QUICK TAKE

GERMAN RETAIL OVERVIEW: CHARACTERISTICS, DEVELOPMENTS AND PROSPECTS

- Germany can be characterized as a leading market for discount retailing and nonstore retailing for nongrocery goods, and a lagging market for online grocery retailing and omni-channel adoption.
- However, grocery discounters are currently losing share to full-range supermarkets, and apparel discounters are facing greater competition from retailers such as Primark.
- Enthusiasm for nonstore retailing for nongrocery products, coupled with a slow push into omni-channel retailing by some brick-and-mortar stores, fueled the growth of pure plays such as Zalando.
- But the online channel captures only a tiny share in grocery, in large part due to the strength of no-frills discounters. REWE is the only one of the major grocery players to offer home delivery through its own fleet of trucks.
- A number of prominent nongrocery brick-and-mortar retailers were slow to capitalize on German shoppers' enthusiasm for home shopping. Established nongrocery retail groups such as Metro Group and REWE Group looked to the pure-play sector when they realized they needed to catch up.

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EXECUTIVE SUMMARY

Germany: A Leading and Lagging Market

In this report, we explore the nature of German retailing and analyze recent developments in the industry, particularly with regard to where the German market leads and where it lags relative to other major Western markets. We characterize Germany as leading in discount retailing and nonstore retailing for nongrocery goods, but lagging in online grocery retailing and omni-channel adoption.

The sectors in which Germany leads are growth channels in a number of other markets. As a result, we consider the lessons that German retailing offers in relation to discount and nonstore retailing.

We characterize Germany as leading in discount retailing and nonstore retailing for nongrocery goods, but lagging in online grocery retailing and omni-channel adoption.

Figure 1. German Retailing: Where It Leads and Where It Lags

Source: Fung Global Retail & Technology

First, we offer some context with regard to retailing overall in Germany, and discuss four prevailing structural factors that help shape the sector and its performance:

- Germany has seen a low-pay economy bolster demand for discount retailers.
- The country's low levels of home ownership bring relative stability to the big-ticket retail sector.
- German retailing remains relatively conservative, inhibiting innovation to a degree.
- Germany's position at the heart of Europe means that consumer sentiment in the country is closely tied to the continent's macro situation.

RETAIL IN CONTEXT: FOUR PREVAILING STRUCTURAL FACTORS

1. A Low-Pay Economy Bolsters Demand for Discount

In the 20 years through 2013, low-paid workers as a share of the total workforce increased by 423 basis points in Germany.

In spite of being Europe's economic heartland, Germany is a country in which low-paid employment has flourished. Labor-market reforms in the early to mid-2000s fed a low-wage culture, and the country's lack of a minimum wage until 2015 compounded this. A boom in low-wage jobs boosted the country's competitiveness and drove up employment rates, but it left many workers with little discretionary income, and consequently resulted in subdued growth in consumer demand.

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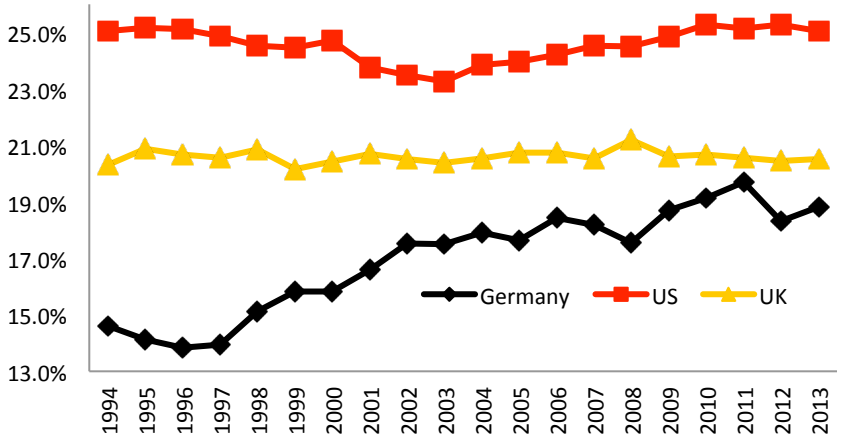
Germany records proportionately fewer low-paid workers than either the US or the UK, according to the OECD, yet it has seen a much more pronounced trend of low-paid workers increasing as a share of all workers: in the 20 years through 2013 (latest), low-paid workers as a share of the total workforce increased by 423 basis points in Germany, while declining by one basis point in the US and increasing by 21 basis points in the UK.

Figure 2. Low-Paid Workers as % of All Workers, Selected Countries



"Low-paid workers" refers to the share of workers earning less than two-thirds of median earnings.

