

2016 Disruption in Retail

And What This Means For Your Business

We have seen a lot of apparently significant change in retail in 2016, to the extent that these changes could be considered disruptive. We have assessed these events and think that the amount of change is on a similar scale to past periods of disruption, including the emergence of online shopping and rise of the discounters. We conclude that retailers need to act to ensure they are still trading in the future and have taken ideas from disruptive innovation expert Clayton Christensen to outline how retailers could structure their response.

Introduction

Retail has always been turbulent and dynamic. However, the events of 2016 felt particularly significant. These included the battle for Argos which Sainsbury's won for £1.4bn, Steinhoff successfully buying Poundland for £610m and Morrisons' collaboration with Amazon.

We think that these changes have had and will have a massive impact on the way customers shop and the way retailers operate. As such, we conclude that these events can be considered disruptive. It has been documented that traditional businesses can fail to stay at the top of their game when markets are disrupted (Bower & Christensen, 1995): retailers need to recognise how they could be impacted by these changes and adapt their businesses in order to survive.

2016 Disruption In Retail

Sainsbury's-Argos

Sainsbury's made an approach for Home Retail Group at the start of the year, and the £1.4bn deal was completed in September. This acquisition has shifted the balance of power, bringing together Sainsbury's high and regular footfall with Argos' multichannel capability and additional product range to make Sainsbury's the largest general merchandise retailer as well as the second largest grocer in the UK. Sainsbury's ambition is to enable customers to shop wherever and whenever they want and to challenge the likes of Amazon and John Lewis. The combined business will offer customers over 90,000 products and generate sales of £30bn per year: close to Tesco's latest UK sales which came in at £37bn.

Over the coming months, Sainsbury's plan to open thirty Argos digital stores, to offer click and collect of Argos products and to open five Habitat concessions in Sainsbury's stores. Looking further ahead, perhaps Sainsbury's will leap frog Tesco to become the largest UK grocer or perhaps Sainsbury's will become a viable competitor to Amazon, setting themselves apart by enabling customers to touch and feel big ticket items before making a purchase.

What Is Disruption?

Disruptive Technologies: Catching the Wave, Bower and Christensen (1995)

"...disruption displaces an existing market, industry, or technology and produces something new... It is at once destructive and creative" (Clayton Christensen, Harvard Business School)

- Traditional businesses can fail to stay at the top when markets or technologies change
- New ideas can be ignored and instead businesses focus on what is currently popular
- This becomes a problem when the new technology or idea becomes mainstream: the traditional business cannot respond quickly enough and is left severely disadvantaged
- Christensen & Bower draw on examples from the hard disc drive industry pointing out that none of the independent manufacturers in existence in 1976 remain in business today
- Taking a more recent example, Uber's arrival in London in 2013 significantly disrupted the taxi industry. Other companies have had to adapt, with Addison Lee focusing on the corporate section of the market by offering free WIFI in their cars and discounts for users with business accounts

Steinhoff

South African conglomerate Steinhoff has also been acquisitive. Having tried to buy Darty and Argos, they completed a £610m purchase of Poundland in September. As a result, Steinhoff is now a large and perhaps unexpected player in UK retail, adding to its assets which include Harveys, Bensons for Beds and Pep & Co. The company has its sights set on rapid expansion, for instance, when Pep & Co was launched in the UK it opened 50 stores in the first 50 days.

