Euro-shop 'Til You Drop

European firms have been highly successful in exporting their proprietary distribution models and formats all over the world. Distribution is one of the industries in which Europe leads the world, contributing important innovations

Executive summary

This article analyzes current realities and trends in the European distribution sector. The authors describe the environment of five important markets (France, Germany, Great Britain, Italy and Spain), and three sectors in which Europe is playing a leading role globally (food, textiles and luxury goods).

Resumen del artículo

Este artículo analiza el presente del sector de la distribución europea apuntando algunas tendencias de futuro. Los autores describen la coyuntura que viven los cinco mercados más relevantes (Alemania, Francia, Gran Bretaña, Italia y España), en tres sectores en los que Europa mantiene capacidad innovadora internacional: alimentación, textil y bienes de lujo.

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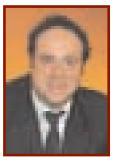

José Luis Nueno
Professor, IESE
Marketing Department
nueno@iese.edu

Carlos Mora
Research Assistant,
e-Business Center PwC&IESE
cmora@iese.edu

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Despite being a very heterogeneous market, the European distribution sector generally follows the same pattern that shares three future tendencies: growing internationalization, a drastic reduction in the number of stores and falling prices

Systematizing the European distribution environment is a complex task - for academics, as well as distributors themselves. However, a number of leading European companies have developed models that stand out for their success and sustainability on the continent, and in some cases, around the globe.

First of all, when analyzing the European market, it should be noted that five countries (Germany, France, United Kingdom, Italy and Spain) represent 75% of distribution sales in food, as well as textiles. Although they have obvious differences, these countries share common characteristics and tendencies, especially in their demographics. Nevertheless, we are still a long way from full convergence and Europe continues to be a group of nations with distinct characteristics, cultures, customs and languages. In order to simplify our analysis of distribution in Europe, we will focus our discussion on these five countries. Moreover, we will study three business lines in which Europe is contributing differentiated formats: food, textile and luxury goods. Outside of these three areas, innovative leadership is driven principally by the United States.

Despite being a very heterogeneous market, the distribution sector in Europe generally follows a pattern with three main tendencies: growing internationalization, a drastic reduction in the number of stores and falling prices.

1. Growing internationalization. The emergence of global competitors in food distribution is led by European companies (9 of the top 10), with the exception of **Wal-Mart** (USA), whose international sales in the year 2000 represented less than 7% of its turnover.

Consequently, international formats in food distribution correspond to European companies whose international sales represent a high percentage of their turnover. Examples are **Delhaize** (83.4%), **Carrefour** (40.2%), **Ahold** (76.6%) or **Tengelmann** (49.0%). In the case of the textile and fashion sectors, we can also observe that many of the most highly international models correspond to European companies. Among the international top 10, are three Spanish firms: **Inditex**, **Mango** and **Cortefiel**. **Mango** and **H&M** are the most representative cases. At the end of the 2001 financial year, **Mango** had 575 shops in 68 countries throughout Europe, Africa, Asia and Central and South America, whose sales represented 66% of the total. For **H&M** in 2002, foreign sales accounted for 89% of the total.

2. Reduction in the number stores in food and textile sectors. Another trend that can be noted is the drastic reduction in the number of stores, both in the food and textile sectors. The fall in the number of food stores has been slower than that of the textile sector, but it has continued the steady decline that began in the 1980s with the proliferation of large supermarkets. On the other hand, the number of stores in the textile sector has shrunk more rapidly recently, due to a combination of factors: the emergence of specialized chains, decline among incumbents, and the globalization of the supply chain. In spite of this common trend, differences among European countries remain sharp. The number of shops per million inhabitants in Spain (1,599) or Italy (1,725), for example, is four times greater

The European Distribution Market

THE KEYS

DISTRIBUTION TENDENCIES	FOOD		TEXTILE
Internationalisation: *Decrease in the number of stores* *Fall in prices*	Market size (2001) in Europe $901 billion • Germany $183 billion • France $147.7 billion • United Kingdom $145.4 billion • Italy $119.2 billion • Spain $59.6 billion The five countries represent 75% of the market	*Tendencies:* • Orientation towards discount: Growth of discount stores. • Sector concentration: Independents lose market share throughout Europe • Strong regulations • Globalisation of the big players • Global expansion players towards Eastern Europe	In 2001, the European textile distribution industry was 210,000 millions of dollars. • Germany (25%) • United Kingdom (18%) • France (15%) • Italy (12%) • Spain (7%) The five countries represent more than 75% of the market. With the exception of Italy the market size has decreased. Independent stores, especially in Italy and Spain, continue to represent an important share, but the specialist chain formats are gaining ground.

than that of Austria (415) or Finland (493). In the textile sector, the implementation of the MFA (1) in 2005, which will permit the free importation of Chinese products, will intensify consolidation.