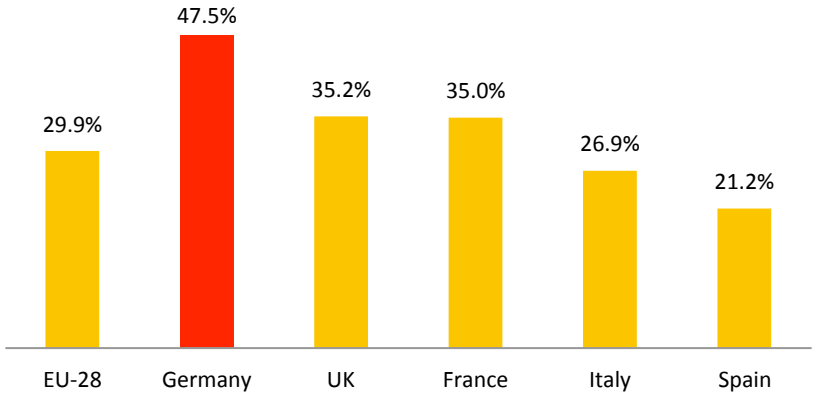
Source: OECD

One consequence of this trend has been strengthened demand for low-price retailing in Germany, where consumers' tendency to shop at discount stores arises at least partly from necessity, rather than solely from choice, as some commentators imply.

2. Low Levels of Home Ownership Bring Retail Stability

Property ownership levels are lower in Germany than in many other Western countries. Almost half the population in Germany rents their home, a much higher percentage than in other major European markets.

Figure 3. Home Renters as % of Population, 2014



Source: Eurostat

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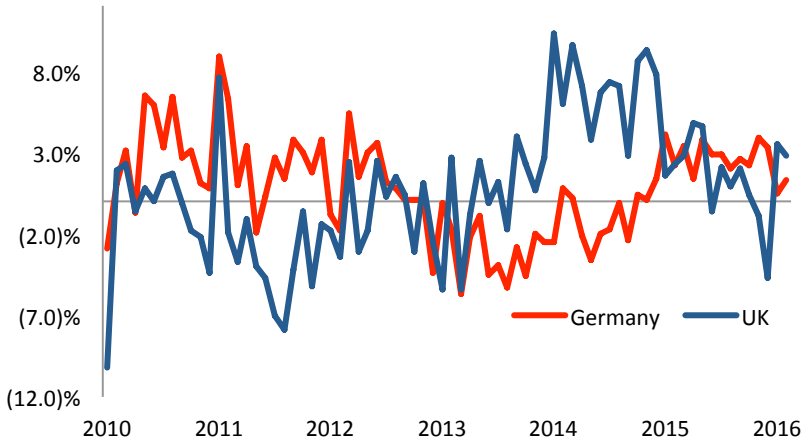
In retail, the most immediate impact of this is seen in the do-it-yourself (DIY) sector, where retailers must cater to tradespeople employed by landlords as heavily as they do to consumers doing their own home improvements. One caveat to this is that it is common in Germany for tenants to do some DIY work, such as redecorating interiors and even installing kitchens.

The high number of rentals feed into the relative stability of Germany's retail sector.

The high number of rentals feed into the relative stability of Germany's retail sector. In a number of other countries, sales of big-ticket items such as furniture and floor coverings are tied to the number of residential property sales, which means category performance can be volatile. In the UK, for example, the home-goods sector sees more dramatic peaks and troughs. In Germany, however, the large rental sector softens this effect, giving home-related big-ticket categories more stability.

Figure 4. Electronics, DIY, Household Equipment, and Cultural and Recreation Retailers: Germany vs. UK, YoY % Change



Source: Eurostat

Entrenched conservatism likely kept several major retail groups from embracing e-commerce and omni-channel retailing until recently.

3. Retail Conservatism Inhibits Innovation and Convenience

A strong thread of conservatism runs through German retail. While many countries have liberalized Sunday trading, most German stores are not allowed to open on Sundays. The only major exemptions to the ban are convenience stores inside filling stations, railway stations and airports, and small bakeries. In addition, shops in many areas continue the tradition of closing at lunchtime on Saturdays—resulting in a full 1.5 days per week when consumers cannot make purchases in physical stores.

The Sunday trading prohibition reflects a conservatism that can be seen in some other elements of German retail, too. For instance, food specialists, such as bakeries, remain prominent, even though consumers in other Western countries have switched to supermarkets for most fresh foods.

Such entrenched conservatism likely kept several major retail groups from embracing e-commerce and omni-channel retailing until recently, when the pressures of competition forced them to act. We discuss this laggardly attitude toward online retailing later in this report.

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In some respects, then, German retailing remains more old-fashioned than in other Western markets such as the US and the UK, where nonstop, one-stop shopping is more the norm.

The scale of migration hit consumer confidence hard and resulted in a political backlash that was evident in spring 2016 elections.

4. Being the Heartland of Europe Brings Major Headaches

Consumer sentiment in Germany is unusually tied to the European macroeconomic context, reflecting Germany's position as the *de facto* economic and political heart of Europe. The economic downturn and its aftermath have only increased the country's importance to the continent.

