

RTT White Paper

KPMG/Synovate Retail Think Tank – White Paper #10

Are there limits to the growth of major retailers or will these companies just continue to get bigger?

Introduction

In its previous white paper (published October 2008) the KPMG/Synovate Retail Think Tank (RTT) explored whether a downturn need necessarily be *all bad* for *all retailers* and looked at the positive and negative effects which the current downturn is likely to have on the sector.

One of the key conclusions of these discussions was that the retail sector over the past 30 years has become characterised by larger retailers and had become increasingly concentrated, noting that the recessions of the 1970s and 1990s acted as a catalyst to accelerate the pace of this structural change.

At its latest meeting, the RTT discussed a topic which followed on closely from this. Given that the group had found previously that the market has become more concentrated – and that downturns had speeded up this process – it debated the question ‘*are there limits to the growth of major retailers or will these companies just continue to get bigger?*’

Until a few years ago, retailers’ growth was limited by a number of issues which no longer seem to act as constraints to growth. At the same time, the sector is much less concentrated than others such as oil and gas, chemicals and pharmaceuticals, which feature a very small number of large, key players, suggesting there may be scope for retailers to grow much bigger.

With this in mind, are there limits to the growth of retailers, and if so, what are they now?

The growth of retailers: how retailers have overcome traditional constraints?

The RTT discussed the factors retailers have traditionally encountered which have constrained their growth. However, the group agreed that the majority – if not all – of these factors have indeed now been overcome in various ways.

So what has traditionally constrained retail growth and how have these barriers been overcome?

The RTT noted that whilst there are bigger companies in other sectors, these industries do not tend to have the same **infrastructure and internal management** issues, with complex structures of individual units which retailers have in place across hundreds, or in the case of the largest retailers, thousands of locations. However, retailers have overcome this constraint by developing ways of managing their infrastructure and internal management through innovative business models. For example the 'spider plant' method of creating new, self-contained divisions, used by retailers such as Carrefour and Wal-Mart, has allowed these organisations to grow without unwieldy layers of management which have proven to be a constraint to growth in the case of some retailers.

Over the past three decades, **information technology** has developed and improved exponentially, allowing retailers to vastly improve many aspects of their business and service. In particular, IT has enabled the growth of large, co-ordinated networks of stores, distribution centres and suppliers, as well as had a positive effect on customer service, marketing and supply chain management. At the same time, **logistical issues** have been overcome by the development of new transport methods, delivery processes and stock control and management systems. Human resources and staff scheduling is another key area where new management systems can determine optimisation on even an hourly basis.

The further issue of **market saturation** is being addressed by retailers through the creation of differing formats. For example, fashion group Inditex operates eight different brands which consist of Zara, Pull & Bear, Massimo Dutti, Bershka, Stradivarius, Oysho, Zara Home and Uterqüe. At the same time, **penetration of different market segments** has been facilitated by innovating new formats, as highlighted by Tesco with its Extra, Superstore, Metro and Express trading styles.

Restrictions to expansion imposed by domestic governments have been overcome by moving into external markets. The availability of - and access to - new markets has increased with European retailers overcoming their reticence to enter the US and, in some cases, finding ways to work without necessarily incurring expensive set-up costs overseas. For example, companies are able to test an overseas market such as the US initially through on-line sales and fulfilment from its UK bases to gauge demand. At the same time, big retailers don't all share the same view on where their next growth opportunity is likely to come from, with different joint ventures opening up markets overseas which were previously closed to outside entrants, such as India and China.

In some cases, retailers have turned what could have been a constraint to their advantage. The challenges which are posed by **new markets and cultural differences** have in turn helped to initiate innovations and ideas, both of which the RTT have previously stated are crucial in retailing, particularly in a downturn.

Regional and cultural differences have been alleviated for some companies by external factors. For example, in the clothing sector, the warming UK climate means that people have more 'year-round' wardrobes making seasonality less important and overseas retailers under less pressure to create UK-specific ranges. At the same time, UK retailers are more able to cater to markets such as the hotter Mediterranean countries with their own home-designed ranges too.

How has the retail landscape changed?

