

# Retail, Wholesale and Motor Distribution

April 2008

## Summary

- Retail sales volumes were resilient throughout most of last year. Latest official government statistics indicate that retail sales grew by a robust 4.3% in 2007, up from 3.1% in 2006. Momentum has also been maintained in the early months of this year according to government statistics but business surveys are flagging a slowdown and there is evidence of increasing price competition in the high street.
- It has been long expected that economic growth in the UK would slow in 2008 as the earlier rise in interest rates began to bite. Concerns about the impact on the wider economy of the disruption in financial and credit markets in the aftermath of the problems in the US sub-prime market have led to a further decline in consensus forecasts, which now suggest that growth will decelerate markedly from around 3% last year to 1.7% in 2008.
- With pressures on real disposable incomes, deteriorating consumer confidence and weakness in the housing market, consumers' expenditure is expected to slow appreciably. The CBI distributive trades survey has indicated deterioration in prospects for some time while anecdotal reports from individual retailers have been decidedly mixed in the early months of 2008 and are almost uniformly cautious about future trading conditions.
- As a result, the prospect is for growth in the retail sector to slow to around 2% this year, with those sectors dependent upon the housing market and discretionary expenditure likely to experience particularly challenging conditions. Further out, providing the credit crunch does not deteriorate markedly further, retailers should begin to experience better conditions during the course of 2009 as the current reduction in interest rates begins to have a beneficial impact on consumers' expenditure but growth is likely to remain muted on a longer term perspective.
- The output of the wholesale sector rose by 3.6% in 2007, the same rate as that recorded in 2006. Growth in turnover was stronger largely a result of rising commodity prices, particularly for industrial materials and agricultural products.
- Prospects weakened towards the end of last year, according recent surveys from the CBI. Overall, we expect growth in activity in the wholesaling sector to slow to 2% this year and that high fuel prices – feeding through to transportation costs - will continue to pressure wholesalers' profit margins.
- The UK car market picked up last year, with sales of new cars growing by 2.4% and sales of CVs rising slightly faster at 3.6%. The private car sector was the weakest element of the new car market last year. It is expected to remain under pressure as consumers are likely to remain cautious about major new expenditure, against a background of falling consumer confidence and uncertainty about the economic outlook. There may also be some easing in the hitherto resilient business and fleet sectors as a result of the lagged impact of the expected slowdown in economic growth.
- Although registrations fell only modestly in the first quarter of the year, we expect a decline of around 5% in the year as a whole. Against this background, price competition is expected to be intense.

## Retailing

### Industry Structure

Retail sales amounted to over £280 billion in 2007 according to official government statistics. Over a third of consumers' expenditure is spent in shops, the remainder going on consumer services (leisure, transport, utilities, etc).

Retailing is a major business sector, accounting for about 5% of the UK economy in terms of gross value added. It is labour intensive and employs 2.9 million people, accounting for about 11% of employees in employment.

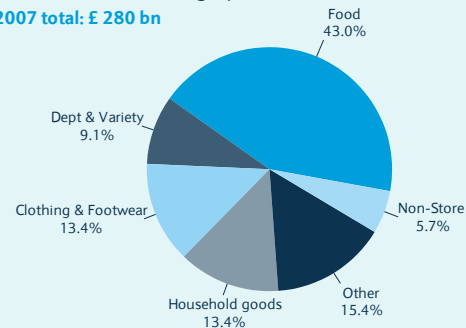
There are over 210,000 VAT-registered retail businesses in the UK, about 11% of all VAT-registered businesses. The vast majority of these are small; just 1% of businesses has a turnover of greater than £5 million. However, a high proportion of sales are channelled through a relatively small number of multiple chains: retailers with a hundred or more outlets account for just 0.1% of businesses but for 55% of sales. In contrast, 90% of businesses have only one outlet but, in aggregate, account for just 20% of sales. Over the longer term, structural issues (economies of scale, brand recognition, consumer loyalty, price competitiveness, logistical and sourcing advantages) have favoured the growth of larger enterprises and consolidation in the sector, which has gained increased impetus in recent years from the boom in merger and acquisition activity.