German economic output makes up around one-fifth of the EU's total GDP, and that proportion has risen in recent years as Germany's recovery has outpaced that of many other countries. Germany's share of EU-28 GDP rose from 20.2% in 2010 to 20.9% in 2014 before sliding back a little, to 20.7%, in 2015.

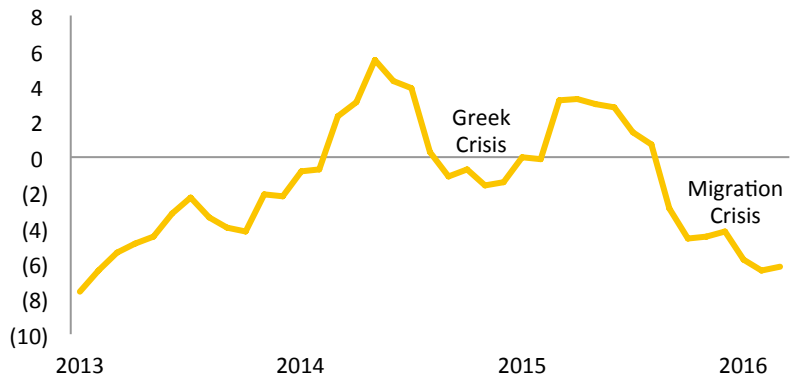
The responsibilities that come with this position inevitably impact consumer sentiment: for example, German consumer confidence fell amid the crisis in Greece. Although ostensibly resolved, the Greek crisis threatens to return, and the country is reportedly close to running out of cash yet again as government reluctance to make further cuts risks its ability to meet a payment under its bailout agreement.

Economics aside, the recent open-borders policy implemented by Chancellor Angela Merkel resulted in a net 1.14 million foreigners migrating to the country in 2015; total foreign immigration amounted to just under 2 million in the year, before 860,000 foreign emigrants are discounted. The scale of migration hit consumer confidence hard and resulted in a political backlash that was evident in spring 2016 elections.

Any resurgence of economic difficulties in Greece would compound this highly negative consumer sentiment: the short-term outlook for consumer confidence is not good.

Negative sentiment has not consistently translated into weaker retail sales growth.

Figure 5. German Consumer Confidence Index



Source: Eurostat

However, this negative sentiment has not consistently translated into weaker retail sales growth. For example, even as consumer confidence was dwindling through the second half of 2015, year-over-year growth in retail sales remained consistently above 3% and above the five-year average of 2.2%.

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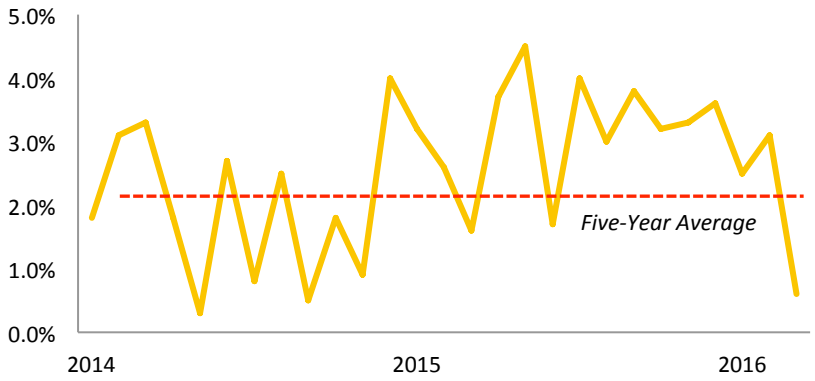
The solidity of total retail sales is likely to have been helped a little by the addition of 1.14 million net immigrants, equivalent to a 1.4% increase in Germany's population. Lower automotive fuel prices are also likely to have buoyed retail spending.

Figure 6. Germany: YoY % Change in All Retail Sales (Ex Fuel)



Data are nonseasonally adjusted, but are adjusted for calendar effects. Five-year average is the unweighted average of monthly year-over-year growth for January 2011–December 2015.

Source: Eurostat/Fung Global Retail & Technology

RETAIL IN FOCUS

A Leading Market for Discount and Nonstore Retailing

Germany may offer an indication of how retail will shift as the discount and nonstore segments continue to gain share in other countries.

Two long-standing, major pillars of German retailing are now driving the retail segments of other countries: discount and nonstore retail. Therefore, Germany may offer an indication of how retail will shift as the discount and nonstore segments continue to gain share in other countries.

Discount: Deutschland Ist Discountland

Germany is known for its discount culture. It is a stereotype that Germans look to save money on everyday shopping, but are willing to trade up for quality on bigger-ticket purchases such as vacations, cars and appliances—but it is a stereotype based in reality.

