Why brands should now be investing in retail

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Historically, brands' core skills have focused on innovation, design, developing and renewing product ranges, production and communication. They sold to retail channels, which dealt directly with consumers. Their role was to innovate and communicate, thereby encouraging consumers to buy their products.

Today, four trends are forcing brands to reconsider this position and to consider investing in retail, either physical or via the internet. This sea change applies not only to luxury or clothing brands, but to all brands.

1. The development of emerging countries

In many consumer goods categories, emerging countries have become the main driver of growth for brands. These economies are experiencing growth in both penetration rates and product value.

For a brand, the challenge in these countries is to grow two or three times faster than the market in order to build leadership positions[1].

One way in which a brand can drive growth forward is through retail. There is a strong relationship between the per capita consumption of a product and the per capita number of stores that distribute the product. However, there is often a bottleneck at retail level.

Therefore, in order to spur revenue growth, it is necessary to accelerate retail growth. Brands cannot simply wait for action to be taken downstream (retailers). They must invest in retail if the traditional channels are not suitable or if modern channels are not developing quickly enough.

This is the strategy adopted by Adidas in emerging countries, for example. Its network of own stores accounts for over 70% of revenue in emerging economies, but only 10% in developed countries (see Table 1).

The issue is particularly critical in rural areas where modern retail is less developed. The solution involves various forms of distribution such as door-to-door or party plan sales. In India, for example, Unilever has developed a home sales network, the Shakti scheme, using Indian widows as a direct in-home sales channel, thereby increasing its presence in rural areas.

The challenge is to determine the most appropriate mode of distribution given the nature and structure of the market:

- *Brand stores* in all forms, be it in terms of size, type of store (small vs medium-sized; local or out-of-town), or model (stores directly owned and operated by the brand; leasehold stores directly operated by the brand; franchise or part franchise; with technical support, etc);
- *Door-to-door*: for certain technical products for which the presentation and demonstration of the product is an important part of its marketing, door-to-door selling remains an effective marketing method. It is used for example by Whirlpool to sell

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[1] See the article: "Which business models can deliver growth in emerging countries?" 2010.

reverse osmosis water purifiers in India, a technical product that needs to be demonstrated and explained to the customer. There is value in a physical presence. An alternative could be to “drum up” business by going door to door and directing customers to brand stores for a more detailed demonstration of products;

- *Party plan sales*: this increases sales activities by relying on a sales force, developing a rapport and the transfer of good practices;
- *Travelling vans*: for products requiring demonstration in remote areas, the travelling van is an excellent tool for market development;
- *Internet kiosks*: can be an effective sales driver in remote areas.

For a brand wishing to attain leadership positions in an emerging country, investment in retail is often essential.

2. The development of the internet

The internet has changed the relationship of brands to consumers by bringing them closer together. It facilitates contact and leads to more fluid communication throughout the customer life cycle, from pre-sales to after-sales. It forces brands to develop an approach that goes beyond the realm of traditional communication (a pull strategy to attract the customer to third-party points of sale).

Several models are developing, some of which are an extension of physical models (online hypermarkets, specialist online stores, etc), while others are developing new approaches, whether in terms of breadth or depth of range.

For brands, the internet can be an opportunity to develop a distinctive and controlled retail channel, guaranteeing the desired consistency and quality of marketing. In developed countries (for non-food products), nearly three-quarters of customers carry out online research before making their choice, and earmark products of interest before they visit a store.

The goal is also to find an alternative to the price-oriented channels whose business model is based on offering discontinued or cut-price products. Just as in physical stores, e-commerce requires segmentation between low-cost approaches and value-based approaches that play up the attributes and features of the brand: value-added product presentation (3D, simulations, etc), personalised marketing methods (click & talk, etc), and complementary services. In this case, the internet may allow the brand to address the consumer directly and to highlight the innovative features and characteristics of the product using attractive formats that offer more than a 30-second TV advertising spot. However, it has to be said that few e-retailers offer a value-focused approach and environment.

This is the strategy pursued by Weight Watchers in the food segment. More than 25% of Weight Watchers’ revenue is currently generated by e-commerce. Lego has also developed an approach to the internet that allows the brand to enhance its services to the “Lego community”. The target is to derive 20% of its sales from the internet within five years (see Table 2).