In terms of sectors, food retailing is by far the largest, accounting for 43% of all retail sales in 2007. Supermarkets have been expanding their activities by acquiring smaller, convenience and metro stores while, at the same time, diversifying their offerings to include a greater proportion of non-food lines, often in large-scale, purpose built, out of town stores. The sale of non-food items amongst the UK's top three supermarkets accounts for 15-22% of their revenue, following the further expansion into stand alone non-food retail outlets and the development of online facilities.

Clothing and footwear shops account for 13.4% of retail sales. This sector is now highly dominated by the leading multiples, which have built up an extensive presence in most leading shopping and provincial centres. Household goods (furniture, lighting, electrical goods and hardware stores) account for 13.4% of retail sales while other specialist stores (a diverse collection of retail operations including chemists, CTNs, carpets, photographic equipment, jewellers and sports goods) account for 15.4%. Department and variety stores account for 9.1% of retail sales while non-store retailers (internet, mail order, market stalls, and repairers of household goods) account for 5.7%, with growth in internet retailing offsetting weakness in the other components of this sector in recent years.

### Turnover of retailing by sector

2007 total: £ 280 bn



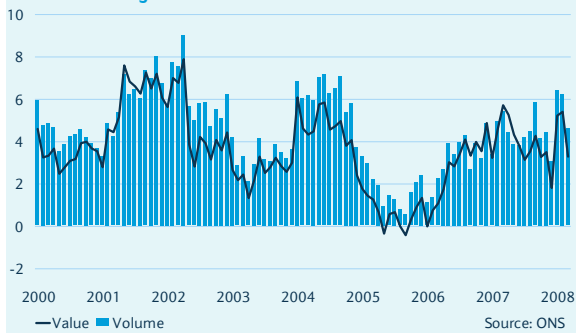
Source: ONS

### Market Conditions

Retail sales volumes were resilient throughout most of last year. Latest official government statistics indicate that retail sales grew by a robust 4.3% in 2007, up from 3.2% in 2006. Quarterly data show that growth was fairly steady throughout the year. December was the weakest month of the year with annual sales volume growth of 3.1%. However, with many shoppers waiting for the post-Christmas sales, growth accelerated to 6.4% in January 2008 and the momentum was maintained throughout the first quarter according to the official statistics.

### Retail sales volume and value

Annual % change



However, retail sales volume increased faster than the value of sales in 2007 as a whole, which is indicative of an environment of falling prices: while retail sales volume rose by 4.3% last year, the value of retail sales increased by 3.9%.

### Retail sales volume

% change (latest 3 months on a year earlier), SA

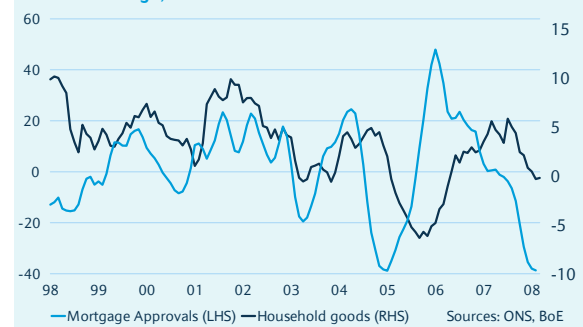


In terms of the major sub-sectors, there was a marked slowdown in the growth of food stores last year which, at 1.3%, grew slower than at any point over the last ten years. This was largely because of a sharp rise in food prices, which helped depress volume growth (i.e. growth in sales adjusted for inflation).

The sales volumes of department stores and household stores/goods as well as other non-food stores, increased faster in 2007 than they have averaged over the past 3-5 years, growing between 5% and 7%. Robust activity in the housing market was a key driver in the first half of last year, but the momentum was maintained in the second half of the year by aggressive price discounting and sales promotions.

### Household goods sales value and mortgage approvals

Annual % change, 3mth MA

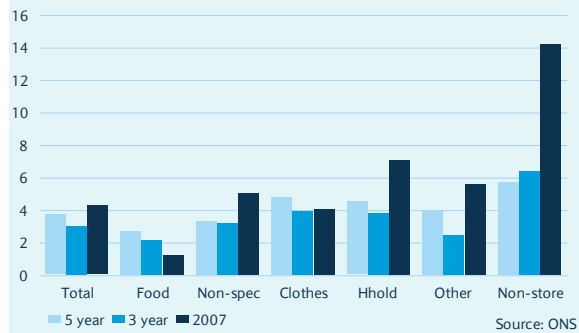


The clothing sector grew by 4.2% last year, broadly in line with the experience of the past three years but slightly lower than the longer term five year average. Demand was generally strong during the first half of the year but was very variable in the past six months, in part reflecting the very unsettled and variable weather conditions.