3. Fall in prices. The risk of investing in emerging countries has led companies to reinvest surplus in their own regions. This has increased, in some instances, capital intensity and the efficiency of companies, while increasing competition. This combination has transferred savings to the consumer and reduced prices. It is precisely in sectors which are easily moved abroad, such as textiles, where the trend toward lower prices is most visible.

The Profile of the European Consumer: Present and future

European consumers are very heterogeneous –different lifestyles and customs still hold sway– yet they share common demographic characteristics which are affecting their purchasing habits. An aging population, increasing immigration, the massive entrance of women into the workplace (particularly in Southern European countries), and the proliferation of single-person homes have all influenced European consumer patterns.

The most important demographic shift has been the overall aging of the population. Reduction in birth rates and an increase in life expectancies have produced an older population, which is being offset by immigration. By 2050, the average age of European consumers is predicted to be 47.4 years old.

Consumer patterns change as customers age. After reaching 50 years of age, consumers start placing a major part of their income into savings, a tendency which becomes more pronounced as life expectancy increases. "Mature" consumers also dedicate more money to other parts of their budget, such as homes and goods. This consumer is very price sensitive and will be increasingly so in the future.

In countries with older populations, such as Germany or Japan, lower retail prices have become visible among a great number of products. A recent article in *Business Week*, "Deflation Nation," describes how high deflation in Japan is reaching all spending groups, but has been significantly impacting food, housing, consumer electronics and clothing. Discount store models have known how to respond best to these low pricing needs.

When predicting future tendencies, one must take into account the incorporation of young, educated consumers into the market. These new consumers will require new business models, different from those of the supermarkets, hypermarkets and departmental stores that have been supplying consumers born in the 1950's, 60's and 70's.

A study made by J.L. Nueno and J. Ferrer (2002) using data from TNS shows that customers loyal to vertical chains in the textile sector (formats such as **Mango**, **Zara** or **Women's Secret**), increase their frequency of purchase, spend twice as much money and purchase double the quantity of goods in the same chain after three years of regular shopping.

Thus, we can conclude that there exists a process of consumer education toward a consumer format or pattern which affects buying behavior. In contrast to the 40-year-old consumers of today, who are accustomed to buying during the inflationary era of the 70's and 80's, the 20-year-olds of today are frequent users of increasingly lower cost models. Without a doubt, this process of education will affect actual behavior patterns and also future distribution formats.

Distribution Formats and Sectors

The Food Industry. In relative terms, the food distribution sector is characterized by high concentration. With the exception of Eastern European countries and Italy, the market share of the three principal players is more than 50%.

Some years ago, the expansion of the French hypermarkets toward the south marked the sector's evolution. However, strong regulation and store policies of strategic selection have slowed down this tendency in favor of the discount format. Local stores have improved their selection and price, thereby attracting many consumers who previously shopped in hypermarkets. We must not forget that the key advantage of the hypermarkets is "one-stop shopping" (the consumer can make all necessary purchases in one place, at a low cost).

GERMANY. If we analyze the three largest markets (Germany, France and the United Kingdom), we see that the German market is characterized by a high proportion of discount stores. According to IGD the leader in the year 2001 was **Aldi**, a discounter, with

	Characteristics of the winning formats: (*) • One brand • Wide target public • Basic products or with a high fashion content • Large stores • Global supplies (*) Based on Inditex (2000)	*Characteristics of the losing formats:* • Multi-brand • Micro-segmentation • Small stores • Orientated towards the domestic market

LUXURY		
• Multi-channel structure has enabled to reach a wider market • Luxury for a wider target public • Forays into the prestige market spending on small affordable luxuries which have become known as *masstige* or *mass-prestige* • Emergence of new luxury products and services concepts such as Starbuck's	*Consumer Tendencies:* • European population (1998): 798 million • European spending (1998): $5.7 billion • Convergence of the characteristics of the European consumer despite existing differences (more than 30 European languages) • Population aging: Average age in 1998: 37,1; 2050: 47,4	• As a percentage of private consumption food and clothing have diminished • Educated young consumers with new business models • Emergence of new consumers with different tastes. The third age, single person homes, unmarried partners and immigrants

16.9% of the market. The success of this formula situates Germany as the cost leader, with prices below those of comparatively less mature economies such as Spain, the second European market in Western Europe where you can shop cheaply. Consequently, it is of no surprise that German distributors' margins are almost half that of the French and the lowest in Europe. Discounters have high own-brand quotas, with a penetration of up to 90% in **Aldi** and 50% in **Lidl**. The next format expansion wave in Europe will occur when discounters move from West to East due to the competitiveness of this format.

