supplier networks

A majority (64%) of retailers also say that longer lead times with suppliers is one of the longer-term issues affecting supply chains. As a result, retailers are more likely to have grown (29%) than consolidated (20%) their supplier base in recent years to obtain more flexibility.

Duncan Reed, regulatory partner at TLT, says: “As well as longer lead times, we’re seeing disputes arising from suppliers renegeing on contractual commitments such as pricing, and threatening to take their business elsewhere. This is a highly unusual situation, and retailers will need to carefully consider their options. For example, what are the alternatives to ending the relationship, and what are the benefits of working with suppliers they’ve known for years and developed a certain degree of trust and understanding with versus having the opportunity to negotiate new contracts with alternative suppliers that are designed with the current market context and future-gazing in mind.”



The most popular locations for signing up new suppliers since the start of the crisis have been Asia (outside of China and India) (19% of retailers), China (15%), the UK (15%) and the rest of Europe (15%). The most popular locations for all suppliers now are Asia (outside of China and India) (76% of retailers), the UK (70%), China (67%), the rest of Europe (63%), India (54%) and the Middle East (52%). This suggests retailers are becoming less dependent on China, and sourcing closer to home – shortening supply chains, supporting the local economy and supporting the planet.

And in what could be a growing trend, a fifth (21%) of retailers are moving some of their manufacturing closer to home. Smaller proportions are planning to in-source some of their supply chain functions such as shipping/transportation (16%), warehousing (11%), distribution (11%) and sourcing raw materials (10%), but it will be interesting to see if and how this develops.



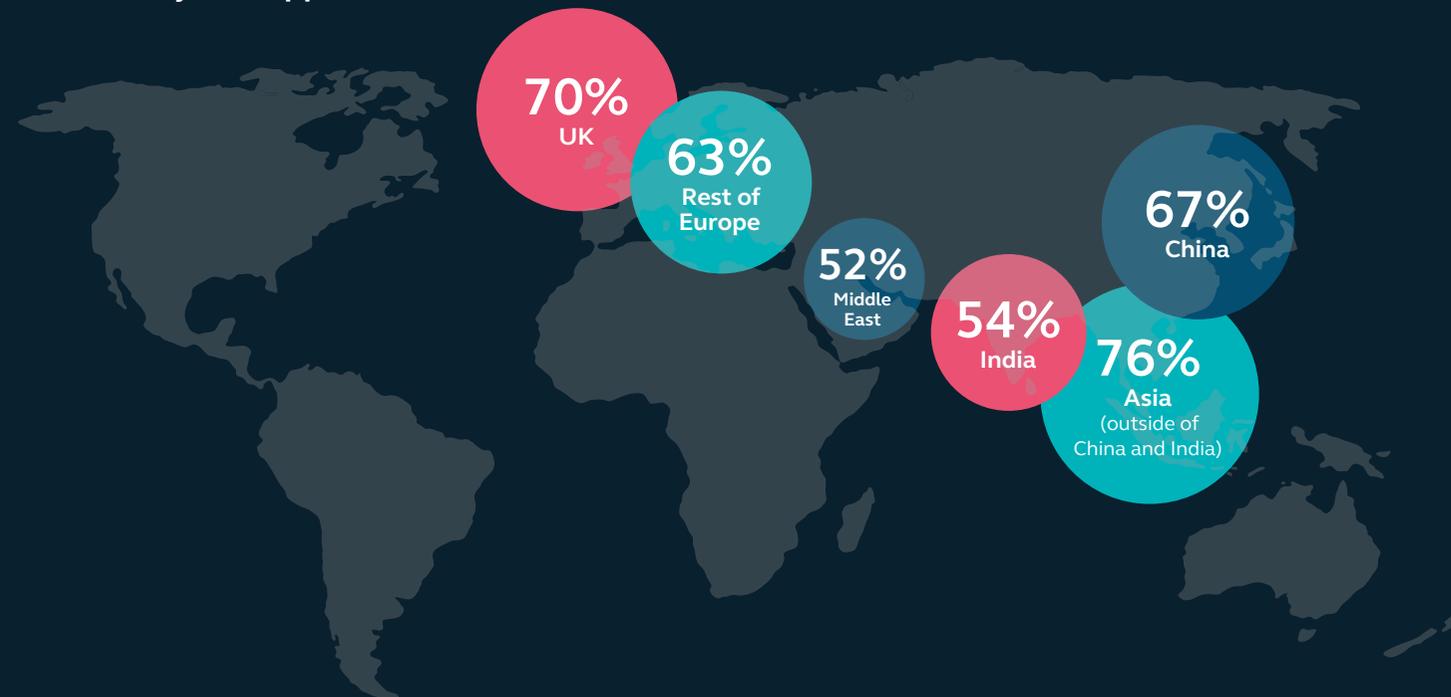
...the impact has been sudden and catastrophic with a downstream domino effect of insolvency and supply disruption.

