



OUR BUSINESSES

FUTURE BUSINESS MODELS



WORLD RETAIL
CONGRESS
AN ASCENTIAL COMPANY
A WORLD RETAIL CONGRESS PUBLICATION

Pillar Partner



OC&C
Strategy consultants



JAMES GEORGE
PARTNER
OC&C STRATEGY CONSULTANTS

INTRODUCTION

It feels rather 'retro' to be introducing a report whose overarching theme continues to focus on the profound impact of the digitisation of the Retail industry. But while this theme may be relatively old news the effect of this transformation is still really in its early stages.

Covid has created a decisive acceleration of the digital shift – and for many given an insight into how far and how fast their business needs to travel in the coming years.

While this digital theme is far from new, it's sobering to think we are just starting to hit the steep part of the transformation 'S-curve'. In our report we establish the concept of a tipping point for retail economics (roughly 30-40% digital penetration) where classic retail models start to break and "Bad things happen to the unprepared".

If this tipping point represents a transformation frontier then today we estimate only 30% of retailer sector-market combinations have crossed it – with the remaining 70% yet to experience the likely substantial shake out and restructuring required.

The positioning of your business relative to this frontier implies some fundamentally different strategies need to be embraced. For those in the 'Land of the Digital Native' the focus shifts to the successive waves of digital innovation playing through, and creating effective and symbiotic relationships with 3rd parties. For those on the frontier the challenge is rapid transformation and a drive to flexibility in cost base and operating model. The 'Last Movers' have an advantage of being able to follow a more established playbook of those that have come before.

This challenge creates a true selection event for retail – one from which those that can innovate and evolve at pace will emerge as future leaders.

We hope you enjoy our report and learning about the successful strategies many have adopted to successfully navigate these choppy waters!

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IAN MCGARRIGLE
CHAIRMAN
WORLD RETAIL CONGRESS
IAN.MCGARRIGLE@WORLDRETAILCONGRESS.COM

INTRODUCTION

At the 2019 World Retail Congress in Amsterdam, an incredible three years ago, OC&C Strategy Consultants presented their much acclaimed report on “High Velocity Retail”. The report acknowledged that we were living in a world of rapid change and that to be successful, retailers had to reappraise their business strategy. Successful retailing was going to be about understanding which retail business model was most suited to their sector and their customers.

If the world pre-Covid was changing fast, the incredible acceleration of change that has taken place since 2020 has transformed the entire retail landscape. Which is why we are delighted that OC&C are working again in partnership with the World Retail Congress and have produced this special report focused on one of our key pillars - what we are calling “Our Businesses”.

This report is important because it is revisiting the winning retail business models identified in 2019 and through their own research coupled with interviews with senior retailers, have set out to find what will ensure sustainable growth and successful retail business models.

What is clear is that the world beyond a pandemic that has shaped our lives for over two years is not going to slow down. On the contrary, the trajectory of change will grow ever steeper and with it a whole new range of challenges which OC&C identify in this report. This will demand radical, bold and constant action by retail leadership teams so that they remain relevant, customer focused and profitable.

The aim of this special report is to help shape the discussion at the 2022 World Retail Congress but that it will go beyond this year’s meeting and will help inform the strategies and direction of retailers around the world.

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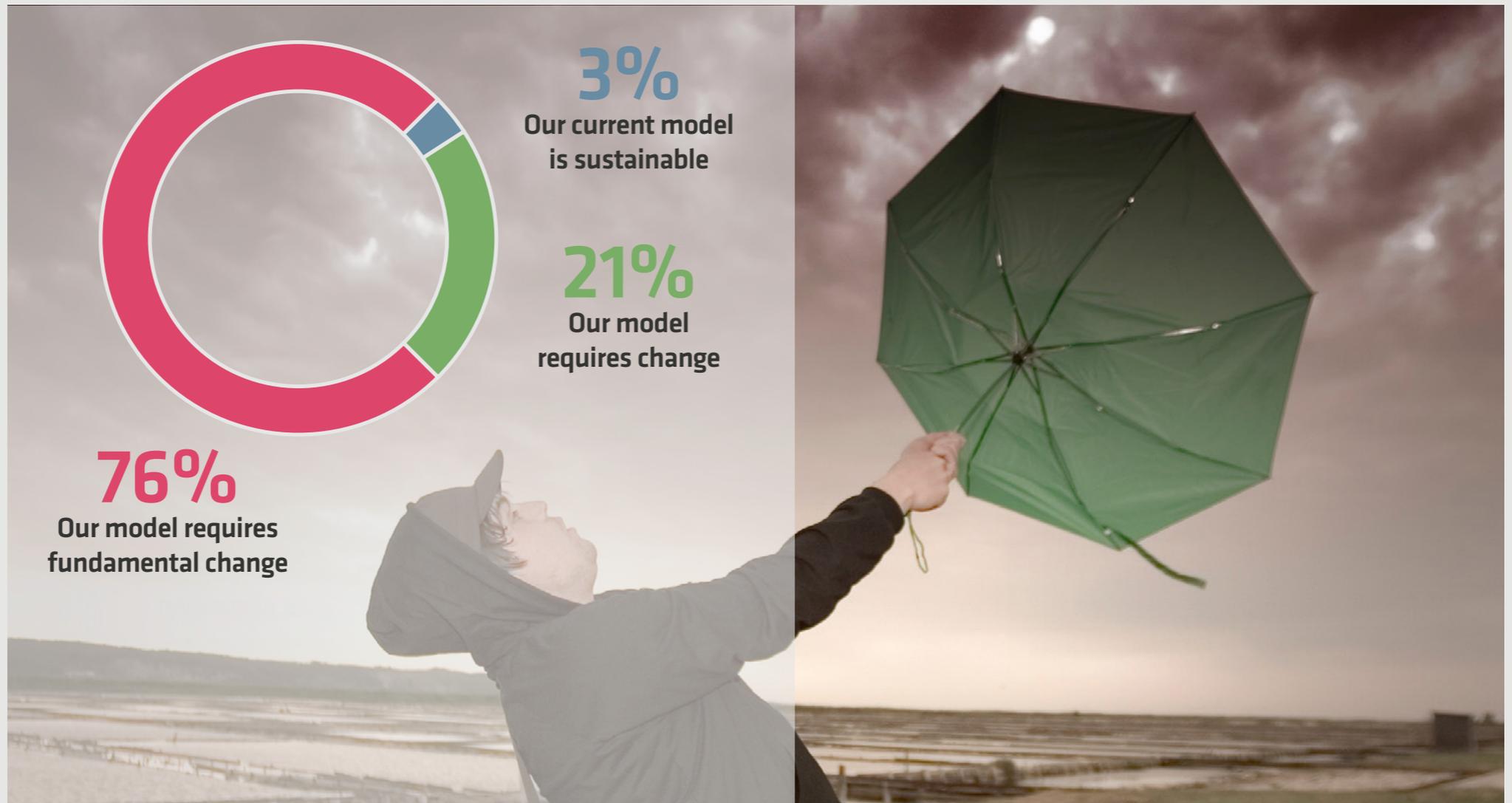
INTRODUCTION