No-frills discount stores hold a strong position in German retail, most obviously in grocery, but also in nonfood sectors such as apparel and drugstores. And the discount segment is dynamic: new apparel entrants such as Primark have seen success, while big domestic names such as Schlecker have fallen by the wayside and long-standing grocery discounters have adapted their offerings.

In **grocery**, discounters abound, including Aldi (Nord and Süd), Lidl, Kaufland, Netto Marken-Discount, Netto (distinct from Netto Marken-Discount), Penny and Norma.

In **apparel**, discount is represented by KiK, Takko and NKD, which have been joined (successfully) by Primark and TK Maxx in recent years. Even away from the clear discount segment, low-price retailing is represented by major specialist chains such as New Yorker.

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In **health and beauty**, Schlecker was the discount-positioned market leader until its bankruptcy in 2012. Chains such as dm-drogerie markt and Rossmann continue to carry the value mantle in this sector.

We focus on grocery and apparel in our subsequent discussion. In grocery, Germany is exporting the discount format, making it the country to look to in order to discern the likely impact of discount in the sector. In apparel, the country's established discounters are facing strong competition from more fashionable newcomers.

The Impact of Discount in Grocery

Among discount retailers in Germany, discount grocers have the biggest impact on the retail landscape. Discounters accounted for 40% of sales by modern grocery formats in Germany in 2015, according to Euromonitor International, compared to only single-digit shares in markets such as the UK, France and the US.

Figure 7. Grocery Discounters' Share of Modern Grocery Retail Sales, 2015

Germany	**40.1%**
UK*	**9.6%**
France	**9.4%**
US	**2.0%**

**At approximate mid-year: 12 weeks ended July 19, 2015.*
Source: Euromonitor International/Kantar Worldpanel/Fung Global Retail & Technology

In our 2015 *European Grocery Discounters* report, we noted the preponderance of German retailers among the top players in this segment: of the top nine grocery-discounter groups (representing the top 10 fascias), five are German.

Discounters offer limited ranges and overwhelmingly private label products, which creates demand for shopping at secondary locations for the branded products and added-value goods that are not available at discount stores.

Figure 8. Top Discounters, by Net Revenues, 2014

	Domicile	Revenues (EUR Bil.)
Schwarz Group	Germany	79.30
Lidl	*Germany*	*59.00*
Kaufland	*Germany*	*20.30*
Aldi (Est.)	Germany	60.78
Netto Marken-Discount	Germany	12.02
Penny	Germany	10.86
DIA	Spain	9.40
Biedronka	Portugal	8.43
Trader Joe's (Est.)	Germany/US	7.07
REMA 1000	Norway	5.94
Netto (Est.)	Denmark	5.50

Source: Company reports/S&P Capital IQ/Euromonitor International/National Retail Federation/Fung Global Retail & Technology

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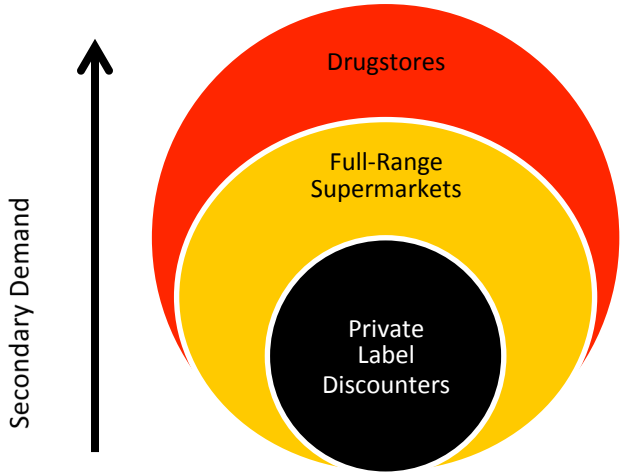
When consumers switch from full-range supermarkets to grocery discounters, they often find they cannot buy everything they want from the discount stores. Discounters offer limited ranges and overwhelmingly private label products, which creates demand for shopping at secondary locations for the branded products and added-value goods that are not available at discount stores. This boosts traffic at smaller supermarkets and drugstores. Effectively, the big, one-stop grocery shop that is traditional in the US and other countries ends up being split between the discount, small supermarket and drugstore channels.

In Germany, this demand for top-up shopping is reflected in the prominence of supermarket retailers such as Edeka, which is the country's top grocery retailer by sales. It is also seen in the breadth of specialist health-and-beauty retailers, from drugstore chains such as dm-drogerie markt to beauty specialists such as Douglas.

Figure 9. Complementary Channels in German Grocery Shopping



Source: Fung Global Retail & Technology

With the growth of discounters in the UK, we are seeing elements of this pattern replicated there: smaller, local supermarkets and convenience stores are thriving as a complement to hard discounters. We also see opportunities for health-and-beauty specialists to piggyback on the growth of discounters in the UK and in other, similar markets.