In the current economic climate, it's important that retailers understand the vulnerabilities in their supply chain, including the financial stability of their suppliers. Promisingly, retailers appear to be working in close cooperation with their suppliers, with three quarters (73%) maintaining close links/regular contact, 60% obtaining credit reports, 42% checking insolvency/other public registers, and 36% obtaining current financial/management information direct from the supplier.

Alastair Lomax, restructuring and insolvency partner at TLT, says: “We are seeing increasing numbers of businesses facing financial pressures resulting directly from supply chain disruption and associated cost pressures. In the worst cases, the impact has been sudden and catastrophic with a downstream domino effect of insolvency and supply disruption.

“Many FMCG suppliers rely on rapid throughput, run lean on stock and are funded accordingly. If delay and disruption become the norm, many will need extensive financial and operational surgery to reorient themselves. Retailers must be alive to these challenges, stick closer than ever to their key suppliers, monitor for signs of financial distress and be ready to respond quickly.”

Where are your suppliers based?



Biting the efficiency bullet

Supply chain crisis makes robotics and automation a necessity

The war for talent

The retail and leisure sectors are continuing to face significant labour shortages after multiple lockdowns and Brexit reduced the number of candidates available and eligible to work in the UK. We have all read about the HGV shortage in late 2021, but since then, when asked where they are feeling the labour pinch the most, the majority (61%) of retailers say warehousing and distribution as opposed to shops (20%) or head office (19%).

Adding to rising supply chain costs, retailers are addressing this with higher pay (63%), sign-on/long-term incentive bonuses (56%), extra benefits (51%), training/upskilling (33%), and to a lesser extent, paid-for visas for non-UK residents (27%) and reassignments from other parts of the business (21%).

Liz Cotton, employment partner at TLT, says: “Retailers are also increasingly embracing the use of AI in recruitment and decision-making generally. While there are many benefits to this, such as reducing touchpoints and increasing efficiencies, it does raise other challenges for employers who will need to ensure that they don’t inadvertently breach human rights or fall foul of discrimination laws.”

Where are you feeling the labour pinch the most?



Retailers are also increasingly embracing the use of AI in recruitment and decision-making...



Automating supply chains

Retailers are increasingly looking at robotics and automation to help address the staffing crisis and increased labour costs. When asked which technologies they are using or considering investing in to improve their supply chain, two thirds (60%) say robotic process automation, 59% say cloud services/adoption, and 44% say machine learning/artificial intelligence.

Dan Read says: “It’s clear from our research that there is still more for retailers to do in terms of investing in new core technology that will not only increase efficiency, but also improve accuracy and ultimately save costs. The challenge is often having the time and money to invest in new, complex technology when margins are squeezed and fixed costs are rising, however I don’t think retailers of all sizes can afford not to adopt cloud and automation technology as they would risk being left behind.”

Gousto, the British meal kit retailer, recently announced it is continuing to freeze prices – effectively reducing prices for consumers amidst the highest inflation in the UK for three decades – and also planning more automation to cut costs. According to the Financial Times, its automated factories use algorithms and machine learning to shorten delivery times and help with customisable orders. Other forecasting algorithms predict supply needs, helping to reduce food waste to 1%.

Warehousing

There is also increasing demand for suitable warehousing in the UK, contributing towards an expected increase in retail warehouse rent in the coming years (0.9% between 2022–2026, Statista) – although developers will also be looking for more opportunities to meet that demand.