E-commerce has many advantages:

- More favourable economics for new entrants that do not have a network to rely on;
- Natural enlargement of the market’s catchment area (beyond the physical location of the stores);
- Possibility of differentiated approaches and added value (beyond price) with a strong qualitative component;
- Optimised, targeted marketing of obsolete and end-of-life products;
- Potential for differentiation from traditional stores with limited risk of retaliation;
- Benefits for brand awareness, even if the actual purchase is made in the physical network.

3. The polarisation of customer buying behaviour and the inadequacy of traditional networks

Retail has traditionally been built around products aimed at a core market in which brands could legitimately develop their expertise. However, we are seeing a development of extremes – entry level and high end – for sociological and economic reasons (increasing numbers of both rich and poor) and behavioural reasons (customers are increasingly segmenting their purchases by category and buying entry-level products for some categories and high-end products for others, regardless of their level of wealth). This polarisation of customer purchasing behaviour raises the question of the marketing of entry-level products, and high-end products in particular.

In many industries, the traditional channels are ill-suited to developing a high-end offer that demands:

- Risk-taking in terms of offers and new products;
- Sales advice and support that highlights the quality or innovative features of products;
- An appropriate environment for the price level and type of products.

Brands that develop innovative products that require explanations and a representative at the point of sale may see their growth limited. Investing in retail allows them to create "concept awareness" and require stores to showcase innovative products.

The success and expansion of the luxury market is primarily the result of the success of its own-store distribution strategy. The traditional network of multi-brand stores was not good at making the most of products, taking risks (particularly in terms of expanding product ranges) and developing a sufficiently qualitative approach to allow luxury brands to grow.

Luxury brands that continued to under-invest in retail, such as Yves Saint Laurent, have stagnated or declined. Those that invested in stores (to the point of accounting for over 75% of revenue) such as Louis Vuitton, Hermès and Coach, aimed at various sections of the market, have grown rapidly (see Table 3).

Similarly, Zara invested in retail because it could not find a network that would allow it to implement its "fast fashion" model. The response time of independent multi-brand retailers and the lengthy buying process was hampering Zara's growth. Investing in retail enabled the brand to:

- Get daily feedback on sales from stores;
- Place new orders for the biggest-selling items;
- Reduce supply lead times to around three weeks through its innovative organisation of the supply chain.

The issue of resource allocation is critical in this case. Retail must therefore be a priority.

4. Pressure from retailers in traditional networks

Retailers carry such a lot of weight that in some cases it poses a challenge to some brands' innovation/communication models.

The pressure that these retailers place on margins reduces room for manoeuvre and means that companies are no longer able to invest in brands and new products. They are then sucked into a downward spiral: products are "commoditised", brand value is eroded and sources of growth and improved profitability vanish.

One solution is to invest in a proprietary retail network, but the timing has to be right. This choice is a radical one. In some cases it may provoke retaliation from the traditional networks. Nevertheless, it opens the way to a virtuous circle and a value-oriented strategy.

This argument also justifies retail investment in emerging countries. What is the value of investing heavily in brands and innovation if only to see margins eaten away 10 years later by retail that captures all of the value?

What to conclude?

Which US retailer has experienced the strongest growth over the past decade? It is not Amazon, which revolutionised e-commerce. It is a brand: Apple. Apple is set to achieve sales of nearly 20 billion dollars through its Apple stores in 2011. Its sales have outstripped those of retailers such as Gap, JC Penney, Toys'R'Us and Kohl's in less than 10 years.

Not everyone is Apple. But all brands have to address the question of investing in physical retail or e-commerce.

The answer to this question is not black or white. It should vary according to circumstance and take different forms: it may prove indispensable in emerging countries, or online, and be inappropriate in the physical networks of mature economies.

Investing in retail offers major potential for growth and differentiation and helps to drive growth in some markets. It requires the brand to clearly define its ambitions, its business model and the relationship between retail investment and traditional activities. It is complex to implement and requires the acquisition of new skills and expertise that historically, brands have not tended to have.

There are not a great many examples outside luxury goods and fashion. However, the movement is underway. It will become the key challenge for brands in the future. The luxury segment, a forerunner in this area, is a reminder of this. Today's leaders are those that initiated the movement towards integration into retail 20 years ago. In other consumer areas too, tomorrow's leaders will be those that chose the right investments and the right approaches. This is an issue that the major brands of the future cannot ignore.