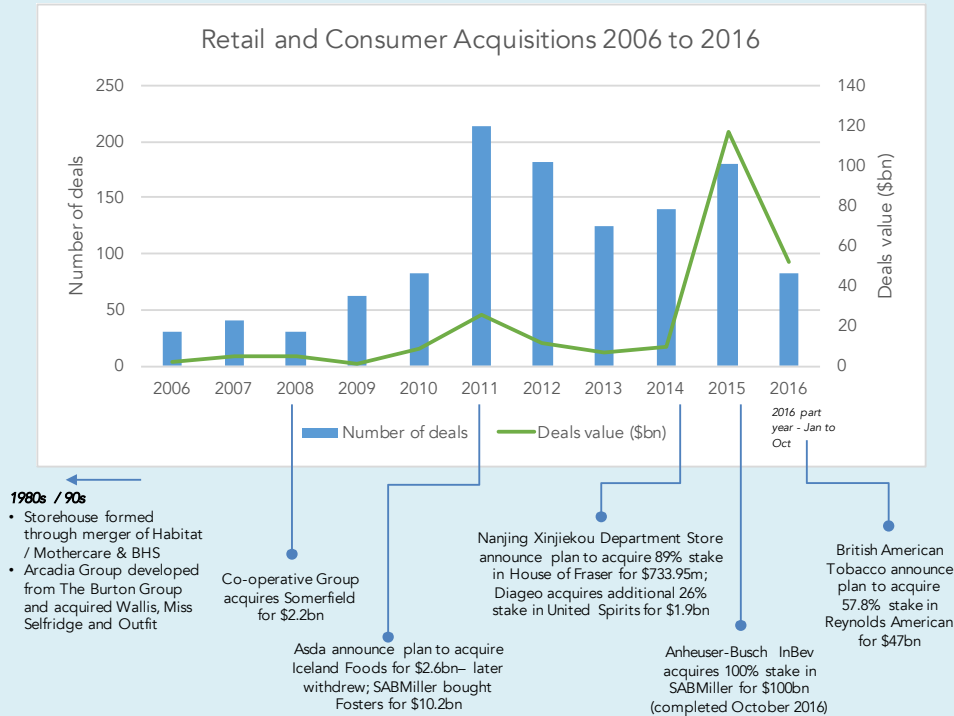
We think that this deal will result in convenience for shoppers as Steinhoff have announced their intent to open Pep & Co outlets in Poundland stores. The company appears to have deep pockets with global sales in excess of £6bn, so it will be interesting to see where they go next. Perhaps Steinhoff will become the next retail powerhouse, like a Storehouse or a Kingfisher. Retailers may soon be fending off their advances, or dealing with the challenge of Steinhoff buying a competitor and supporting their growth.

Data from the past decade shows that 2016 (YTD) has not been unprecedented in terms of the number of deals. We believe, however, that while the numbers are not unusual, the consequences will disrupt the industry significantly. Taking grocery as an example, the development of Sainsbury's-Argos will change the industry far more drastically than the Co-op's acquisition of Somerfield in 2008, which resulted in a relatively small supermarket with 8% market share.

Acquisitions In Retail And Consumer Industries 2006 - 2016

Verdict Retail, 2016

Note: Deal volume includes all announced deals; deal value included wherever disclosed



Amazon Fresh

It would be impossible to discuss retail disruption without covering Amazon, a retailer who has shaped the industry in 2016 and in preceding years. Amazon entered the grocery market in June with Amazon Fresh which by July was available in 128 post code areas in London. Amazon Fresh is available to Amazon Prime members and provides over 130,000 SKUs including products from local suppliers, plus Morrisons products. Other grocers have been responding to this threat by bolstering their own fulfilment offer, with Sainsbury's preparing to roll-out same day deliveries to 30 stores and Tesco offering customers the option of collecting their shopping from one of 300 stores within three hours of placing an order.

Studies have suggested that Amazon Fresh products are 20% cheaper than the big four supermarkets and 30% cheaper than Ocado. However, the £79 per year plus £6.99 per month fee to access Amazon Fresh may only appeal to higher spend customer groups, meaning Ocado is perhaps most at risk. Ocado have diversified their business by providing the technology for Morrisons' ecommerce operations which is perhaps a timely move. Further down the line, perhaps convenience stores will be impacted by Fresh as customers order their lunch online for delivery to the office within the hour instead of venturing out to a store.

Amazon and Morrisons

While most retailers see Amazon as a threat, Morrisons is an interesting case in point, choosing instead to partner with them (as they did with Ocado in 2014). Morrisons provide thousands of goods to Amazon Fresh and have recently installed Amazon lockers in some stores. They hope this will enhance their bricks and mortar offer, increase footfall and make better use of excess space. Maybe this marks a new age of collaboration between traditional retailers and the .coms. Perhaps this will go further with Amazon buying Morrisons (or others) to establish a physical offer and increase their market share.

Market Turbulence

An added challenge is that the disruption we are seeing is going on in an uncertain market. The National Living Wage has created turbulence for retailers, Brexit is providing instability and the trend towards omni-channel continues. Market turbulence is muddying the waters and encouraging retailers to focus on day-to-day survival and not the retail world of tomorrow.

Historic Disruption In Retail

We believe we have seen disruptive change in retail approximately every ten years. We think the disruption we have seen in 2016 is on a level with historic periods of disruption, including the emergence of teleshopping in the 1970s, online shopping in the 1990s and the rise of the discounters in the 2000s.