In discussing the removal of constraints, the RTT reviewed the top ten global retailers in 2007 and in the two previous decades to assess whether this has effected change within the retail landscape.

The world's biggest global retailers (in million US\$)

1989		1999		2007	
Kmart	\$29,533	Wal-Mart Stores Inc ↑	\$163,532	Wal-Mart Stores Inc. =	\$375,126
Sears Roebuck & Co	\$28,824	Carrefour Group ↑	\$52,196	Carrefour Group =	\$113,502
Wal-Mart Stores Inc	\$25,810	Kroger Co ↑	\$45,352	Tesco Plc ↑	\$95,123
American Stores	\$22,004	Metro AG ↑	\$44,163	Metro AG =	\$88,945
Tengelmann	\$19,216	Home Depot Inc ↑	\$38,434	Home Depot Inc. =	\$77,300
Kroger Co.	\$19,103	Albertson's Inc ↑	\$37,478	CVS Caremark ↑	\$76,329
Metro/Kaufhof	\$18,200	ITM Enterprises ↑	\$36,762	Kroger Co. ↓	\$74,120
JC Penney	\$16,103	Sears, Roebuck & Co ↓	\$36,728	Schwarz Group ↑	\$67,850
Rewe	\$15,280	Kmart Corporation ↓	\$35,925	Target Corporation ↑	\$64,023
Dayton Hudson	\$13,644	Target Corporation ↑	\$33,702	Costco Companies, Inc. ↑	\$63,882

Source: Institute for Retail Studies, University of Stirling

Please note: \$ conversion rate affects the figures of non-US retailers but does not change the ranking in these years

Key:

General
General (including food)
Food
Department stores
Pharmacy
Home improvement

From the three top ten lists of retailers, the RTT observed the ascendancy of 'general' retailers which also sell food (or food retailers which also sell non-food goods). This has grown from one company (Wal-Mart) in 1989, which occupied the third position, to three retailers (Wal-Mart, Carrefour and Tesco) in the top three spots in 2007, perhaps highlighting the willingness of consumers to purchase a wider range of food and non-food goods from one retailer.

In the three different years shown, the gap between the top three retailers and the rest of the top ten has opened up significantly; in 1989 top-placed Kmart was just over twice the size of the tenth largest (Dayton Hudson) while in 2007 Wal-Mart was almost six times larger than Costco in the number ten spot.

Although the table was dominated by US and German-based retailers in 1989, one UK and two French retailers entered the top ten in 1999 and 2007, illustrating the historic impact of the size of the US market on the sector globally and a greater willingness from European retailers to be more international in the last decade. The 2007 table highlights Tesco's rapid growth as it appears in the third position, having not appeared in the list eight years before. This concentration of retailers hailing from a small number of countries suggests that more globalisation is possible as retailers from emerging markets grow.

The presence of pharmacy operator CVS Caremark in 2007 at number six in the table and American home improvement retailer Home Depot at number seven shows that 'single sector' retailers do still have the ability to maintain their position despite the rise of general retailers.

Are there new constraints to retail growth?

Having explored the top ten retailers globally and looked at how they have grown, the RTT agreed that this shows that many of the traditional constraints have been removed to allow this expansion.

Although retailers have successfully overcome many of the barriers they have traditionally faced and growth within the top companies has progressed rapidly, the group agreed that there are still factors which constrain growth and believes the following list represents a *new* set of constraints which businesses now face.

People

Quality of leadership is crucial in a retail business and the RTT agreed that this is one reason why previously successful companies have floundered in the past. As a business grows and the number of individual outlets increases, there becomes a smaller pool of people who have the knowledge and skills to maintain focus, cohesion and strategy as well as keep driving it forward.

At the same time, staff on the shop floor and in back office roles are essential in providing and maintaining quality of service, replicating the culture and ethos which flagship stores have become known for; the group highlighted the importance of the 1001st store being able to embody this every bit as much as the first.

At both ends of the scale on personnel, retailers continue to encounter the challenge of having both the time and resource to keep recruiting people who can replicate the skills and culture of the business across multiple sites as a retailer grows.