A DARWINIAN MOMENT

A DARWINIAN MOMENT

IN 2019 OC&C AND THE WRC JOINTLY CONDUCTED A PIECE OF RESEARCH WITH A PANEL OF LEADING GLOBAL RETAILERS.

This revealed that ~75% of global retailers believed that their business models required fundamental change. Covid has further amplified this need for change, and the vast majority of retailers feel ill-equipped to deal with this challenge.



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INTRODUCTION

A DARWINIAN MOMENT

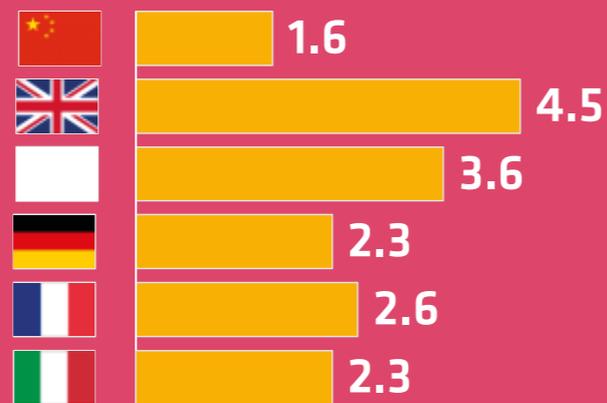
At the heart of this change remains the digitisation of the retail industry and while some retailers and sectors have embraced and internalised this shift - many are only just reaching the tipping point, where, without profound changes, their business models risk obscurity and failure.

We are at the steepest part of digital transition S-curve and this has coincided with a Covid driven 'adrenaline shot'. In

many markets we see this Covid impact driving a 2-4 year acceleration in the pace of digital adoption.

In this report commissioned by the WRC for the Rome 2022 Congress we explore the many faces of this ongoing digital transformation of the industry and the new models and adaptations winning retailers continue to take to stay ahead.

Years E-Commerce Acceleration in 2020



OC&C
Strategy consultants

Many markets are facing a digital tipping point

We expect pressure on physical channels will accelerate

THE KEY TAKEAWAYS FROM OUR REPORT ARE THE FOLLOWING:

1. Digitisation is coming in waves – it is not a singular effect and retailers need to evolve continuously
2. There is a tipping point in retail economics – at 30-40% digital share traditional economics shatter
3. The digital frontier (where retailers cross this tipping point) is accelerating rapidly and by 2025 most retail categories will be at or beyond the frontier
4. Retailers need to adopt different strategies depending on their position relative to this digital frontier and continue to adapt their strategies...
5. ... overall winning retailers continue to demonstrate a core set of principles in their business models - driving flexibility into the cost base, leveraging their fixed cost investments by adding scale, reinforcing the proposition through digital amplification, building services, and investing in digital engagement to ensure customer stickiness

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Strategy consultants

SECTION 1

THE WAVES OF DIGITAL TRANSFORMATION

THE WAVES OF DIGITAL TRANSFORMATION

Digital transformation is not a single phenomenon, but overlapping and accelerating waves. The most profound impact is the failure of physical retail, but we are also starting to see last generation digital models beginning to fail too or have to adapt as channel shift starts to slow and insurgents with alternative routes to customer acquisition or novel economic models challenge first wave digital models.