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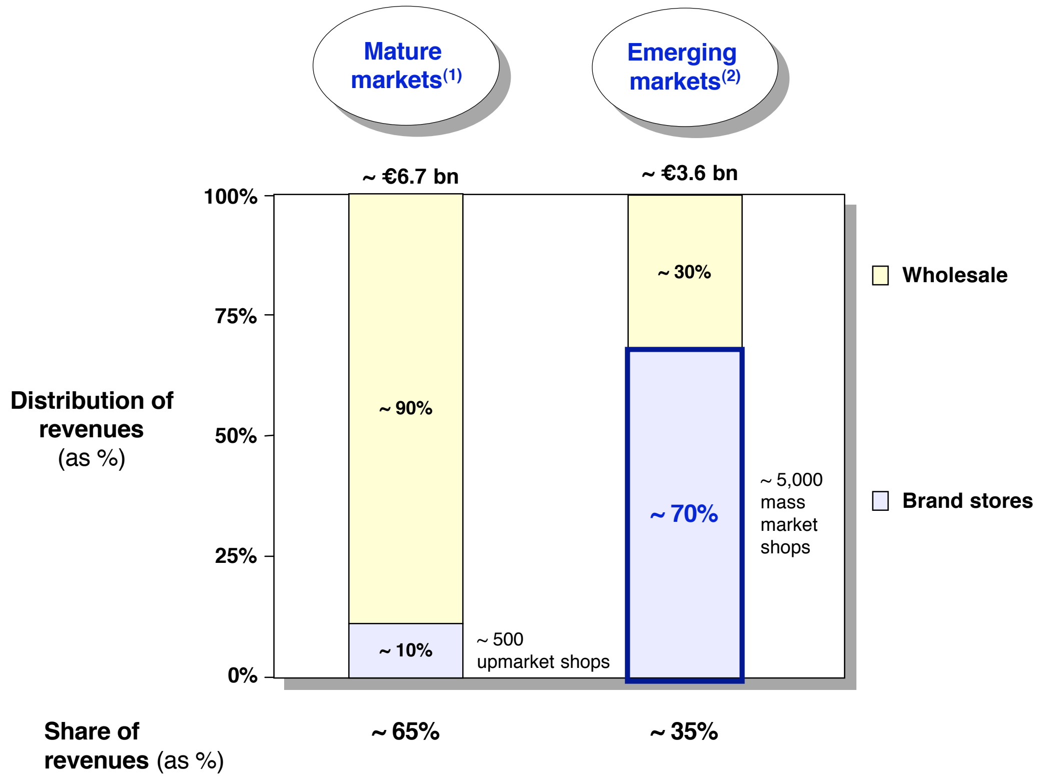
Estin & Co is an international strategy consultancy based in Paris, London, Geneva and Shanghai. The firm assists the boards of major European, North American and Asian groups in their growth strategies, and private equity funds in analysing and improving the value of their investments.