Competitors

Competitors will inevitably find new ways to erode different parts of a retailer's market, and the RTT pointed out that when retailers expand, it is crucial to remain focused on the developments and innovation which their competitors are implementing. The development of separate brands within the same group has been successful in alleviating this to some extent, but it remains a key area which requires focus.

Finance

The availability of finance post-credit crunch is a relatively new constraint, following a long period of funding being available. However, the RTT noted that innovative retailers have already started to find ways of dealing with this, such as working in partnership with suppliers to help continue to finance expansion.

Creating shareholder value

Creation of shareholder value is a fundamental function of the capitalist system. The group discussed that as a result of this, there may become a point where divesting a brand could actually create more value for shareholders than it can by continuing to be part of a retailer's business, pointing to the consumer products sector where this process has been already been witnessed. Could retailers in the future find that optimum shareholder value is created by shedding brands to focus on the strongest performers? If this is the case, shareholder value could be created more effectively through the seeming paradox of an organisation making itself smaller rather than growing larger, effectively putting a limit on growth within some companies.

Consumer backlash

If an organisation becomes perceived to be 'too big', and this is seen to be detrimental to the consumer's experience or contrary to their values, this too might become a growth constraint. The group agreed this has not yet arisen on a significant scale, so it is difficult to predict what the consumer's response might be. However, in recent years it is evident that consumers have become more aware of the power they have and are prepared to lobby and/or vote with their feet if they don't like what they see. Even if this isn't enough to effect significant change, the negative publicity alone could be detrimental and this in turn could become a new and significant constraint to future growth.

Fundamentals of retailing

Finally, the group recalled the discussions in its white paper from November 2007 entitled 'what are the secrets of successful retailing and how can retailers survive and prosper in a

downturn?’ The white paper highlighted the fact that ignoring the fundamentals of good retailing – knowing the customer, having the right proposition and a sound business model – can become a constraint, whether trading in a downturn or a buoyant economy.

Conclusions

In the course of its discussions, the RTT agreed that the global retail market is not as concentrated as other industries, meaning that there is *still* considerable scope for growth, which has already picked up pace over the past 20 years. However, while many traditional constraints have been overcome, new hurdles have nevertheless emerged.

The group concluded:

- **There are still limits to the growth of retailers.** The current list of top retailers highlights that businesses have continued to grow by developing ways of overcoming traditional constraints to growth, but new constraints have and will always emerge;
- One of the most important constraints to growth which now has an effect is that as retailers get bigger, they often **lose their focus and cohesion as they grow** and the right **people** to implement strong leadership are crucial in avoiding this situation. As retailers expand, leadership and quality of service can become challenging to maintain;
- There is still a **long way to go to before a truly global market exists.** Although the RTT agreed this process has already started, it predicted it could take 20 years to fully develop;
- Ultimately though, no single retailer can be **‘all things to all people’**. Because of this, retail remains varied and competitive and there will continue to be a role for ‘niche players’ despite the continued and exceptional growth of the very biggest companies.

-Ends-

Note to Editors:

First mentions of the Retail Think Tank should be as follows: the KPMG/Synovate Retail Think Tank. The abbreviations Retail Think Tank and RTT are acceptable thereafter.

The RTT was founded by KPMG and Synovate (formerly SPSL) in February 2006. It now meets quarterly to provide authoritative ‘thought leadership’ on matters affecting the retail industry. All outputs are consensual and arrived at by simple majority vote and moderated discussion. Quotes are individually credited.

The Retail Think Tank has been created because it is widely accepted that there are so many mixed messages from different data sources that it is difficult to establish with any certainty the true health and status of the sector. The aim of the RTT is to provide the authoritative,

credible and most trusted window on what is really happening in retail and to develop thought leadership on the key areas influencing the future of retailing in the UK.

Its executive members have been rigorously selected from non-aligned disciplines to highlight issues, propose solutions, learn from the past, signpost the road ahead and put retail into its rightful context within the British social/economic matrix.

Members are:

Nick Bubb, Pali International
Prof. John Dawson, Universities of Edinburgh and Stirling
Dr. Tim Denison, Synovate
Helen Dickinson, KPMG
Richard Lowe, Barclays Retail & Wholesale Sectors
Vicky Redwood, Capital Economics
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