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*Only the
innovative survive*

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**The European
retail renaissance**



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Executive summary



Growth in retail is no longer dependent solely on the quality of the product, the loyalty of the customer, or past success. In an increasingly competitive retail environment, those reaping rewards are the bold, agile innovators. Those are the retailers with a willingness to adapt quickly. They know how to anticipate market fluctuations and changing consumer demand. They make tough decisions early.

In this report we examine the European retail scene with fresh data from the Netherlands, Britain, France, and Germany. Smaller retailers once hamstrung by their inability to enter markets dominated by large players have been liberated by fresh technologies, new business models, and the increased availability of capital. As a result, they have become more creative and more willing to exploit new niches by differentiating their offerings. And they are pushing themselves harder on a daily basis to provide a more enticing customer experience and value proposition.

This is just as true of the more innovative incumbent retailers that, faced with increasing turmoil, have been steadfast in setting a new course, developing business models that are not easily replicable by rivals, and thus ensuring a long-term competitive advantage. Their boldness in attempting to differentiate their business models rather than relying on their brand recognition and legacy ways of operating has been essential to profits.

The larger lesson: Retailers that focus on what works now, and pare away what doesn't, stand an excellent chance of surviving and thriving in a rapidly changing retail environment.

Rapid rebirth

Retail across Europe is in crisis. Many of the traditional chains, industry giants, and even new outfits have failed for a variety of reasons: They've been too slow to join the e-commerce revolution and too cumbersome to compete against nimbler, more innovative online rivals.

Or so we're told. Except it isn't quite like that.

Yes, there have been failures, and there will likely be more. But we have found quite a different scenario in our analysis, based on the 2016 findings about two retail segments — clothing and footwear, and consumer electronics and appliances — in the Euromonitor Passport database. Whether they are incumbent high-street chains, independents that may also operate online, or startup companies operating online, offline, or both, retailers are already beginning to make bold decisions, create innovative new business models, and operate with agility. In doing so, they are winning business online, offline, and through omnichannel platforms. The result is a retail renaissance throughout Europe, in categories as diverse as clothing, electronics, and food.

The media's focus on the bankruptcies of incumbents that have tried to innovate but have seen their sales decline has obscured a more encouraging picture. Daring innovators are taking advantage of incumbents' failures by bringing more variation to the high street and responding to consumers' desire for a more enticing, intuitive shopping experience.

Indeed, the scale of the retail recovery throughout Europe comes as a surprise to us, given what we predicted in our 2013 study of the European retail landscape, "Footprint 2020." Retail remains a zero-sum game in which the market as a whole is not growing, but success is being redistributed, to the benefit of more innovative rivals. And the speed of change has been much faster than we expected. Pure-play online businesses and innovative high-street stores have grown their market share at the expense of incumbent rivals that have yet to refresh their business models.

Our prediction that retailers would disappear if they failed to respond adequately to the changing market turned out to be accurate, as evidenced by the alarming stories of high-profile retail collapses across Europe. But the accelerated emergence of innovative online and offline players has hastened these failures.

In short, the developments over the past several years only highlight the fact that in a constantly evolving market driven by rapidly changing consumer tastes and a plethora of energetic innovators, traditional incumbents need to take radical steps to survive and thrive. Rather than simply reacting to circumstances, they must act with greater urgency and ruthlessness to shape their futures. Otherwise, bankruptcies among retailers large and small will likely continue.

Why retailers fail

Unquestionably, the European retail environment remains in a state of turmoil. In our 2013 study we predicted that more than a quarter of all clothing sales would be online by the end of the decade, compared with just 6 percent in 2012, along with a third of consumer electronics and appliances sales, compared with 16 percent in 2012. This would result in many smaller chains going out of business.

Our current analysis of the data from Euromonitor indicates that those predictions were accurate. In Exhibit 1 (*next page*), using our home market of the Netherlands as an example, we see that by the end of 2015, 13 percent of clothing sales and 20 percent of consumer electronics and appliances sales had already moved online. As a result, there have been several business casualties in this market, especially among the smaller players, with Van Dalen (fashion accessories), Dr Adams (shoes), and iCentre and de Harense Smid (both electronics) all filing for bankruptcy.

What is surprising is the bankruptcy rate among the larger incumbents in the Netherlands. Chains such as Miss Etam and Dolcis (fashion), Manfield and Invito (shoes), Dixons (electronics), and, more recently, Perry Sport and Aktiesport (sporting goods retailers) have all gone under. Added to that list is V&D, the largest department store in the Netherlands, with a history dating back to 1887.