- Table 1 -

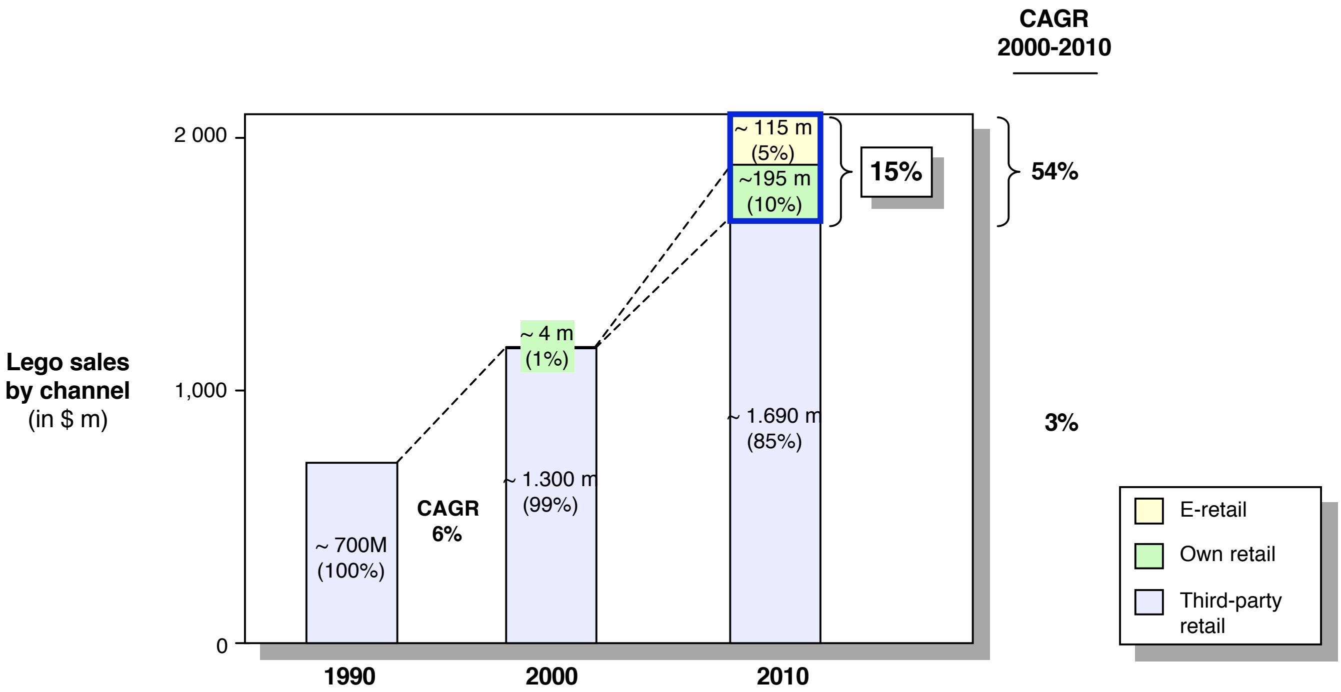
Adidas has expanded its business through its own-brand stores in emerging countries



(1) Western Europe, North America, Japan, Australia, New Zealand; (2) Stores mainly in China, India and Russia. This zone also includes Latin America, other developed Asian countries and Eastern Europe
Source: Adidas, Estin & Co analyses

- Table 2 -

Lego's sales growth

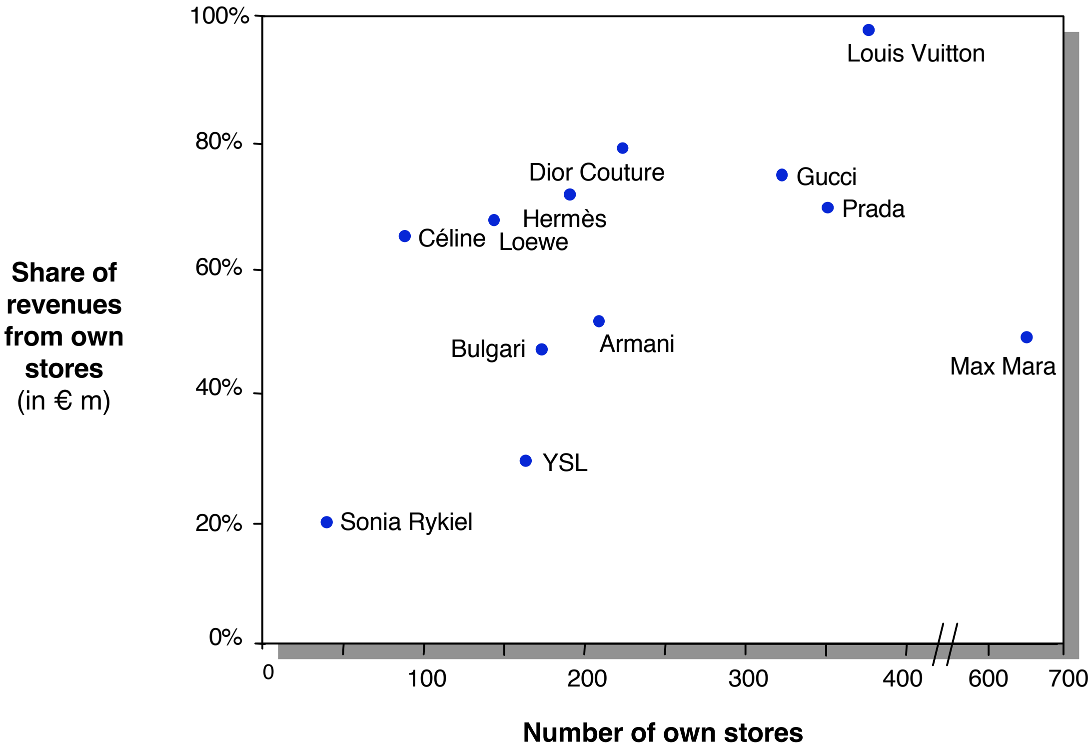


	1990	2000	2010	CAGR 2000-2010
Total sales (in M€)	**700**	**1,300**	**2,000**	**4%**
Number of own stores	**0**	**1**	**52**	