“The digital transformation of the industry is not a single phenomenon, the innovation and disruption of models that are just emerging will be as profound and impactful as the ones that have been established over the last decade”



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SECTION 1

THE WAVES OF DIGITAL TRANSFORMATION

An example of this is Shein who we referenced in our 2019 report. Shein were at that point a relatively unknown online apparel player, who was rapidly growing share and winning with Gen Z consumers.

Reports now suggest the socially driven retail brand has global revenues >\$10bn anchored in it's huge and rapidly shifting range - 6000 new products a day. But it is still relatively unknown to many!

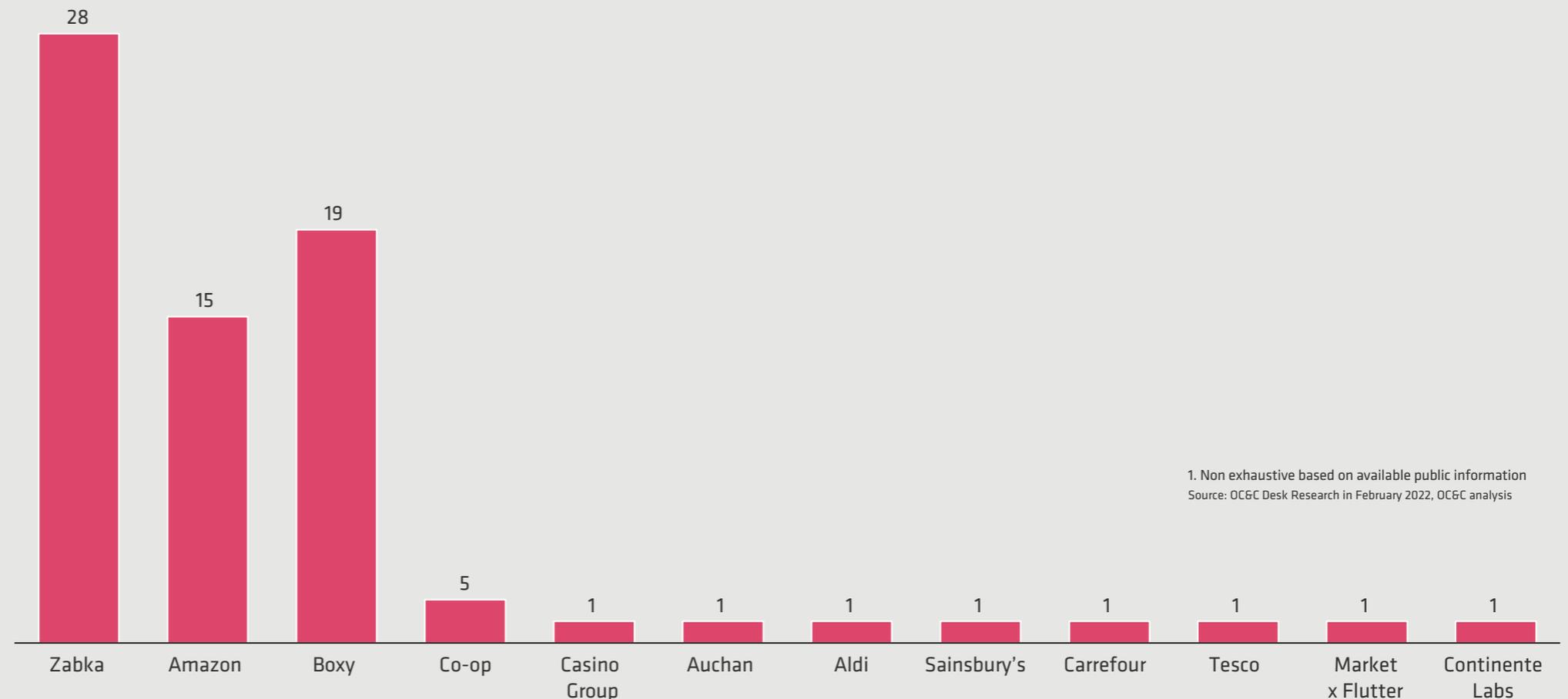
Another such wave is the digitisation of physical retail. There has been a phoney war around the power of digital to enhance instore propositions. A range of digital solutions have been trialled and failed. But we are now seeing the

coming of age of digitally enabled physical experiences (or "Phygital" to use a horrible portmanteau) that represents a new opportunity for retailers to deliver connected propositions that link physical space with digital sales channels and loyalty mechanics.

Autonomous retail technology promises a range of potential benefits from 24hr service, improved operating efficiency, personalised customer experience and pricing, and 'live' stock availability. Zabka a Polish convenience retailer is now operating >25 of these stores. A higher number than Amazon have rolled out in Europe.

Autonomous store numbers are now growing across Europe

Number of Autonomous Stores in Europe for Select Retailers - March 2022



1. Non exhaustive based on available public information
Source: OC&C Desk Research in February 2022, OC&C analysis

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SECTION 1

THE WAVES
OF DIGITAL
TRANSFORMATION

This requirement to consistently innovate is also reflected in what consumers increasingly value in retail brands. Innovative research from BAV from WPP rates thousands of brands on 75 metrics of brand attributes.