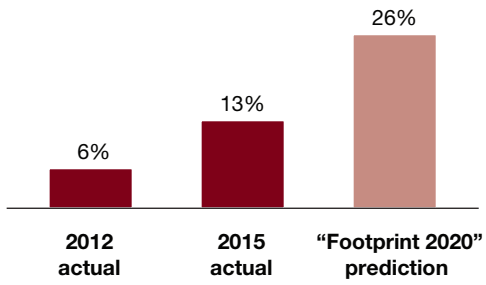
Overall, our analysis of the specialists — retailers that focus on selling one product category — indicates that floor productivity, or offline revenue, among clothing incumbents in the Netherlands is down 3.5 percent, with bankruptcies between 2011 and 2015 totaling an additional 5 percent of the market. Consumer electronics and appliances incumbents have suffered even more, with offline revenue down 11.7 percent and 5 percent bankruptcies. Other countries have seen similar impacts (*see Exhibit 2, page 9*).

Although many commentators have attributed these results to companies' inability to grow their businesses online, that is only part of the story.

Exhibit 1
Clothing and electronics sales are rapidly moving online

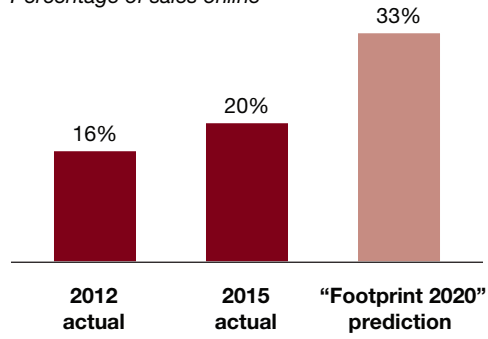
Dutch clothing and footwear market

Percentage of sales online



Dutch consumer electronics and appliances market

Percentage of sales online



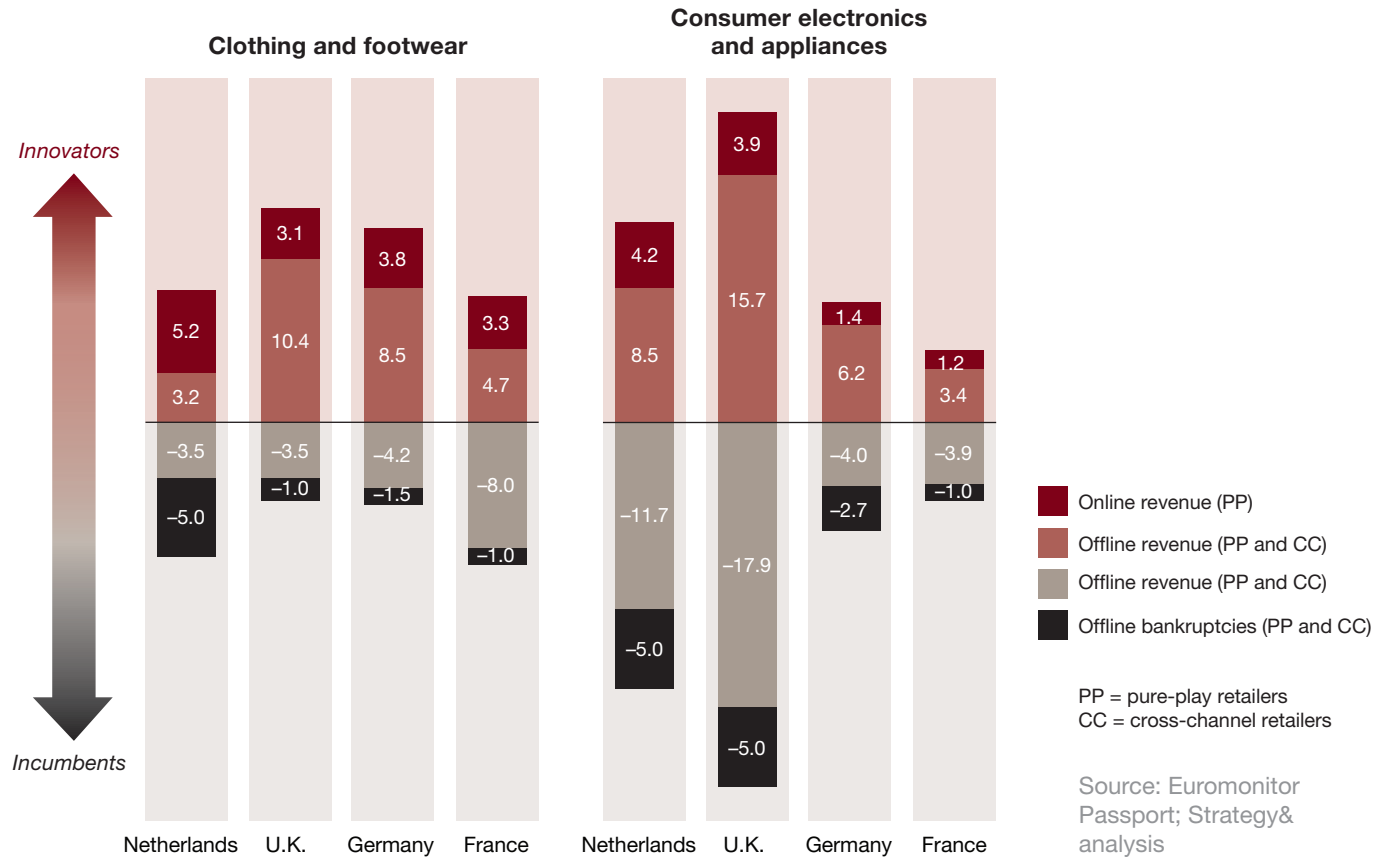
Source: Euromonitor Passport; Strategy& analysis