A second effect of small-store discounters is the limited encroachment of the grocery sector into nongrocery categories. Large-store grocery retailers such as Carrefour in France and Tesco in the UK have built substantial nongrocery offerings that include fashion, DVDs, games, books, homewares, DIY and consumer electronics.

Grocery discounters, by contrast, tend to feature a selection of fast-changing nongrocery special deals, rather than a consistent nongrocery offering. That means specialist players, particularly those at the low-price end of the market, tend to experience less competition in markets where discount grocery is a major force than they do in markets with a substantial hypermarket presence.

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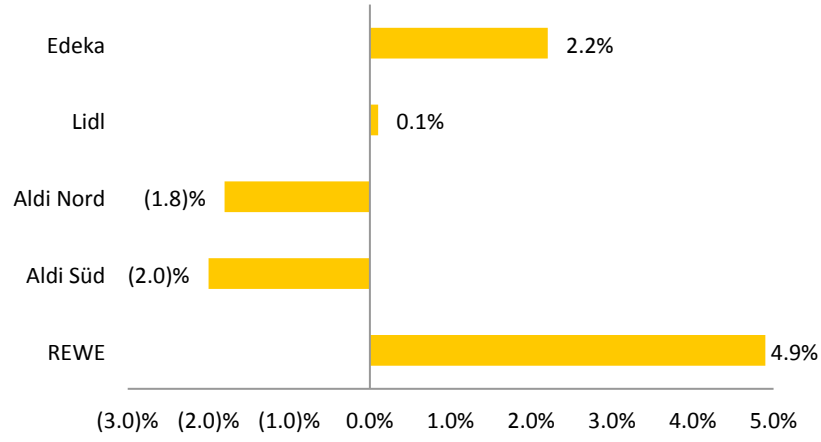
Recent Developments: Grocery Discount On The Wane

While grocery discounters have made gains in the US, the UK and Australia, they have been ceding share in their German heartland. Full-range supermarket retailers have gained as German shoppers have traded up.

Market-share measurement service GfK found that full-range supermarkets Edeka and REWE outperformed in 2015, while Lidl turned in marginally positive food-sales growth and Aldi Nord and Aldi Süd saw food sales decline. Note that the figures in the graph below strip out nonfood revenues, and that Aldi Nord and Aldi Süd claim to have seen positive total revenue growth for the year.

Figure 10. Germany: Top Four* Grocery Retailers' Food Sales: YoY % Change, 2015



**Counting Aldi Nord and Aldi Süd as one retailer.*

Source: GfK/WirtschaftsWoche

The poor performance at discounters has come despite their investments in better store interiors and TV advertising as well as their introduction of more brands. And it has come despite the deeply negative consumer confidence noted earlier, which should have, in theory, led consumers to trade down. German consumers' migration to full-range supermarkets does, however, accord with the strong performance of German retail in 2015; both trends show that Germans have been willing to spend a little more despite their pessimism.

Anecdotal evidence suggests that the upgrading of stores and the popularity of own-brand lines at full-range supermarkets such as REWE and Edeka have driven these increased sales. Meanwhile, GfK surveys show that German grocery shoppers are putting less emphasis on price: 10 years ago, 60% of those surveyed said they focused primarily on price when buying groceries, but by 2016, that figure had fallen to 49%.

Budget Competition Heats Up in Apparel

KiK, Takko and NKD are the big domestic names in discount apparel. They were Germany's fifth-, eighth- and 21st-largest apparel and footwear specialist retailers, respectively, in 2015, according to Euromonitor. But these long-standing players are facing heightened competition from new entrants.

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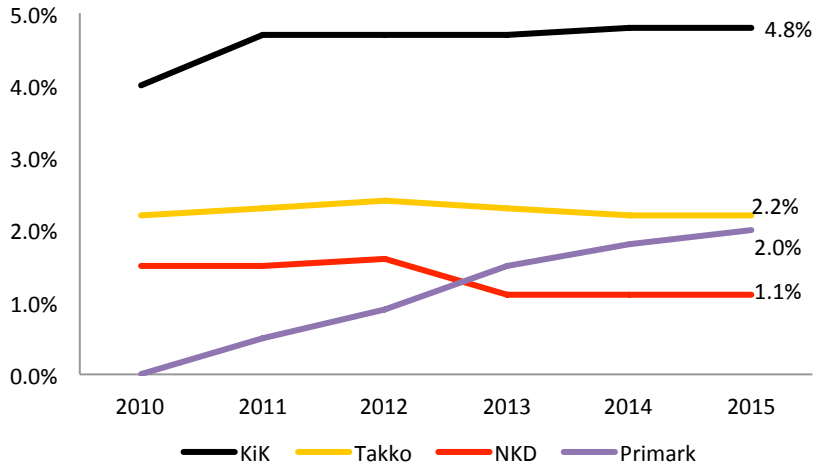
The most prominent challenge has come from Primark, which offers a more fashionable product and a more appealing store experience than the relatively conservative discount incumbents do. Primark opened in Germany in 2009 and has grown to account for 2% of the apparel and footwear specialist sector, making it the 10th largest specialist chain, according to Euromonitor. By year-end 2015, Primark had 19 German stores.