BAV OVERVIEW



THE LARGEST AND LONGEST-RUNNING STUDY OF BRANDS IN THE WORLD

14 BILLION
DATA
POINTS

~60,000
DIFFERENT
BRANDS

\$160 MILLION
INVESTED

29
YEARS OF
LEARNING

50
COUNTRIES
SURVEYED

75
CONSISTENT
METRICS

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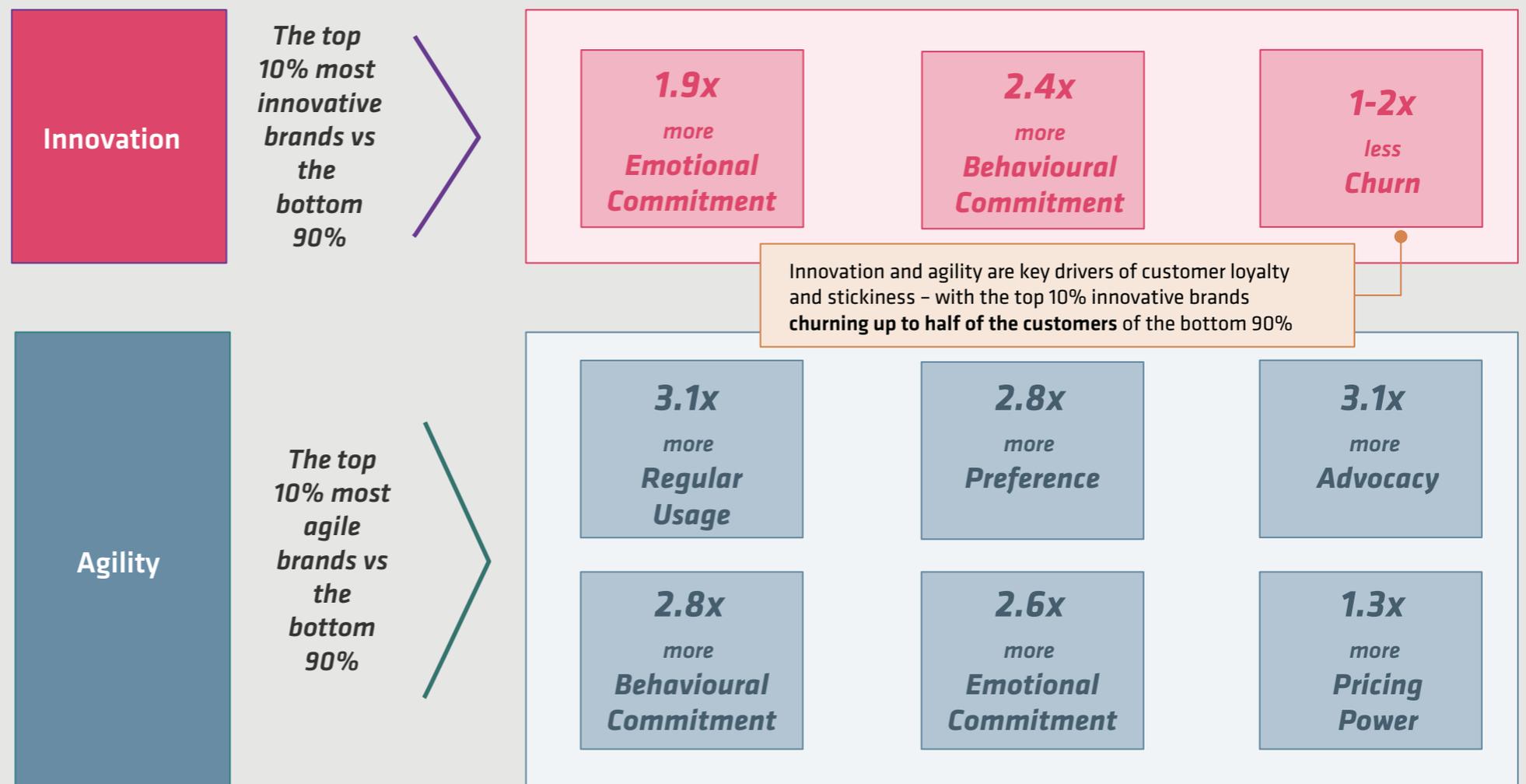
SECTION 1

THE WAVES OF DIGITAL TRANSFORMATION

The most recent BAV data post-Covid has revealed that innovative and agile brands are likely to drive double the level of emotional commitment and 2X plus regular usage and lower churn.

Agile and innovative brands are best placed to succeed, as they drive much higher customer stickiness and loyalty

Value of Innovation and Agility, BAV Data



Source: BAV, OC&C analysis

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SECTION 2

THE TIPPING POINT

THE TIPPING POINT

Digitisation in retail is not a new trend, but the Covid acceleration has materially turned up the heat on more traditional retail business, as store-based economics become unviable and many have proven unable to adapt.