Exhibit 2

Online specialist retail market share gains in Europe have been offset by offline losses

Online and offline specialist market

Percentage change in market share, 2011–15



True, many of these companies plowed significant resources into online sales to compensate for their offline losses. But they failed to understand how the multichannel digital revolution — in which retailers are able to expand their offerings online, offline, and on mobile — might solve their problems. The intention was good, but the execution failed. These companies misjudged the growing complexity of the online world, and were simply outperformed by their more tightly focused pure-play rivals. Their offline strategies weren't effective against newer, more innovative formats. And because mobile technologies are equally available to smaller companies, the larger players could no longer rely on scale to protect their market share.

To make matters worse, these companies refused to reduce the footprint of their overexpanded legacy store network even as sales suffered, instead of cutting their costs strategically, and quickly.

The point is that these failures should not be seen as inevitable. Instead, they were often the result of shortsighted decision making on the part of business leaders too focused on quarterly results and too fearful of change. Rather than taking bold steps to beat back the threat, these leaders instead tried to manage their way through. Clearly, the time to make radical changes is now. The retail revolution that we expected would take several more years has already happened and is ongoing, and companies that are slow to grasp this fact will soon be left behind.

Why retailers succeed

The retailers that are succeeding now are those that steered their own course rather than relying on past successes, copying mediocre competitors, or delaying or avoiding change. Instead, the retailers that have succeeded in this new landscape — whether online or off — have done so thanks to two key strategies.

Superior business models. High-profile online fashion retailer Zalando saw an annual growth rate of 50 percent between 2011 and 2015, and electronics specialist Coolblue grew 20 percent annually over the same period. Both have consistently concentrated on pushing their business models further, experimenting iteratively to perfect their offerings, and proving themselves to be more innovative than competitors. Zalando, in particular, sees itself as a mobile-first retailer that uses the platform to amass data on its customers so it can tailor personalized products accordingly. It has also just unveiled a new partnership deal under which competitors can promote clothing on the Zalando website; then customers can either visit those individual stores or have the products delivered through the Zalando distribution network. In essence, this leverages the retailer's already strong business model to compete with larger incumbent competitors.

Both Zalando and Coolblue also offer enormous breadth and depth of product offerings, providing far more lines than brick-and-mortar competitors. Zalando boasts of supplying 1,500 separate labels and 150,000 products, while Coolblue has more than 350 different online stores so that no matter what product is typed into a search engine, a “dedicated” Coolblue store pops up.

In addition, these retailers are reducing the barriers to purchasing online through a series of innovations such as same-day delivery options, and flexible and free returns. Coolblue has been perfecting such offerings since beginning the effort in 2012.

All of this is enabled by superior digital capabilities, creating a kind of virtuous retail circle. As these stores grow, their logistics partners are willing to offer better, more differentiated services, such as more

frequent warehouse pickups that allow for more flexible delivery, and picking up return packages from customers' homes, all for better rates.