Meanwhile, KiK and Takko have seen their market shares plateau—not unexpectedly, given that they are mature, established players. NKD has been hit worse, according to data from Euromonitor.

Figure 11. Major Discount Apparel Retailers' Shares of Apparel and Footwear Specialists' Sector Sales



Source: Euromonitor International

Primark is not the only challenger to the established apparel discounters. Others include Internet pure play boohoo.com, which entered the German market in 2014 and whose prices are broadly pitched between those of Primark and H&M.

And it is not only in the "pure" discount segment that competition has increased. Other budget and low-price retailers adjacent to discount have tapped German shoppers' preference for value for price paid:

- ASOS, which is highly price competitive on private label and branded ranges, entered the market in 2010.
- H&M, which is a low-price retailer but not a discounter, has grown to become the leading specialist apparel retailer in Germany, displacing long-standing sector cornerstone C&A.
- TK Maxx has brought brands to what was a purely private label, low-price segment of the market. It entered Germany in 2007 and had 76 stores in the country as of year-end 2015, making it the ninth-largest apparel and footwear specialist chain, according to Euromonitor.
- Amazon is effectively an online off-price retailer akin to TK Maxx, and it has gained considerable success in Germany. In January 2015, Mintel reported that Amazon was Germany's third-most-popular retailer for

H&M, which is a low-price retailer but not a discounter, has grown to become the leading specialist apparel retailer in Germany, displacing C&A.

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clothing, online or offline, by shopper numbers. In online-only terms, Amazon is the country's most popular clothing retailer.

- It was reported in 2016 that Hudson's Bay Company is planning to launch its off-price Saks Off 5th chain in Germany, bolstering the still-new branded offering in the budget segment.

While Germany may lead the world in grocery discounting, its apparel discounters tend to trail in the fashionability stakes. British and American competitors are showing that there is much more to budget apparel retailing than just price, and they are raising standards in the low-price and discount segments. As a result, we expect German players to experience sustained competitive pressures in the coming years.

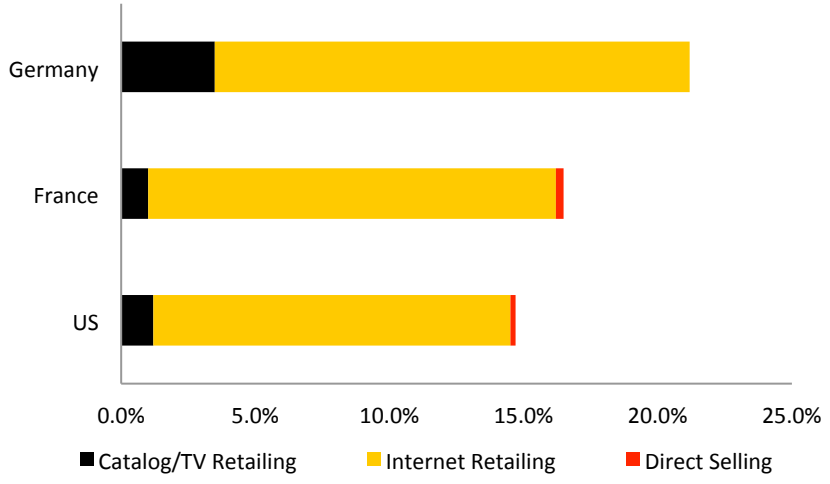
Nonstore: Catalog Legacy Boosts Internet Shopping

Alongside discount, a second unusually prominent segment in German retailing is nonstore retailing in nonfood categories, especially apparel. German shoppers have long shown enthusiasm for home shopping via catalogs, TV shopping channels and, more recently, the Internet. This legacy has created a ready customer base for e-commerce, as it is much easier to convert an existing nonstore shopper to Internet shopping than it is to convert a store-based shopper.

Nonstore retailing accounted for fully 21% of all apparel and footwear sales in Germany in 2015, according to Euromonitor, compared to 15% in the US and 16.5% in France.

Nonstore retailing accounted for fully 21% of all apparel and footwear sales in Germany in 2015, compared to 15% in the US and 16.5% in France.

Figure 12. Nonstore Retailing's Share of Apparel and Footwear Sales, by Segment, 2015



Source: Euromonitor International

In **catalogs**, Otto Group has long dominated the sector, and has outsurvived major rivals such as Neckermann (which filed for bankruptcy in 2012 and then finally closed down in 2014) and Quelle (which went bankrupt in 2009). Like major catalog retailers in other countries, Otto Group has been rebuilding itself as a major player in e-commerce. Klingel and Bader are among the traditional catalog names remaining in Germany.