Growth in non-store retailing continued to outperform other sectors, with sales expanding by 14.1% last year. Consumers are showing an increasing preference for internet shopping as an alternative to high street retail and are now buying increasingly expensive items online (such as sofas and fridges, not just 'traditional' online goods such as books and cds). In terms of revenue, sales of clothing and electrical goods account for the largest proportions of internet retail expenditure. According to the IMRG (Interactive Media in Retail Group) it is not yet clear whether pure internet retailers or established high street names will dominate online retail. Last year a survey conducted by Microsoft suggested that a significant number of the UK's largest retailers still did not have online sales facilities. However, many are now realising the opportunity and high street names are likely be key to driving online growth.

### Long term growth by retail sector

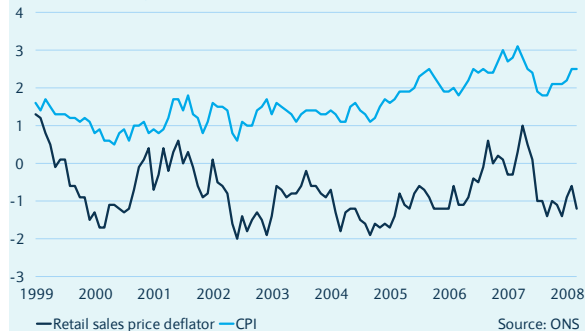
Compound annual % growth



Continuing the trend of the last few years, prices within the retail sector fell again in 2007. According to the latest government data, retail prices declined on average by 1.4% in the year as a whole. However, there was a marked contrast between the first and second halves of the year: modest price increases in the first half of the year were reversed in the second half as retailers cut prices and introduced aggressive sales promotions to entice increasingly reluctant consumers to the high street. Price declines were particularly marked in the household-goods and non-store retail sector, with the former down by 8.9% and the latter declining by 7.5% in 2007.

### Retail prices

Annual % change



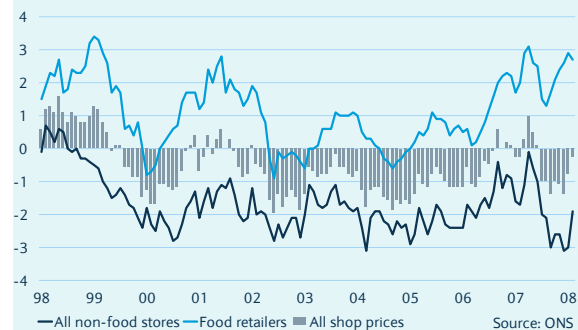
The exception to this general trend was food retailing where prices rose, accelerating faster than they have for nearly a decade. Food prices increased by 2.6% over the year, driven by the rising price of agricultural commodities, which rose by 40% in the year to January.

In recent years, the price of consumer goods has declined as a result of a combination of factors, in particular the rise in supplies from low labour

cost countries and technological innovation amongst consumer electrical goods. It remains to be seen to what extent rising inflation in many developing countries eventually feeds through to the cost of goods imported from those countries. The weakness of the dollar has also reduced the costs of imports from the US and those countries in the Far East whose currencies are linked to the dollar, though, equally, there is likely to be upward pressure on the price of goods imported from Europe in the future as a result of the appreciation of the euro against sterling.

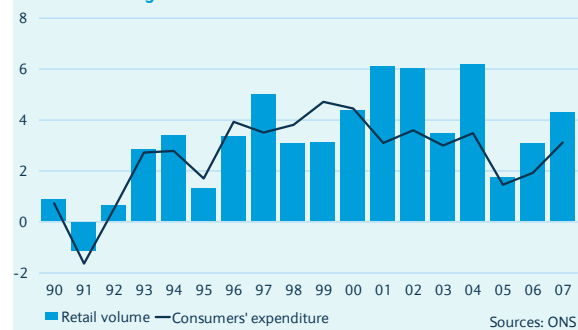
### Shop prices

Annual % change



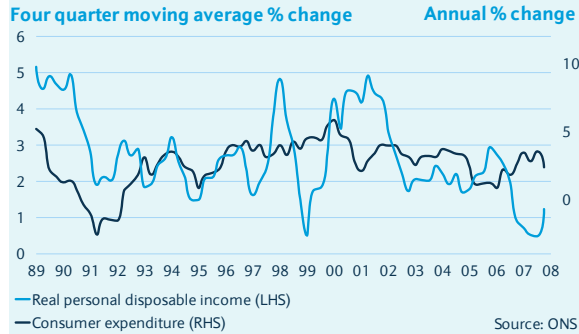
### Retail sales volume and consumers' expenditure