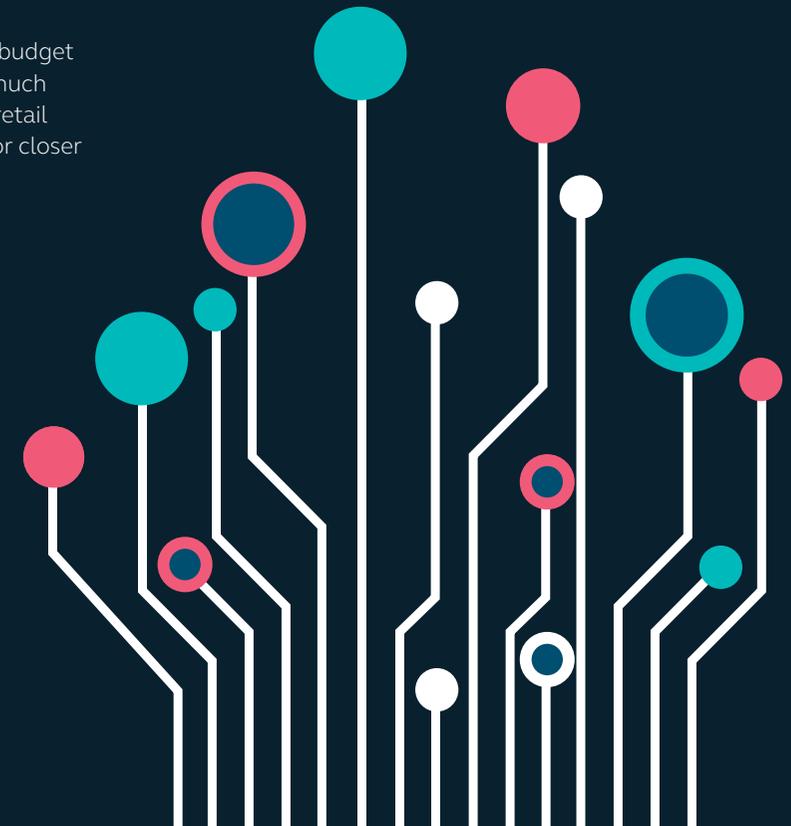
Retailers predict they will need 7% more warehouse space on average over the next five years, and two fifths (39%) say there isn’t currently enough suitable warehousing available in the UK.

When it comes to location, half (50%) of retailers are opting for larger, strategically-placed sites, while 13% are favouring smaller, local sites, and 37% are using a mixture of the two. Local warehousing may become more beneficial as a means of offering a cheaper place to carry stock.

Perran Jervis says: “Retailers should consider how to budget for greater costs and investment in warehousing as much as they might in sales space, especially as the online retail market continues to grow and there’s greater need for closer inventory management with less product in-store.”



“...I don’t think retailers of all sizes can afford not to adopt cloud and automation technology as they would risk being left behind...”



Conclusion

Two years ago, discussions about UK retailers' supply chains were dominated by Brexit. Today, the issue is more global – the pandemic has highlighted weaknesses in global supply and retailers are facing long-term changes that fundamentally undermine traditional ways of doing business.

Retailers can expect a great deal of scrutiny over how they respond to these issues. Their relationships with suppliers, consumers, investors, employees and the environment are fragile, requiring them to balance many, often competing ideas.

These relationships are also governed by an increasingly burdensome legal and commercial framework that requires further compliance and increased process in this respect, and can lead to significant financial and reputational damage if the retailer hasn't acted appropriately. It's never been more important for retailers to understand the risks they face as they adopt a transformation mindset and make some difficult but necessary decisions in order to survive.



About TLT

For what comes next



We act for more major retailers than any other UK law firm and are ranked as a top retail law firm by Chambers UK.



Our clients represent over 15,000 stores, one million employees and £100 billion of retail sales.



Our national retail team has an in-depth understanding of the industry, offering advice in context and solutions that work. We provide strategic advice on major projects, as well as support for in-house teams on day-to-day matters.



We also support retailers through our retail-specific training programme, seminars, e-alerts, industry reports, risk reports and are actively involved in retail industry groups.

To find out more visit tlt.com/retail

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Research methodology

To gain a sector and category view of the retail sector, independent research was conducted by GlobalData on behalf of TLT LLP. GlobalData interviewed 100 leading UK retailers in April 2022. In all cases, interviews were carried out with senior management. The sample was representative of sectors within the retail space including: food and grocery; fashion and beauty; home; and lifestyle and leisure. All charts, data and statistics featured in this report are the product of the research. All rights reserved, May 2022.

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