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In **TV shopping**, QVC leads, but domestic names, including HSE24, Channel 21 and 1-2-3.tv, are among the top players. Germany is QVC's largest market outside the US.

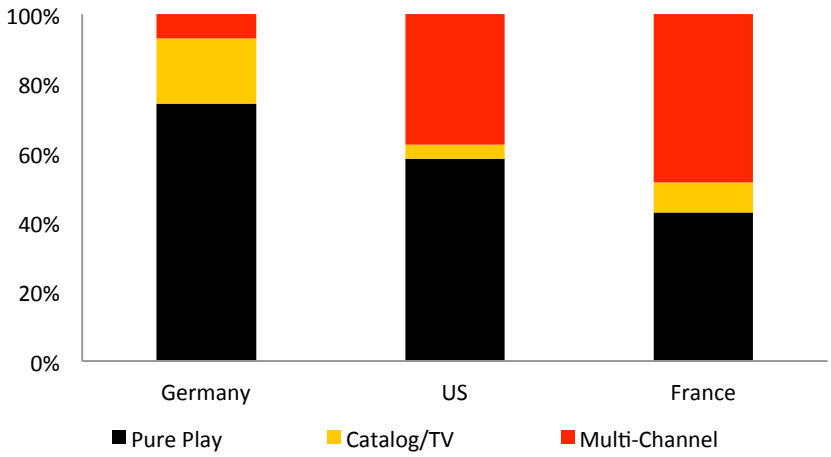
We see a similar picture **online**, where Germany is Amazon's biggest non-US market. Amazon sees competition from some strong domestic players, such as Zalando (and its original e-commerce parent company, Rocket Internet), Redcoon and Notebooksbilliger. Internet-only retailers are prominent in part because a number of major established retail groups were slow to launch online.

Several **major brick-and-mortar** groups, including Metro Group and REWE Group, have been playing catch-up online. As we discuss later, some of the country's largest established retailers were slow to harness consumers' appetite for online shopping, leaving the field open for pure plays to flourish.

Analysis of the 10 biggest nonstore retailers highlights the unusual strength of pure plays and catalog/TV players in Germany. Multi-channel retailers, i.e., those with a brick-and-mortar background, comprise a very small share of the top 10 players' aggregate market shares.

Analysis of the 10 biggest nonstore retailers highlights the unusual strength of pure plays and catalog/TV players in Germany.

Figure 13. Distribution of Top 10 Nonstore Retailers' Share of Nonstore Retail Sales, Selected Countries, 2015



Source: Euromonitor International/Fung Global Retail & Technology

A LAGGING MARKET FOR E-GROCERY AND OMNI-CHANNEL

Germany may be ahead of the pack in discount retailing and nonstore retailing in nonfood categories, but it lags in terms of two other major retail trends: online grocery retailing and omni-channel development.

Online Grocery Hampered by Discount Prominence

The online grocery sector in Germany has been hampered by German consumers' preference for low-price, no-frills shopping. The high-cost nature of e-grocery fits poorly with discount retailing. As a consequence, just over 1% of grocery sales were made online in 2014, according to Kantar Worldpanel. This figure is far lower than in comparable economies such as the UK and France, though it is higher than the US percentage.

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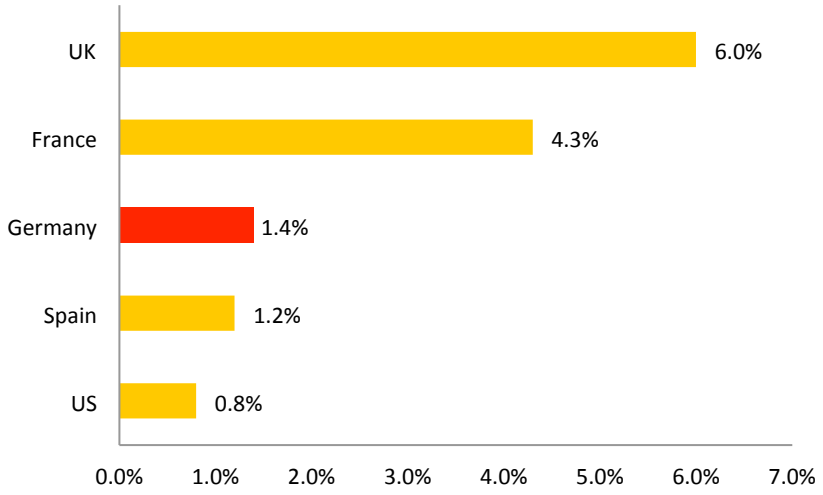
Development of a significant online grocery sector has been hampered by German consumers' preference for low-price, no-frills shopping.

Figure 14. E-Commerce's Share of Fast-Moving Consumer Good Sales, Selected Countries, 2014



Source: Kantar Worldpanel

Some nondiscount grocery retailers, such as REWE and Real, have dipped their toes in the e-commerce waters, including through click-and-collect. REWE is the only one of the major players to offer delivery through its own fleet of trucks.