Annual % change



Having slowed in 2005, consumers' expenditure – which is the driving force behind retail sales – has accelerated subsequently. Consumers' expenditure grew by 3% in annual average terms last year, slightly above its long-term trend. Moreover, despite the unsettling impact of the turmoil in financial markets, consumers' expenditure remained fairly resilient in the final quarter of the year, growing by 2.4% compared with a year earlier.

## Real personal disposable income and consumer expenditure



However, according to consensus forecasts, growth in consumers' expenditure is expected to slow appreciably to around 1.6% this year, which would be the slowest rate since 1995. This slowdown is likely to represent the culmination of a number of factors.

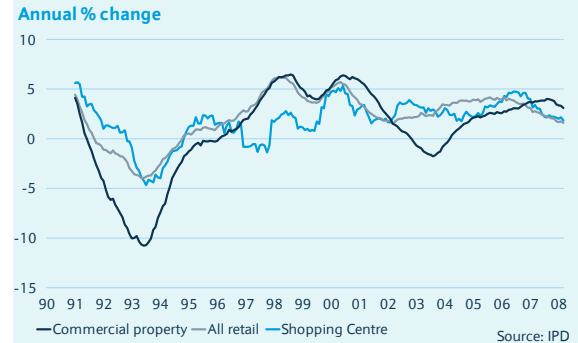
- First, real disposable income has already come under considerable pressure from modest growth in nominal incomes at a time when both prices and taxes have risen. Real disposable income rose by just 1.2% in 2007. With inflation expected to rise in the near term, this pressure on real disposable incomes is likely to persist in 2008.
- Second, the decline in equity markets and fall in house prices could impact how wealthy households feel, deterring additional borrowing and boosting the savings ratio from current very low levels.
- Third, there is evidence to suggest that developments in the wholesale financial markets are now beginning to have an impact on the availability and cost of credit to some households, particularly those that are perceived to be higher risk.
- Fourth, discretionary expenditure in particular is likely to be adversely affected by the rising costs of servicing mortgages and other debts and the rising costs of staple goods and services such as foodstuffs and utilities.
- And finally, consumer confidence has been unsettled by the increasingly

uncertain economic outlook and is now at its lowest level since the mid 1990s.

## Costs

Whilst retailers' prices have come under pressure, costs have been relatively well contained – thereby limiting some of the potential pressure on margins.

### Commercial property: rental values



Growth in retail rental values was slower in 2007 than 2006, with a more marked slowdown in growth in the second half of the year. Rental values grew by only 1.8% in the year to December 2007 compared to 3.1% in the same period of 2006.

### Average earnings



At the same time, average earnings in the retail sector continued to increase at a slower rate (2.9%) than for the economy as a whole (3.6%) during 2007. The difference was notable in the second half of the year when a particularly modest level of increase in the minimum wage (3.2%) benefited wage growth in the retail sector.

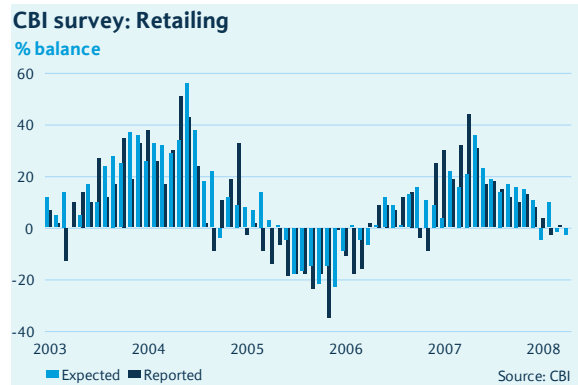
Utility costs rose by 7.2% in 2007, a significant slowdown following a 24.8% increase in 2006.