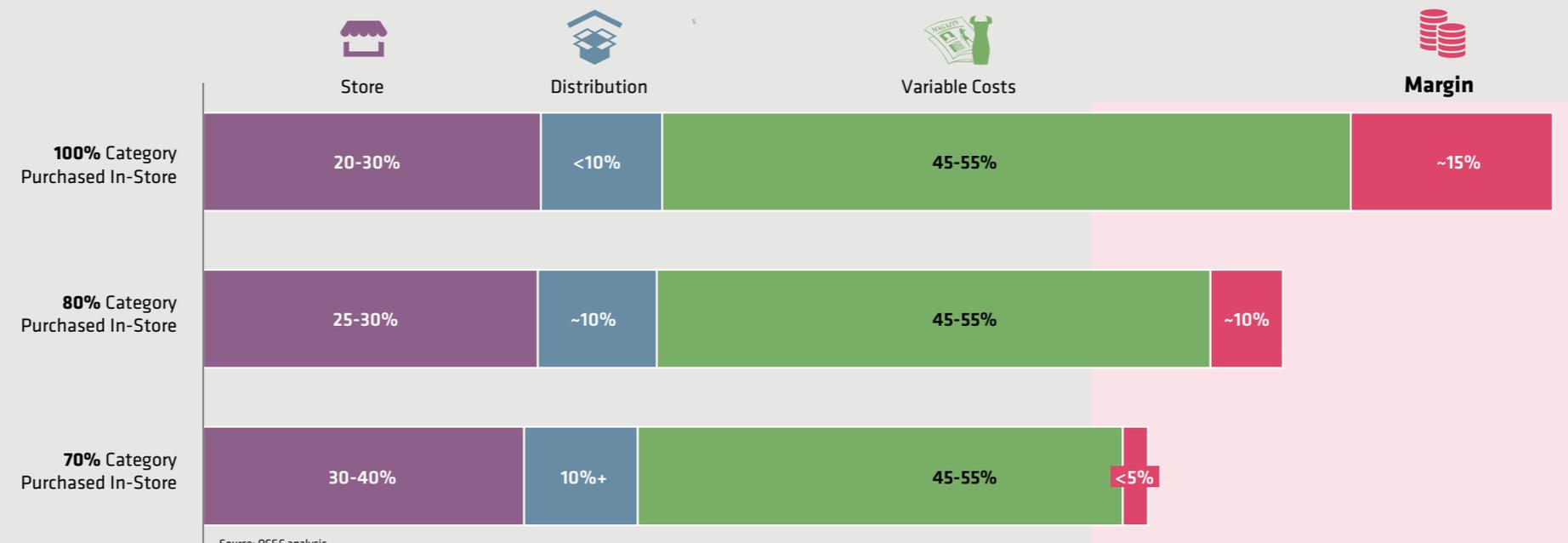
The driver of this relates to the traditionally high fixed cost base of the offline retail model with inflexible rents, rates, and distribution costs. As digital retail sucks sales, and volume from those channels traditional economics start to break down. Our analysis of typical retail economics suggest a tipping point,

where store based economics start to break down, typically occurs when digital sales reach 30-40% of overall retail sales.

This estimate enables us to map a 'frontier' in Online Retail penetration rates, at around c.30-40%, that represents a tipping point for physical retailers where store contribution margins become unviable. This varies by category, and for individual retailers but in our experience correlates with clear waves of retail failures and closures across sectors and geographies.

We estimate an 'frontier' in Online Retail penetration rates, at around c.30-40%, that represents a tipping point for physical retailers

Margin based on Revenue Demand - Based on Average Clothing Store
% of Total Sales Revenues



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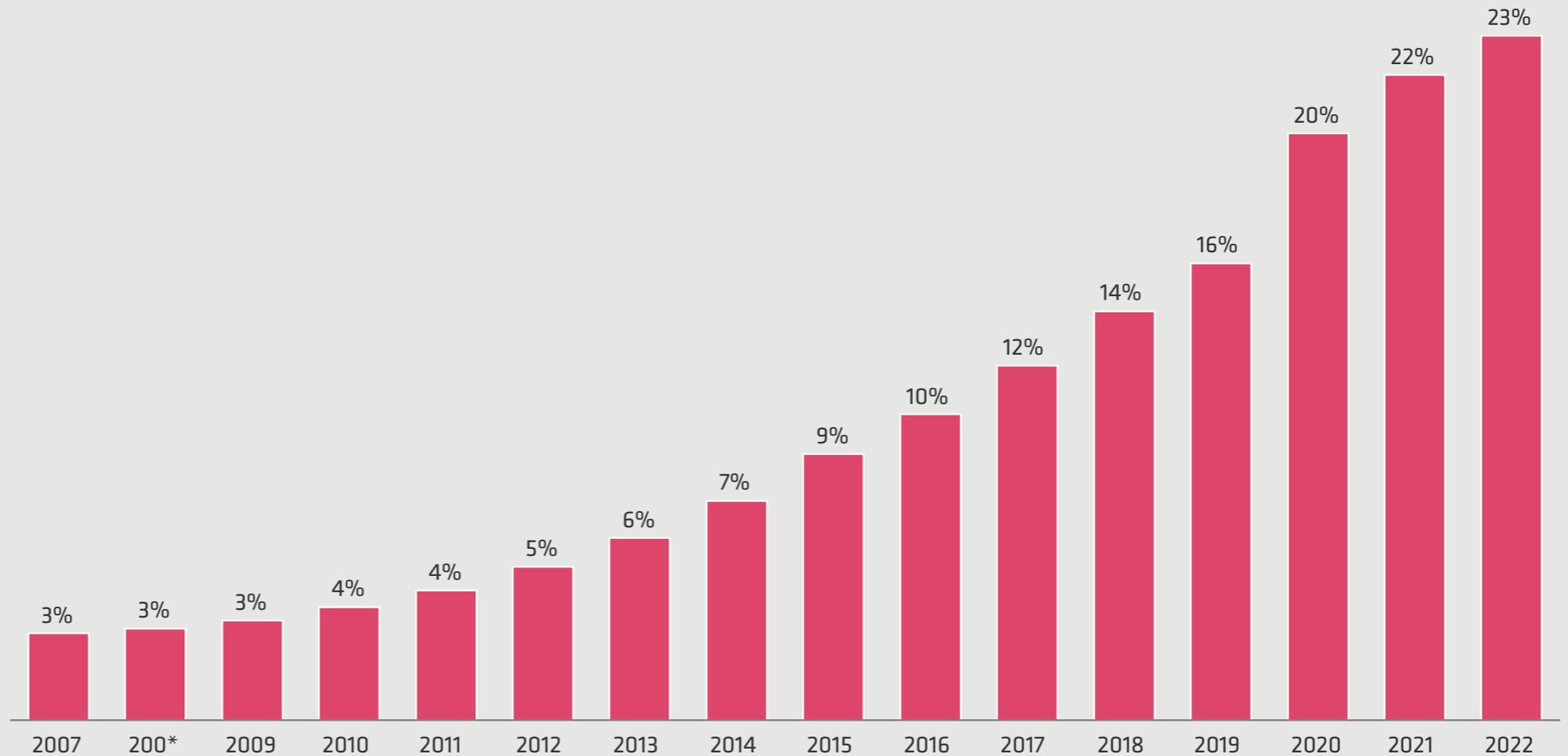
SECTION 3

