# How retailers are being forced to adapt to weather risk scenarios

Retailers frequently blame the weather for their trading performances, but this needn't be the case

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For retailers, weather is no small talk topic. It is a volatile external factor influencing consumer behaviour and market dynamics. The weather can quite literally make or break a company's year.

The perception that our climate is becoming less predictable appears to be borne out by evidence from a number of sources; Food and drink companies are indeed experiencing sometimes significant impacts on their revenues, costs and margins.

Unsurprisingly for many of the businesses impacted, 2012 was the second wettest year on record; March 2013 was the coldest since 1962 and July 2013 the 3rd warmest on record.

2015 has also been a disappointment for many retailers who rely on the summer months to deliver their peak demand as the temperature rises. The Met Office said summer 2015 was cooler and wetter than either of the two previous summers, with a provisional mean temperature of 13.9C, which is 0.4C below the 1981-2010 average. Conversely, rainfall was above average, with 113% of the average falling on UK shores during the summer months.

But while the sector will expect wet and cold weather during autumn and winter, what if seasonal averages upon which their forward planning is based no longer apply? How much of that financial impact can be absorbed?

While manufacturers and suppliers have a variety of means at their disposal to manage the risk posed by unseasonal weather in the form of derivatives that smooth out pricing volatility for raw materials; retailers have historically had fewer options. Weather derivatives were pioneered in the 1990s and allowed companies to reduce the risk associated with adverse or unexpected weather conditions; paying out if conditions force commodity prices up beyond a pre-defined tolerance or if poor conditions impact a key trading season.

**WEATHER DERIVATIVES ALLOW COMPANIES TO REDUCE THE RISK ASSOCIATED WITH ADVERSE OR UNEXPECTED WEATHER CONDITIONS**



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This lack of options may therefore account for the fact that retailers continue to blame weather conditions for poor trading results. A scan of investor relations pages will tell you that the weather remains high on bosses' list of problems at which to point the finger of blame. 2015 has been no exception, with an inclement summer unfortunately hitting the bottom line for some as sales, and profits, both fell. If the Winter of 2015-2016 continues to be unseasonably warm, clothing retailers may also be forced to admit defeat.

Ironically, the opposite can also be true. Two years ago, the weather was blamed by major food brands on the high street for a fall in customer numbers, but industry trade magazines simultaneously reported in the same month (July 2013) that ice cream sales had shot up by as much as 300%, with retailers struggling to fill shelves quickly enough to meet demand.

If you look back far enough, the resignation by retailers over how weather impacts their business is categorical, and in most cases made without any recourse to a solution. The default position is to hope that this year things will work in your favour.

## Making excuses?

Unfortunately, investors appear increasingly to label this tactic in rather unflattering terms. 'Earnings excuses' was the subject of a recent article in Fortune Magazine titled 'the weather ate my returns', highlighting how the weather alongside other macro trends like currency fluctuations, the price of oil and so on are increasingly used to justify falling profits. "A 2014 study by Emory University researcher Dexin Zhou, titled 'The Blame Game,' found that the more corporate executives blamed poor performance on external factors, the less their stocks returned in the future[1]," it said.

**THE QUESTION FOR RETAILERS IS ABOUT TOLERANCE. HOW MUCH BAD WEATHER IS TOO MUCH?**

The question for retailers is about tolerance. How much bad weather is too much? Every organisation has a risk appetite but with modern approaches to data mining and analytics it has now become possible for companies to identify and isolate a trading loss as an insurable interest and hedge against that loss without resorting to the sorts of complex derivatives used to protect commodity prices.

Historical climate analysis can be overlaid against trading data to produce a 'real time' review of how and why the weather influenced your company's sales over time. For retailers that habitually look to the skies for a reason why consumers open their wallets, this can be a very powerful tool, not only when sales drop but also when demand surges beyond expectations.

The UK has recently been enjoying just such a scenario with the Rugby World Cup coming to a close on 31st October. The fate of numerous brands has been riding on the success of the competition with food, drink, clothing and merchandise promotions in every retail outlet. The 2016 UEFA European Championships will provide similar, if not greater opportunities and challenges, as no less than four nations compete in France for the trophy, while the 31st Olympics in Rio de Janeiro promises more success for the athletes of Team GB.

The performance of our home nations' sportsmen and women can and does have an influence on sales, leading many retailers to build 'what if?' scenarios into their planning process. But when pub gardens across the country are washed out from an unseasonal deluge it stands to reason that winning on the field should not be the only variable Britain's retailers should plan for.

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1 http://fortune.com/2015/04/24/the-weather-ate-my-returns/