However, this deceleration in utility costs is likely to prove temporary since several energy suppliers have announced price increases of around 15% in the early months of this year.

## Outlook

It has been long expected that economic growth in the UK would slow in 2008 as the earlier rise in interest rates began to bite. Concerns about the impact on the wider economy of the disruption in financial and credit markets, in the aftermath of the problems in the US sub-prime market, have led to a further decline in consensus forecasts, which now suggest that growth will decelerate markedly from around 3% last year to 1.7% in 2008.

With pressures on real disposable incomes, deteriorating consumer confidence and weakness in the housing market, consumers' expenditure is expected to slow appreciably. The CBI distributive trades survey has indicated deterioration in prospects for some time while anecdotal reports from individual retailers have been decidedly mixed in the early months of 2008 and are almost uniformly cautious about future trading conditions.



As a result, the prospect is for growth in the retail sector to slow to around 2% this year from over 4% in 2007, with those sectors dependent upon the housing market and discretionary expenditure likely to experience particularly challenging conditions, both in terms of a deceleration in the growth of demand in volume terms and pressure on retailers' profit margins. Further out, providing the credit crunch does not deteriorate markedly further, retailers should

begin to experience better conditions during the course of 2009 as the current reduction in interest rates begins to have a beneficial impact on consumers' expenditure but growth is likely to remain muted on a longer term perspective.

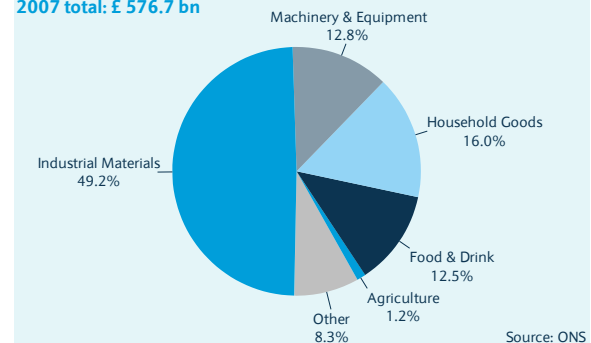
## Wholesaling

The wholesaling sector is very diverse both in terms of the activities undertaken and the structure of the industry.

The turnover of the sector amounted to about £577 billion in 2007 according to official government data. While the distribution of consumer goods to retailers is an important element of the industry, the wholesaling of industrial materials and equipment and machinery accounts for over half of the turnover of the wholesale trade. There are about 104,000 enterprises in the industry but just 8,100 have an annual turnover of greater than £5 million.

### Turnover of wholesale trades by sector

2007 total: £ 576.7 bn



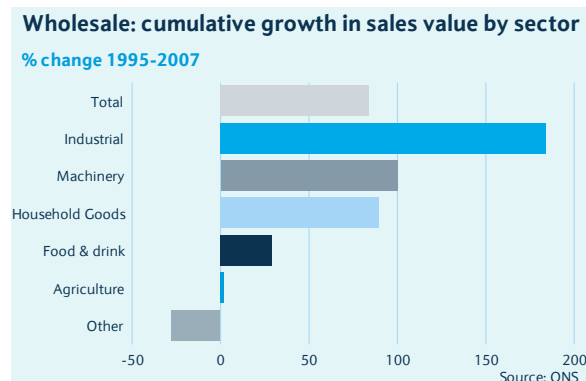
The past few years have seen significant changes in the role of wholesalers within the distribution process, and a consequent blurring of responsibility between agents, distributors, wholesalers, manufacturers and specialist logistics companies. The introduction by manufacturers of tightly-managed production techniques (eg JIT) has resulted in a greater sophistication of distribution chains. Indeed, in some sectors, the entire distribution function is increasingly being out-sourced by manufacturers, such that wholesalers are expected to have sophisticated supply systems to run goods direct from the production plant to end-users. At the same time, the volume of goods sourced directly from overseas has

increased markedly with the benefits of trade liberalisation and globalisation, which means that wholesalers have increasingly become importers of goods.

As a result, distribution is becoming more capital-intensive. Larger wholesalers are better placed to meet the increasingly sophisticated demands of suppliers and customers for management expertise, IT and financial skills, understanding of environmental and safety regulations, market knowledge, logistics skills, warehousing, physical distribution, debt collection, stock management, sales and marketing (packaging, POS, literature, own-label branding), after-sales service and technical advice.