DE-AVERAGING THE DIGITAL LANDSCAPE

DE-AVERAGING THE DIGITAL LANDSCAPE

DIGITAL SALES HAVE BEEN CONSISTENTLY GROWING AS A SHARE OF TOTAL RETAIL SALES REACHING ALMOST A QUARTER OF ALL SALES IN 2022.

Share of Retail Market Purchased Online, 2007-22 for 15 Major Markets



Source: Euromonitor, OC&C analysis

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SECTION 3

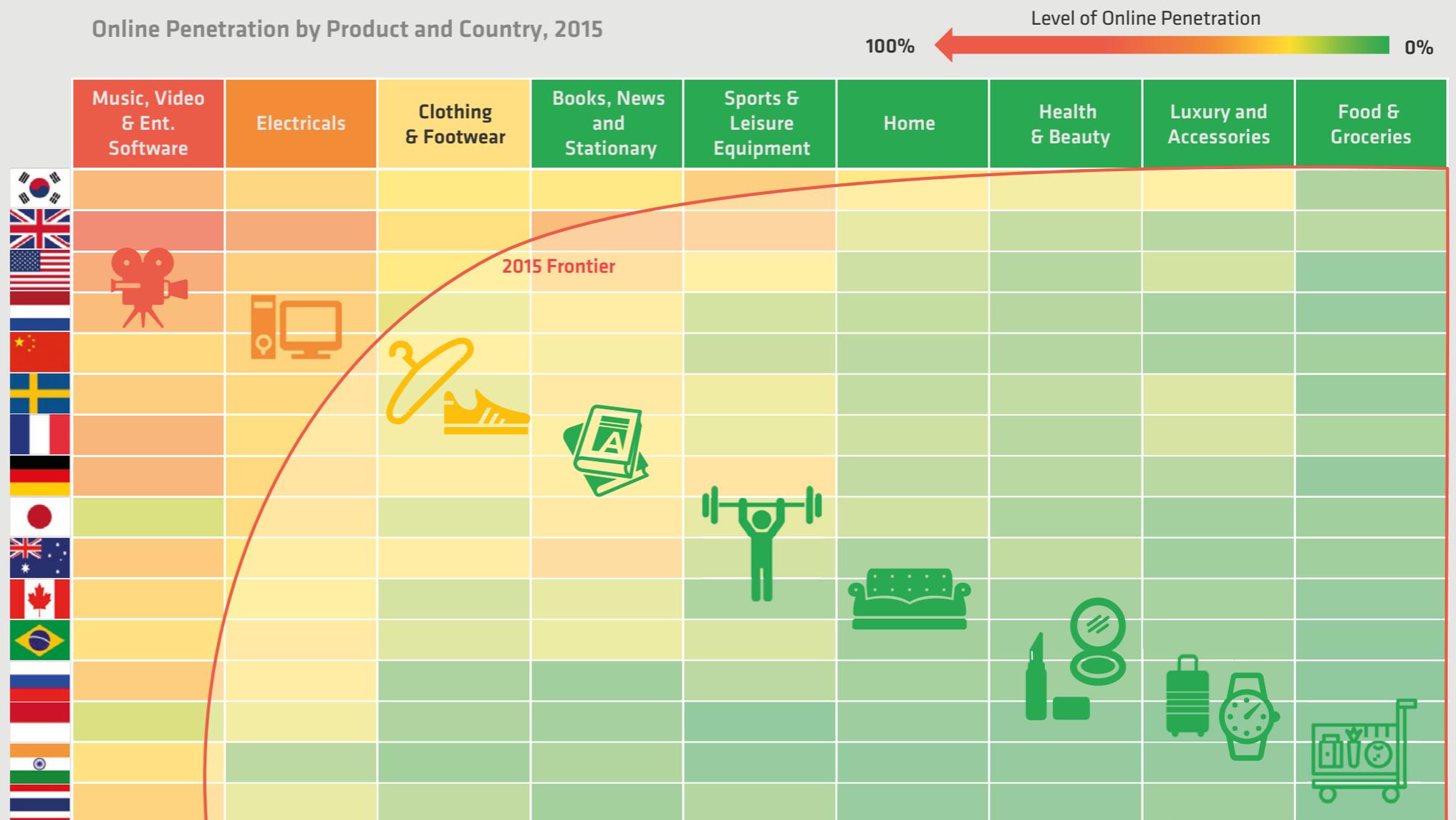
DE-AVERAGING THE DIGITAL LANDSCAPE

However, we need to beware averages – the digital frontier is not uniform, and many markets / sectors have yet to reach the tipping points while many others have already passed this point.

In 2015, only Digital Entertainment demonstrated online share of over 40% across all geographic markets, while Electricals and Clothing & Footwear had crossed the frontier in the most advanced markets. This