FRANCE. Hypermarkets continue to lead as the principal food distribution channel. Distribution is highly concentrated and **Carrefour** heads the list with a market share in 2001 close to 23%, followed by **Leclerc & Système U** and **Intermarché**. This concentration of competition has allowed distributors to maintain high margins (almost 20%), despite the overall trend toward price reduction. Own-brand quotas are relatively low among distributors (around 20%).

UNITED KINGDOM. The U.K. has the highest own-brand quotas in Europe. As a result, the low market share of the hypermarkets and discount stores and the relative protection of the continental players permit higher margins (27%) among the three countries being analyzed, in spite of growing pressure from competitors.

One common characteristic of food distribution across Europe is the high regulation of prices, opening hours and expansion. The intensity and scope of regulation varies according to country but there exists a clear duality between French and German (stricter) regulation which marks trends in the rest of Europe.

Encountering major obstacles to growth within their own countries has led major players to greater geographic diversification (both within Europe and globally), as well as business diversification, also regulated and limited by authorities.

Excessive regulation, which restricts market leaders from acquiring smaller companies so that they do not take a dominant position in their respective markets, leaves second league players immune. These lower-tier players will, in all probability, generate the next wave of mergers in European food distribution. Other countries (the United Kingdom, Spain or Italy) and other formats (supermarkets, convenience store chains) will play the leading role in this activity.

The luxury goods industry. Another clearly European contribution to the sector is the distribution of luxury goods, led principally by French and Italian companies. Traditionally, luxury goods were sold to affluent consumers through exclusive stores, owned by the companies themselves. In recent years, however, the sector has undergone a structural change, expanding its selection to a larger consumer group with a medium/high purchasing capacity.

New luxury goods consumers are the same as those who shop in discount stores, however, they make forays into the prestige market, spending a part of their budget on small affordable luxuries. These products have become known as *masstige* or *mass-prestige* products. The sector has gained a group of sporadic luxury goods consumers, and shifted from selling a lot of products to a few consumers, to selling fewer products to many consumers.

These new consumers have contributed to the success of new concepts such as **Starbucks**, **Aveda** or **Origins**, the MINI or those that buy the silk accessories of **Loewe**, **Gucci** or **Louis Vuitton**. This market is above all composed of medium-range consumers who are inclined to buy one type of luxury product but not necessarily more. Each year these consumers make one or two luxury goods purchases, especially products such as accessories or perfumes in the fashion sector or bottom-of-the-range top-brand products, such as small leather goods, which represent a medium/low purchase value.

Intensive consumers continue to be very important for the sustainability of the luxury business model. These consumers buy intensively and regularly, and submerge themselves in all the aspects of luxury and its categories. The polarization of income has led to an increase in the number of affluent consumers, with more disposable income. The top 1% Europeans, ranked by revenues, are growing their wealth much more than the remaining 99%. These intensive consumers are then very important to luxury. Within this group of consumers attracted to luxury, the relevance of the Asian consumer should be highlighted, and in particular, the Japanese, who have a high appreciation for top-range quality artisan products. For companies such as the **LVMH Group**, **Pinault-**

C. A Metro-politan

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Printemps-La Redoute and **Richemont**, the purchases of these wealthy tourists could represent between 15% and 50% of sales, when combining sales made in Japan and those of travelers, and depending on which brand is considered.

In order to reach a greater number of customers, the original Italian and French luxury goods stores have changed their models and have taken advantage of a multi-channel structure. In this way, luxury brands use their own stores as “flagships” in the main commercial and tourist thoroughfares of the large cities to tend to their loyal clients: the great luxury consumers.

The distribution of luxury brands through department stores is an opportunity to offer access to a wider market, especially in the larger cities. Luxury brands are presented in the department stores using the “store within a store” concept, which is a natural extension of own-stores. Duty free shops also permitted access to a massive market, but suffered an important decline following the fall in international air traffic. Moreover, the multi-brand store offers a channel that permits a greater selection of brands and is especially effective in reaching medium-size populations, where it is not feasible to open an own store.

The Textile Industry. Unlike the previously mentioned sectors - which reflect generally stable values in terms of size, when not slightly growing – the evolution of the clothing sector has been marked by a drastic reduction in terms of spending in monetary units. Spending on this sector within the family budget has dropped 20% since 1995. This phenomenon has been accompanied by deflation, and falling prices year after year. The textile sector can relocate the generation of the total value added and, as in toys or consumer electronics, demonstrate its effects on price and quality.