(1) Assessments were made about the average store size (250 m^2), and the average turnover by square metre in a given sales point ($15,000)
Source: Estin & Co analyses

- Table 3 -

Luxury brands that have invested in retail have grown the most

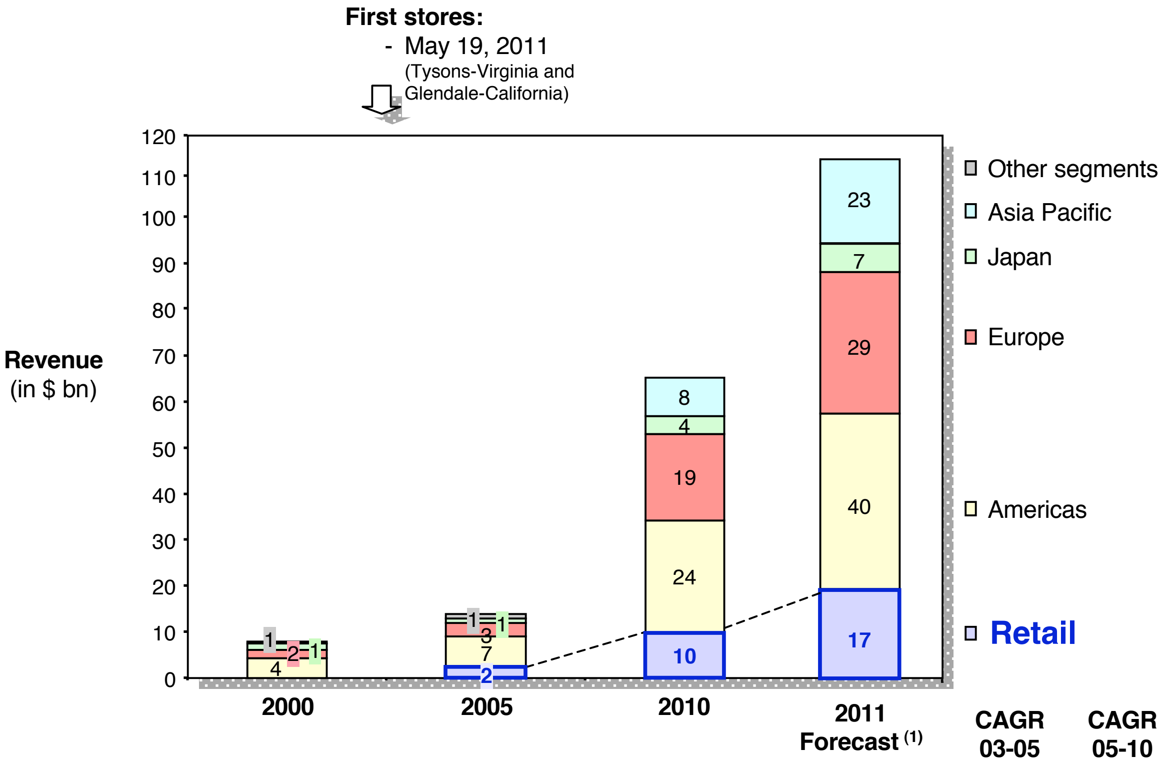


Source: Merrill Lynch, Estin & Co analyses

- Table 4 -

Apple has become a close to $20 billion retailer in 10 years

Apple – Retail sales vs total - 2000-2011



	2000	2005	2010	2011 Forecast (1)	CAGR 03-05	CAGR 05-10
Total revenues (in $ bn)	8	14	65	116	34%	36%
Retail revenue (as %)	0%	16%	15%	15%	100%	34%
Stores (units)	0	124	317	415		

(1) Projection of sales based on results for the nine months to June 2011
Sources: annual reports and Estin & Co analyses and estimates