Lidl offers grocery e-commerce service of a sort, which is unusual for a discounter: the range is limited, covering only ambient categories, and delivery is through DHL, rather than through the company's own fleet, which helps keep a lid on costs.

Figure 15. Germany: Top Grocery Retailers' Online Services

	Delivery via Mail	Delivery via Own Fleet	Click-and-Collect; Number of Locations	Nongrocery Categories
Edeka	Yes, via DHL	No	Yes, via four Edeka Drive collection points; also partnered with Emmasbox at Munich Airport for grocery collection	Yes
Aldi (Nord and Süd)	No	No	No	No
Lidl (Schwarz Group)	Yes, via DHL	No	No	Yes
Kaufland (Schwarz Group)	No	No	No	No
REWE	No	Yes, via Lieferservice in 15 cities	Yes, via one location in Füerstenfeldbruck	No

Source: Company reports/Fung Global Retail & Technology

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There is a recurring rumor that Amazon will launch AmazonFresh, its full-service home-delivery offering, in the German market. The most recent rumor at the time of writing, reported by *Süddeutsche Zeitung*, claimed that AmazonFresh could launch in Munich in September 2016.

Given German consumers' apparent preference for Amazon, and the lack of competition in grocery home delivery, AmazonFresh may establish an early-mover advantage—if it can convince consumers that it is a value-for-money option.

Late to the Omni-Channel Party

A number of prominent brick-and-mortar retailers were slow to capitalize on German shoppers' enthusiasm for home shopping.

A number of prominent brick-and-mortar retailers were slow to capitalize on German shoppers' enthusiasm for home shopping. Some examples of major retail groups arriving late to e-commerce and omni-channel retailing include:

- Electricals chain Media-Saturn, owned by Metro Group, launched transactional websites for Germany only in 2011 and 2012. Metro Group also pushed multi-channel options at department store chain Galeria Kaufhof only in 2014 (prior to its sale to Hudson's Bay Company in 2015).
- REWE Group has lagged in e-commerce, and it attributed the collapse of its ProMarkt electronics chain in part to its late adoption of e-commerce. Its Toom Baumarkt DIY chain remains an offline-only retailer.
- In apparel, major names such as Kik, AWG and Peek & Cloppenburg (Düsseldorf) launched transactional sites only in recent years. TK Maxx still does not sell online in Germany.

The slowness of some companies to launch transactional websites has benefited pure plays, including Notebooksbilliger in electronics, Home24 in homewares and Zalando in fashion. In turn, established retailers looked to the pure-play sector when they realized they needed to catch up. Metro Group acquired electronics pure play Redcoon in 2011, ahead of the launch of e-commerce operations for Media-Saturn. And REWE Group has made investments in pure plays Home24 and ZooRoyal, as well as in software provider Commercetools, to help it catch up in e-commerce.

At this point, however, most of the major nonfood retailers have made the move online. The subsequent phase has been integrating stores and e-commerce by offering click-and-collect or providing in-store ordering points. In these omni-channel services, Germany tends to lag the UK, but other major markets, such as the US, do, too.

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KEY TAKEAWAYS

The German retail landscape has distinctive characteristics, the most notable of which are its strong discount sector and the prominence of its nonstore channel. Both are the result of entrenched shopping habits.

The German retail landscape has distinctive characteristics, the most notable of which are its strong discount sector and the prominence of its nonstore channel. Both are the result of entrenched shopping habits, and are in contrast to some other countries, where the switch to discount channels and nonstore retailers are new trends—and ones that are posing significant challenges to established players.

Given these characteristics, is German retailing the model toward which other countries are working? Yes and no. While Germany leads in grocery discounting, its apparel discounters are looking a little tired versus their British and American competitors. Moreover, very few countries will see grocery discounters take a share as large as that enjoyed by German discount grocers, because the limited choice discounters offer is alien to many consumers in other markets. In many countries, shoppers are accustomed to the convenience and choice of one-stop shopping.

Our key takeaways from the German market are:

- The common insistence that multi-channel retailers will continue to dominate, including online, is questionable, based on the strength of pure plays in Germany. Given Germans' strong legacy of nonstore shopping, we see little to indicate that Internet shoppers in Germany will switch their buying from pure plays to multi-channel players.
- Shopping at grocery discounters results in a splintering of grocery spend. Some of this goes to other grocery retailers, such as full-range supermarkets. But some sales are lost to the grocery sector altogether, as many consumers decide to shop at specialists in health and beauty or in nongrocery categories.
- In apparel, the budget boom being seen across countries is about much more than low prices. It is also about off-price stores and discount fast-fashion players such as Primark driving up standards in value retailing. The German apparel sector shows that the discount trend in apparel is not a rising tide that will lift all boats.

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