Teleshopping

- The purchase of goods over the telephone
- This was **disruptive**, enabling the emergence of new retailers and allowing customers to shop from their homes

Out of town shopping centres

Loosening of regulations, the demise of industry and availability of land and labour resulted in the growth out of town shopping centres

Aldi and Lidl enter the UK

- Aldi entered the UK in 1990 and Lidl arrived in 1993
- Hurt traditional retailers who trade on being value for money

Online shopping

- Amazon.com and eBay were launched in 1995
- This was **disruptive**, signaling the move towards online shopping which continues to grow and is now valued at £47.5bn in the UK

Kingfisher opened its first store in China

- Kingfisher enjoyed rapid expansion through mergers and acquisitions in the 1980s and 1990s (e.g. buying Comet, Superdrug and Darty)
- The company opened its first B&Q in China in 1999

Walmart outbid Kingfisher to buy Asda

- Purchased the supermarket chain for £6.72bn
- Analysts warned that UK supermarkets would suffer from Walmart's low price formula
- Concerns were raised that Walmart could go on to buy Kingfisher

Launch of Facebook and Twitter

- Facebook was launched in 2004 – 42% of marketers say it is critical to their business
- Twitter was launched in 2006 – the last two years have seen a 2.5x increase in customer service conversations using this platform

Rapid growth of discounters

- The financial crisis provided favourable conditions for the discounters to grow
- This was **disruptive** and challenged the dominance of established grocers

Launch of click & collect

- By 2008, retailers were increasingly offering click and collect to remove the hassle of home delivery
- In 2015, half of John Lewis' online orders over Christmas used this service

Morrisons and Ocado partnership

Morrisons partnered with Ocado to use their smart platform, providing a website plus fulfilment equipment and optimal delivery route technology

What Does This Mean For Shoppers?

The disruption we are seeing is likely to benefit shoppers due to greater choice, convenience and an improved customer experience as retailers compete for their attention. However, market consolidation plus rising costs could result in retail price increases. Additionally, economic uncertainty may encourage shoppers to keep hold of their cash and not engage with the offers being put to them.

What's Next?

Perhaps selling through social media will be the next wave of disruption, forcing retailers to adapt their operating models to incorporate a new sales channel. H&M has already ventured here, working with social network Kik to enable users to chat to a "bot" about their style preferences. Customers are sent outfit suggestions and can tap on an item to be taken to H&M's mobile site.

Social media has a massive amount of customer engagement. For instance, Instagram has 400 million users globally, representing a huge opportunity for businesses who work out how to sell through this channel.

How Should Retailers Respond?

In light of this disruption, retailers need to adapt to avoid becoming redundant. We think that entrepreneurialism and innovation will become increasingly important, separating the winners and losers as we ride this wave of change.

Christensen highlights a number of steps a business should take when faced with disruption:

1. **Identify whether the change is disruptive or sustaining:** Sustaining change improves current offers for mainstream customers; disruptive change develops new offers
2. **Define the strategic significance of the disruption:** Understand how the disruption will impact your business
3. **Locate the initial market for the disruption:** Identify the customers and what will matter to them
4. **Place responsibility for managing the disruption in an independent function:** Isolate your innovation team so that they won't be influenced and distracted by the demands of the mainstream business

Retailers need to continue trading, but must lift their heads to consider what changes they need to make to ensure they are still trading in the future.

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We would add that retailers could use scenario planning to help manage the disruption. This explores different ways the industry could evolve, the impact each scenario may have on your business and what you should do to protect against any risks.

Retailers could also implement a number of initiatives to ensure their business is robust enough to survive this wave of disruption. Initiatives may include becoming more customer focused or reviewing your processes and applying lean six sigma principles to cut out waste and improve efficiency, making things

better for customers, easier for colleagues and cheaper to run. The disruption we are seeing should give fresh impetus to improve your business for the better - and these are likely to be things you should be doing anyway.

Disruptions can be ignored if they are not currently popular as businesses focus on making "the right decisions for circumstances that are about to become history" (Bower and Christensen, 1995). Retailers need to look outside their businesses and adapt before it's too late.

About PatelMiller

PatelMiller is a business consultancy that works closely with its clients to develop their strategies and deliver their full benefit. Our team have gained their skills from working for leading consulting firms as well as some of the world's best consumer facing businesses. We combine the tools, methods and analytics of a strategy consultancy in a pragmatic, engaging way, to make sure potential benefits become real benefits, quickly.

Our service offering includes:

- Strategy
- Lean operating models
- Analytics
- Programme management
- Due diligence
- Digital

Our people have worked with businesses including Dunelm, feelunique.com, John Lewis, M&S, Monsoon Accessorize, Morrisons, Nisa, White Stuff, BT and Thomas Cook.

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