was the era of a series of famous retail failures however as we said goodbye to HMV, Circuit City, Silverscreen, and Virgin Megastores amongst others.

In 2015, only Digital Entertainment was outside the frontier, followed by Electricals and then Clothing & Footwear beginning transformation

Online Penetration by Product and Country, 2015



Source: GlobalData, OC&C analysis

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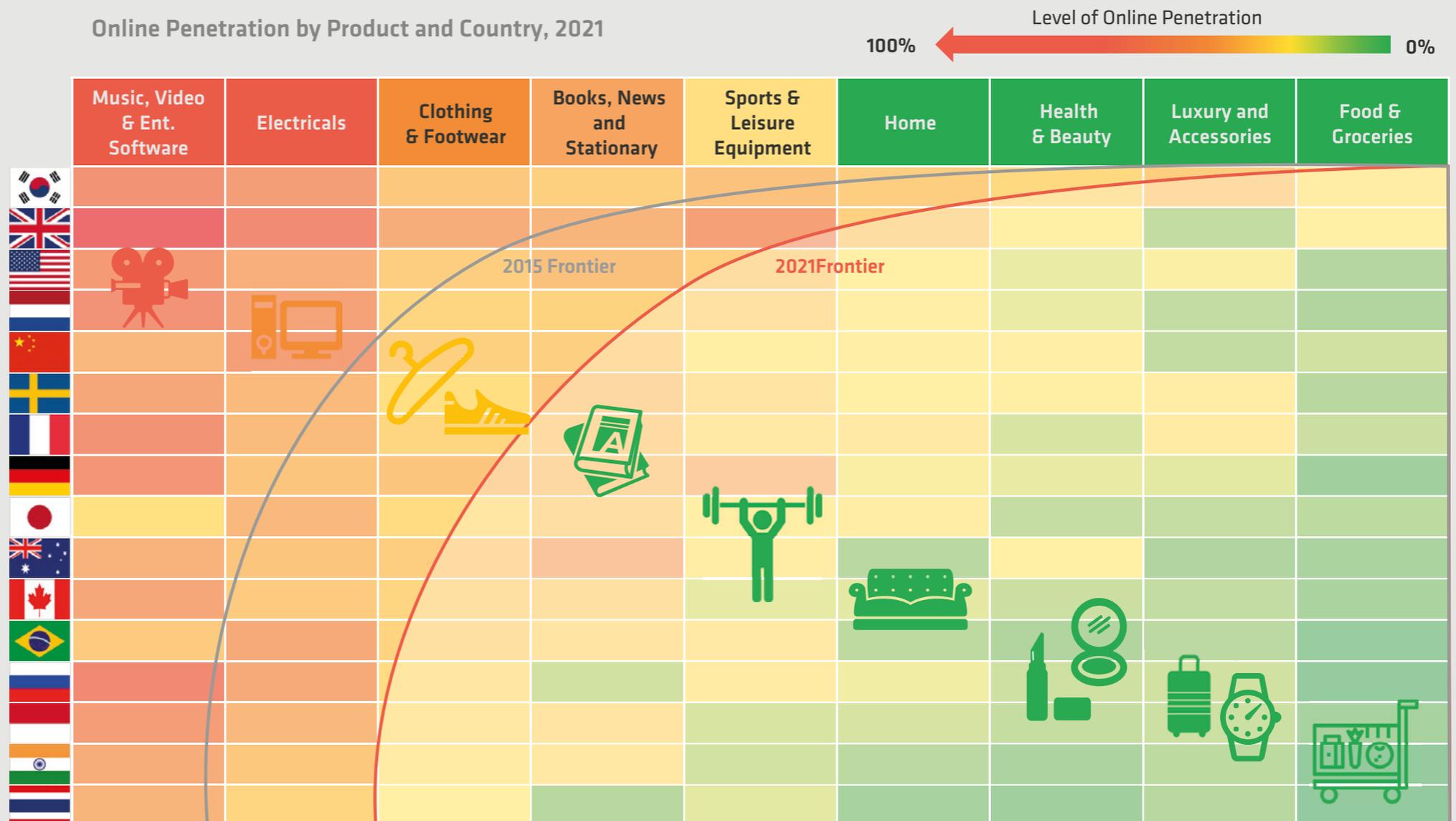
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DE-AVERAGING THE DIGITAL LANDSCAPE

Today, Clothing and Footwear is accelerating through the Frontier in Europe, NA and developed APAC markets, where online in other categories grows. This has ushered in another wave of major retail casualties including Arcadia formally one of the world's leading Apparel brands.