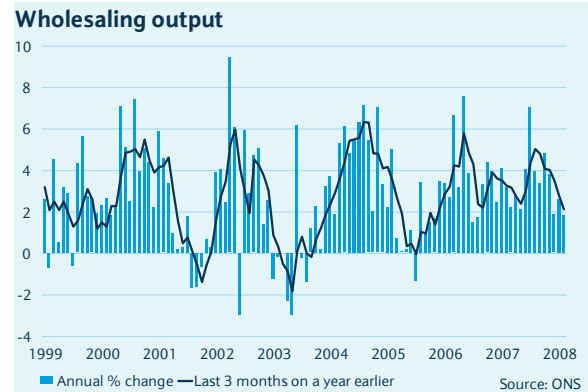
Meanwhile, in some sectors (particularly food, drink and consumer goods markets), the rationalisation of supply chains is threatening the wholesale function altogether. The bargaining strength of traditional wholesalers in many consumer goods markets has been weakened not only by powerful, multinational manufacturers but also by dominant retailers who have developed their own extensive sourcing and distribution networks.

The industrial materials and machinery sectors have enjoyed the most rapid growth in turnover over the longer term, although household goods wholesalers have also experienced above trend growth.



Wholesale output rose by 3.6% in 2007, the same rate as that recorded in 2006. Annual growth rates were reasonably steady throughout the

year, although they began to ease a little in the final months.



Growth in turnover was much faster than growth in output, up by 9.7% in 2007. All the major sectors of the wholesale market experienced turnover growth over the year as a whole. In value terms, the industrial sector remained the most buoyant over the year as a whole, with turnover growth of 12.7% largely reflecting the strong price rises of commodity materials, such as oil and non-ferrous metals.

Turnover growth accelerated at the fastest rate for five years in the agricultural and food and drink sectors. The final quarter of the year was particularly strong, again reflecting the rise of global foodstuff commodity prices.

### Value growth - Wholesaling

Q4 2007 / Q4 2006

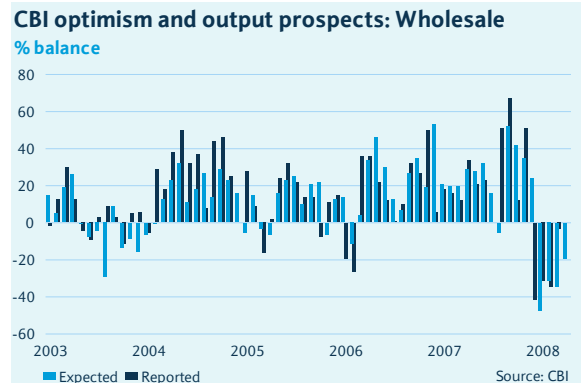
| Sector                | % value growth |
|-----------------------|----------------|
| Industrial materials  | 31.1           |
| Machinery & equipment | 8.2            |
| Food & drink          | 7.6            |
| Household goods       | 3.7            |
| Agriculture           | 29.0           |
| Other                 | 28.0           |

Source: ONS

### Outlook

Prospects for the wholesaling sector have deteriorated recently with evidence from the CBI Distributive Trades survey showing a significant fall in reported sales towards the end of last year,

and the latest survey conducted in April shows depressed expectations.



Importers of consumer goods from overseas will benefit from the strength of sterling against the dollar, although those importing goods from Europe will find their costs rising as a result of the weakening of the pound against the euro. Demand is likely to weaken reflecting the pressure on consumers' expenditure and general expectations of a slowing in economic growth. Wholesalers of big ticket household and electrical goods are likely to face the most cyclical demand. Suppliers of industrial materials to the manufacturing sector are expected to experience more stable demand but will no doubt have to contend with high and volatile energy and raw material prices.

Overall, we expect growth in activity in the wholesaling sector to slow to 2% this year and that high fuel prices – feeding through to transportation costs - will continue to pressure wholesalers' profit margins.

## Motor Dealers

### Industry Structure

There were some 25,565 enterprises involved in the sale of new and used vehicles in 2007. Most of these are fairly small businesses with less than 2,000 enterprises recording a turnover of over £5 million. However, dealer groups have gradually strengthened their influence over the new car market. Of the 5,273 or so franchise sales outlets in the UK in 2007, dealer groups controlled 3,989 (76%). Moreover, the top twenty largest dealer

groups increased their control to 1,378 (26%) of total franchised outlets.