Another characteristic which distinguishes the textile sector from other sectors is its high level of fragmentation. With the exception of the United Kingdom, independent stores make up 40-60% of sales. The United Kingdom, Italy and France are the three principal markets of the textile distribution sector. The U.K. market is one of the least fragmented and in which the **M&S**, **Arcadia** and **Next** chains control almost 30% of the market. Specialist chain stores such as **Zara**, **Mango** and **Uniqlo** have had a good acceptance despite the high number of specialists, which makes competitor market entry difficult. Deflation has also affected this country, despite having low international presence.

The Italian market is the largest European market in the textile sector. It is characterized by high fragmentation (65% of sales correspond to independent stores), principally due to the application of strict regulations. In order to enter into the market, it is necessary to obtain not only the consent of local government and the municipal economic authorities, but also that of the adjoining competition. Consequently, models that are enjoying success at an international level have difficulty in entering the market and the few means to entry are through alliances and acquisitions. Italian chains (**Superga**, **Diesel**, **Benetton**, **Stefanel** or **Armani**) are the territory’s undisputed leaders. Another peculiarity of this sector in Italy is

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the existence of a large group of local consumers who buy luxury and prestige brand textile products, an effect that sustains textile sales in the country and which is not observed in any other European country.

France is a very peculiar market. In spite of having relatively low fragmentation (25% of sales correspond to independent stores), food distributors – the large hypermarkets – also have a high market share in the textile sector. In the undergarment market, for example, hypermarkets channel 30% of sales and are the main distribution channel. In this market, the entry of new players such as **Zara**, **Mango** or **H&M** are stepping up competition. On the other hand, department stores are also seeing a boom and are especially important in distributing luxury garments.

In textile distribution, the new winning business models that stand out are those that have understood the changing needs of fashion, adapting their business models to compete in terms of time. The winning formats such as **Zara**, **Mango**, **Gap**, **Next** or **H&M**, share certain characteristics. For the most part, they have supplies on a global level, a single brand aimed at a wide segment, with basic products or high fashion content and they sell from large stores (more than 250 m2) to a global client. On the other hand, formats that are losing market share are those that have small stores, aimed at a narrow segment and centered on a local market.

Conclusions

1. The Euro-consumer is still far from being a reality despite the real convergence in consumer tendencies. Throughout Europe, one can sense a significant attraction among consumers to the discount model, reflected by the "Everyday Low Prices" model of **Wal-Mart** in the USA or **Mercadona** (the retailer with the largest growth in all of Europe) in Spain. Given this situation, retailers in the food and textile sectors have been obliged to improve operational efficiency and reduce prices, causing smaller-size businesses to feel the squeeze of competition.

This situation, together with the continuing mergers, acquisitions and alliances within the sector, has created high concentration within the food and textile sectors. On the other hand, given the size of their original markets and the restrictions arising from regulations, we have seen that European retailers have become more international than their counterparts in other regions and, and have done so far more rapidly. As a consequence, European distributors have important international market shares in Europe, South America and emerging shares in Asia. In upcoming years, growth will center principally on Eastern countries.

2. In the food sector, the emerging model and winning format is the discount store. Following this model, one consequently observes a general fall in margins and the growth in share of own brands. The hypermarkets are trying to improve their margins by adjusting their strategies with important discounts in food and through the extension into other business lines such as bazaar, textile and electrical appliances. In the future, a wave of consolidation among supermarkets can be expected, while Italian operators continue to be isolated in their own playing fields, and German discount stores gaining share in their Eastern expansion.

3. U.K. convenience store chains will be another of the models to emerge in other European countries over the next few years, to serve new consumers, especially males with little experience in purchasing food stuffs.

4. In the textile sector, the most international business models correspond to the Spanish short-cycle fashion chains and the French and Italian luxury stores. Nevertheless, this sector continues to be dominated by the independent multi-brand stores that represent the bulk of the market. The progressive loss of competitive capacity of these stores is opening up an opportunity for the emergence of specialists, vertical chains or even multi-brand chain stores. The deregulation within two years of Chinese imports will have a big impact on the textile sector and especially in short-cycle distribution.

5. A large number of European specialist players have emerged in other markets such as sports (**Decathlon**), entertainment (**Fnac**, **Virgin**), home improvement (**Leroy Merlín**, **Bauhaus**), electrical goods and consumer electronics (**Saturn**, **Miró**, **Dixons**, **Darty**), furniture (**IKEA**, **Habitat**) and others. Nevertheless, most of these models are inspired or imported from the U.S. category killers. In Eastern Europe, these players are going to find great growth opportunities, being a market without any type of competition. Certain areas continue to provide important opportunities for specialists: Bed & bath (stores focused on bathroom and bedroom accessories), car dealers (deregulated as of 2004) and office supplies, which needs a winning format in Europe. ■