Smaller online players are also reaping the success of going to market with highly focused business models. For example, the Cloakroom, a personal shopping service for men ages 30 to 55, concentrates on a very specific target market in a highly focused way. Its 40-plus employees buy clothes for their male customers based on their personal tastes, consulting via mobile or in person, and any rejected items are returned free of charge. Success stems from the personalized precision of the offering.

Success isn't only to be found online. Inditex, which owns Zara, one of Europe's key high-street success stories in recent years, and pan-European giant H&M have also focused on developing a superior business model. Their expansions are the result of investing in more advanced supply chains that enable new lines to be brought to market quicker and at a cost advantage, based on data-enriched customer insights.

Other retailers take a different tack. Suitsupply and Sonos, both of which operate both online and off, have developed their own niches in men's suits and audio equipment, respectively. By offering less, they create greater brand loyalty. Suitsupply's success has also been founded on its vertical integration, allowing new offerings to be brought to market quickly.

Point-of-purchase execution. In addition to having superior business models, successful online retailers are "born digital" and know how to execute in an online environment. Zalando's and Coolblue's digital capabilities allow them to A/B test new versions of their online stores quickly, continuously optimizing the online experience. Their in-depth data analytics capabilities allow for highly accurate customer targeting and product suggestions. Companies like the Cloakroom use technology to learn about their clients and understand their personal needs.

Traditional high-street stores have also had to radically transform their in-store and online experiences to develop growth in difficult circumstances. Inditex, for example, owns several familiar high-street stores, such as Zara, Pull&Bear, Massimo Dutti, Bershka, and Uterqüe. All these brands share Inditex's sales and supply chain formula — capitalizing on trends by ensuring that their new lines are in stores faster than those of their rivals — and all successfully target different customers through audience-specific in-store execution.

At the other end of the spectrum, electronics and appliances specialist Media Markt stands out from the competition because of its in-store

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innovations. First, it attracts clients by allowing them to test a wide range of products in all of its shops. Second, those products are competitively valued, and shoppers can compare their prices with those of online and offline rivals. Third, the Media Markt franchise structure encourages local entrepreneurship — regional managers are empowered to offer the products and deals they believe are most relevant to their particular customers. Finally, if stores underperform over an extended period, they're simply closed.

Another major retailer that has benefited from relentless innovation is Primark, a brick-and-mortar giant renowned for its cheap clothing. Rather than relying solely on its discount business model, the retailer has also been highly agile in adapting that model, taking bold steps that demonstrate why legacy cannot always be relied on. It's quick at spotting fashion trends and then introducing lines that capitalize on changing tastes. It deliberately targets products to people — especially young females — who are both fashion and price conscious. And it uses online social media channels to build word-of-mouth, interact with customers, and let them share comments and pictures worldwide. Primark uses different channels for different purposes — retail messages are adapted to tablet, mobile, or mainstream publishing according to the type of user. Success has been dramatic: Between 2011 and 2015, worldwide revenues increased 15 percent annually, and the number of stores from 223 to 293.

How incumbents succeed

Our research also identified a limited number of incumbents that have successfully anticipated the accelerating market shift and are working hard to secure their future success. Though their strategies vary, they have a common theme — trying out new ideas while cutting costs where possible.

- **Closing underperforming stores.** All too often, retail chains shutter unprofitable stores as a last resort during bankruptcy proceedings, a painful, time-consuming, and brand-destroying process designed to let them emerge with a smaller footprint of profitable stores. Instead, they would be wise to make such moves before they are forced to do so. Companies such as B&Q and Homebase have taken just this route, closing as much as a quarter of their stores since 2014.
- **Limiting choice.** For years now, the strategy among large mid-market grocery stores has been to increase choice in hopes of being all things to all people. SKUs at industry-leading Tesco, for example, have tripled since 1980. More recently, however, discounters such as Aldi and Lidl have experienced significant growth by doing the opposite — offering a limited product choice while keeping prices low. As a result, they are eating away market share from the mid-market stores. Up-market grocers, too, have gained market share through a similar strategy.

The problem with the unlimited offering strategy is that it increases supply chain complexity and cost structure while having limited positive impact on the shopping experience. Companies now are moving in the opposite direction. For example, when Tesco conducted trials in reduced stock choice, only a minority of shoppers noticed the reductions, and sales actually increased. Removing slow-selling products from shelves can boost revenue through higher stock turnover, sales per square meter, and customer satisfaction. And the added shelf space can be used for fee-based product placements, more in-store services, and promotions. Costs are lower, too, thanks to a more streamlined supply chain and reduced

restocking costs. Since 2015, Tesco has reduced its product offerings by between 25 and 50 percent.