New EU Block Exemption regulations became fully operative in October 2003. Dealership groups may now buy and sell businesses without having to obtain the agreement of manufacturers and following this there have been a number of high profile mergers and acquisitions with significant consolidation within the sector, and increased concentration amongst the largest companies.

As a result of poor margins on car sales, many dealers are relying increasingly on the aftermarket to boost revenue. Sales of motor maintenance and repair services have experienced strong growth over the last few years, averaging 7.1% per annum between 2000 and 2007.

Following new EU Block Exemption regulations, the splitting of sales and service within a franchise has given dealerships the opportunity to establish service only facilities on low cost sites. Although this has been slow to take off, it has proved most popular amongst high volume brands.

Service franchises, whilst trying to boost service revenues, face difficulties in the wake of manufacturers' policies, many of which may have extended warranties, increased service intervals and reduced hours per retail job card.

Rules introduced under block exemption should have intensified competition within the aftermarket. Independent repairers may now carry out work without invalidating a car's warranty although they report that they continue to struggle against larger dealerships in obtaining access to technical information. The Right to Repair Campaign, a European-wide initiative has been established to represent the rights given to independent repairers under EU block exemption.

Some dealerships have become involved in all-makes parts distribution programmes, working together to supply local independent repairers. According to Motor Trader there has been

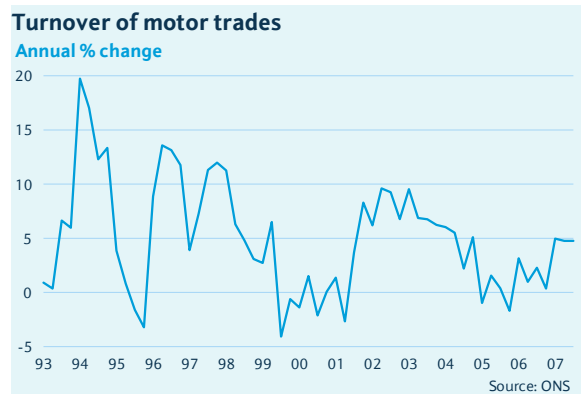
significant improvement in service “quality and commercial acumen” of the independent sector, which now carries out 70% of MOTs.

The so-called ‘location clause’ was finally removed in October 2004. Franchised dealers are no longer restricted by area although some manufacturers have reportedly tried to retain control by insisting on exacting showroom standards.

The number of multi franchises has increased, though not extensively. Multi franchises reduce overhead costs and can help build presence in prime locations. So long as brands are not in direct competition they can all benefit; minor brands benefit by association and major brands by reduced overheads.

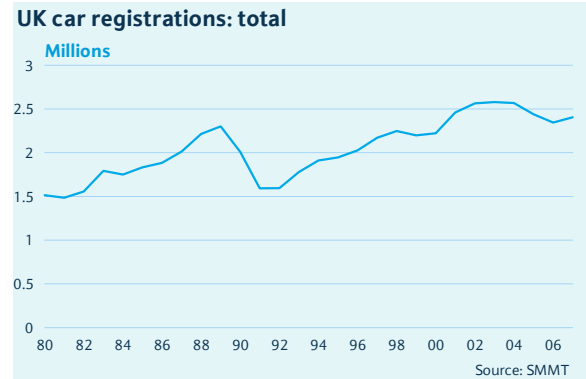
EU initiatives to combat climate change and rising fuel costs have encouraged manufacturers to develop lower emission models and have boosted the sale of diesel cars. Growth in diesel cars continued to outperform petrol vehicles, with the former increasing by 7.7% and the latter falling by 0.7% in 2007, according to SMMT data. The larger car segments are being threatened by measures to cut emission targets and tax hikes on cars with high carbon dioxide emissions.

### Market Conditions

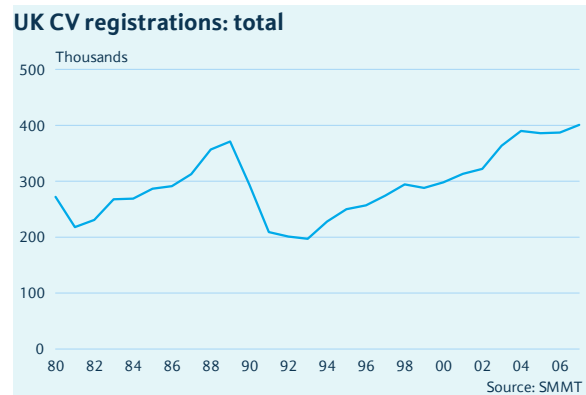


Growth in turnover of the industry picked up in 2007, following slow to negative growth over the course of 2005 and 2006. According to government statistics, the turnover of motor trades rose by 5.5% in 2007. However anecdotal evidence suggests that dealers’ margins have

come under pressure following rising costs, more intense competition and pressure in the used car market.



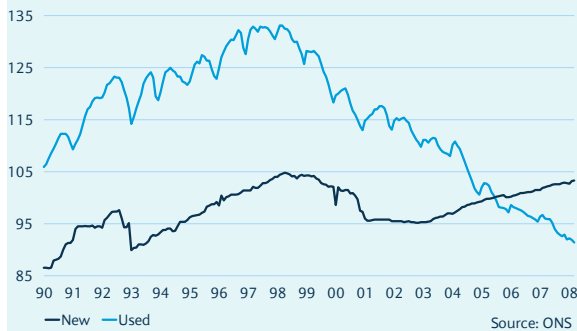
Having fallen in 2006, new car sales picked up by 2.5% to 2.4 million last year although they were not as strong as they were in the first half of the decade. Private registrations were the weakest element of the market last year, up by only 1.2%. New registrations by fleet operators rose by 3.8% in 2007, while those in the business sector (ie operators with less than 25 vehicles) grew by 5.5%. Private and fleet registrations represent over 90% of the new car market.



Registrations in the CV sector grew by 3.6% in 2007. The light CV sector increased by 3.2%, truck registrations fell by 8.7% and the bus and coach sector increased by 4.3%. Registrations in 2007 were the highest on record.

## New and used car prices

Index 2005 = 100

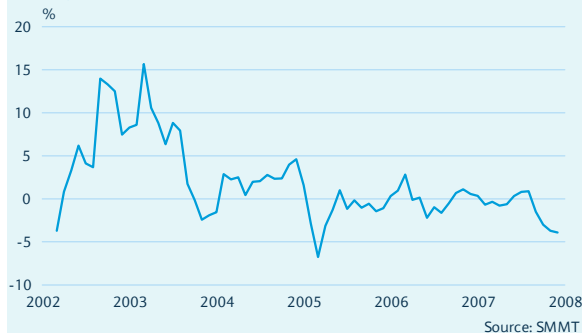


New car prices rose modestly throughout 2007 as manufacturers responded to increased cost pressures (energy and metal prices) according to official government data although anecdotal evidence suggests that aggressive price promotions pressured the profits of dealers.

Used car prices have been under pressure for sometime due to the large number of trade-ins available, as a result of high levels of new car sales, and attractive deals on new cars. As a result sales of used cars fell by 2.6% in the second half of the year, impacting the profits of some of the larger dealer groups.

## Used car market

Trend growth



## Outlook 2008

Registrations of new cars in the first three months of this year were 0.7% lower than in the same period a year earlier. However, business sentiment within the motor trade remains downbeat according to the latest CBI Distributive Trades Survey, with expected sales weak in the near term.

Consensus economic forecasts suggest economic growth will slow in 2008 and consumers are likely to become increasingly cautious about undertaking new expenditure against a background of high levels of consumer debt and increased pressures on disposable income.

Whilst the business and fleet sectors have remained more resilient than the private sector, slowing economic activity and the increase in fuel costs could impact on demand from the fleet/business sectors.

As a result, despite the good start to the year, we expect the new car market to fall by 5% in 2008. Against this background, competition among dealers is expected to remain intense and profit margins are likely to remain under pressure.

Prepared by Patrick Redshaw, Head of Economics and Catherine Seymour, Economic Analyst, Portfolio Management, Barclays Bank PLC.

All data and factual information referred to in this report were correct as of 28 April 2008.

Source of ONS data: National Statistics website:

[www.statistics.gov.uk](http://www.statistics.gov.uk)

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