- **Returning to the core.** Over the years, large global retailers such as Walmart and Tesco have tried to expand into more carefully selected locations with their smaller “express” stores. However, these stores have typically been sited in more expensive inner-city retail markets, which only raised costs. The expansion also meant a dilution of the chains’ brand identity, moving away from what customers expected of their retailers: extensive choice, wide aisles, and a pleasant shopping experience. Closing these stores and moving back to their core brand identity and historical strengths has lowered revenue to some degree, but it has also significantly streamlined their core structure. A more recent example is Makro, which has chosen to close its online stores in order to focus on its successful offline channel.
- **Partnering.** In a daring, innovative, and some might say counterintuitive move, some retailers are actually partnering with competitors to boost their offerings — a successful tactic that many incumbents are being persuaded to test. For instance, Dutch online housewares superstore Bol.com, founded in 1999 and now owned by Ahold, opened its platform in 2012 to third-party retailers that in the past had competed with its own offerings. This collaboration has helped it create a unique value proposition, enabling it to outperform its rivals. Bol.com now offers more than 11 million products, two-thirds of which come from its partners. The company’s management estimates that owners of single brick-and-mortar stores can increase their sales by as much as 30 percent by joining forces with Bol.com.

A strategy that works

If incumbent retailers are to grow in this disruptive arena, they need to act less conventionally. Their challenges are greater than those of new entrants because of their cost base and legacy, so standard reactions to problems are unlikely to bring immediate rewards. They can't simply expect revenues to rise because they set up an online channel and developed some apps. Nor will they suddenly become competitive by cutting costs, or by making incremental improvements to their stores. Instead, they must focus on the five strategic imperatives discussed at length in Strategy&'s *Strategy That Works*:

- 1. Commit to an identity.** Focusing solely on growth can trap a business on a “growth treadmill” — measuring success on a quarter-by-quarter basis rather than planning for the long term. Every retailer's first task is to be clear-minded about its identity, what it is offering, and how it is differentiated. For example, fashion retailer Cos, the up-market sister brand of H&M, has set itself up as a more expensive, specialized retailer focusing on “fast fashions” — rapidly produced lines dependent on the ability to pick up insights into current trends. As a result, it has gained a significant foothold in just eight years, and now has more than 150 stores worldwide.
- 2. Translate the strategic into the everyday.** Retailers must deliver their strategy consistently. Attempting to be all things to all people is no longer attractive. Successful innovators make sure their new model is their core business, rather than presenting it as a side offering, as some incumbents do. Their strategy is not simply about a vision but about what they do on an ongoing basis — bringing something new to the customer every week, sourcing more efficiently, and practicing the strategy daily.
- 3. Put your culture to work.** Culture is an asset that can't be duplicated and can reinforce strategy — or undermine it. At companies where strategy doesn't connect to execution, executives complain about culture. Employees, they say, reject the strategy and resist change.

But winning companies view their culture as their greatest asset. Retailers must celebrate and leverage their cultural strengths rather than simply being buffeted by a whirlwind of reorganization. Extraordinary cultures are distinctive — each outstanding company has its own. But they're marked by a few common traits: emotional commitment (everyone buys in), mutual accountability (people hold one another to high standards), and collective mastery (a unified culture makes the whole more than the sum of its parts).

4. **Cut costs to grow stronger.** Invest in what matters and cut what doesn't. A ruthless approach to paring away the activities and stores that aren't contributing to your strategic intent is often required to ensure growth.
5. **Shape your future.** Create demand by reimagining the capabilities that made you great rather than reacting constantly to market changes. Successful incumbents create new business models, new capabilities, and fresh product lines in ways that don't compromise their cost advantage.

Conclusion

The European retail revolution that many believed was still a few years off is happening now. The landscape is already being disrupted by the e-commerce revolution, an overabundant brick-and-mortar legacy, price-obsessed consumers, and increased competition from any number of innovative startups.

Despite the turmoil, a retail renaissance is beginning to emerge. The winners are proving agile enough to spot trends and create niches, fueling demand for goods and services. Instead of shortsighted tinkering around the edges, these companies are changing their value propositions to distinguish themselves from the competition. And instead of relying on tried and trusted supply chains, winners are adapting them to push their portfolio of products in smarter, more efficient ways.

In other words, the winners are winning in spite of the challenges. They are innovating on their own terms — and the bolder they are, the greater the rewards.

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