Today, Clothing and Footwear is accelerating through the Frontier in Europe, NA and developed APAC markets, where online in other categories grows

Online Penetration by Product and Country, 2021



Source: GlobalData, OC&C analysis

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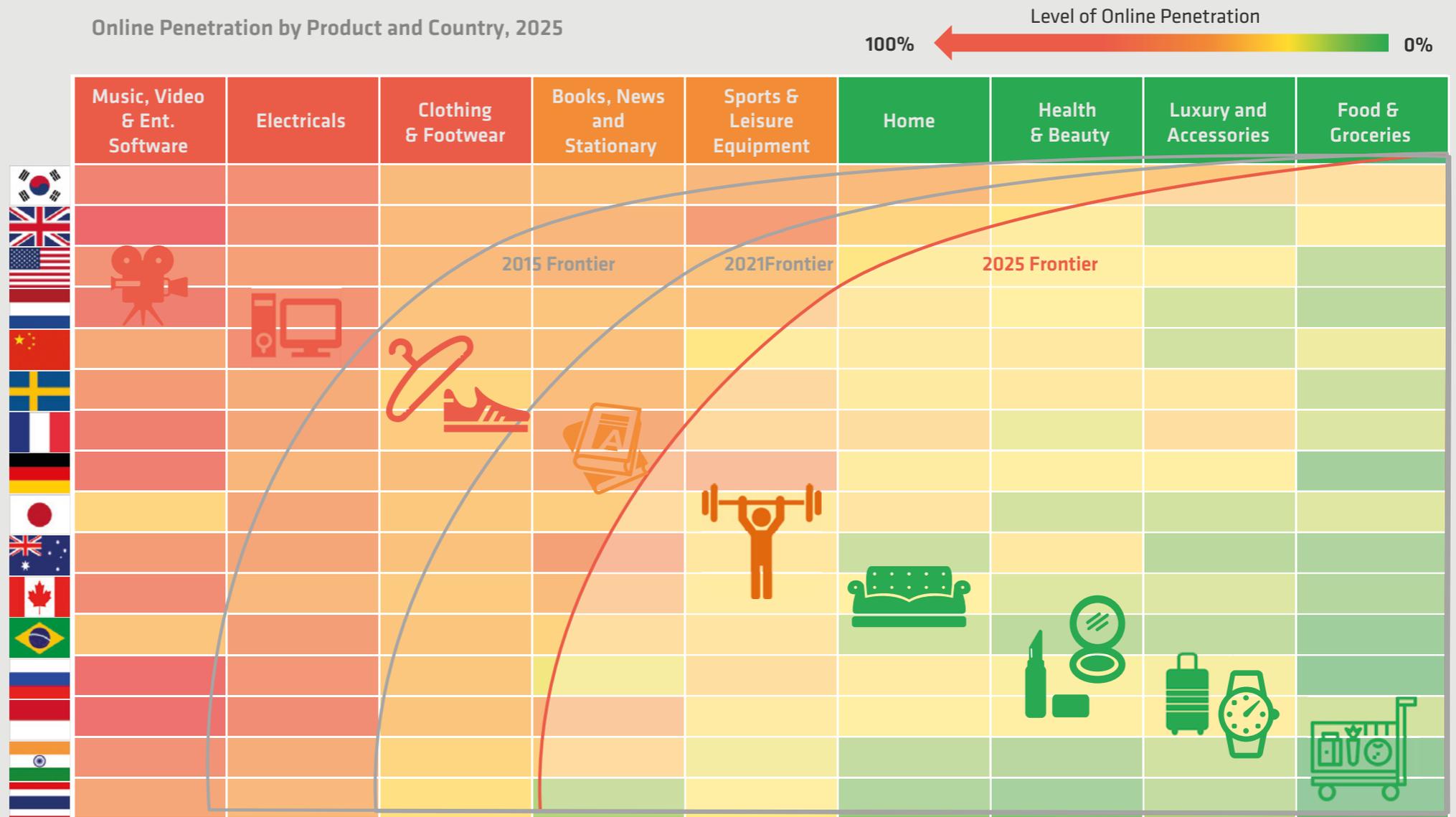
SECTION 3

DE-AVERAGING THE DIGITAL LANDSCAPE

But by 2025, the frontier will have advanced significantly, taking in most categories in the most advanced ecommerce markets, and leaving just food, beauty and luxury categories as 'hold-outs' where store-based retail remains the dominant channel.

But by 2025, many sectors will still be behind the Frontier, even in developed markets – physical channels will remain key in F&G, H&B, Home and Luxury

Online Penetration by Product and Country, 2025



Source: GlobalData, OC&C analysis

The implication of this is that retailers will need to continue to adapt their business models in response to this wave of digital acceleration and their relative position to the frontier.

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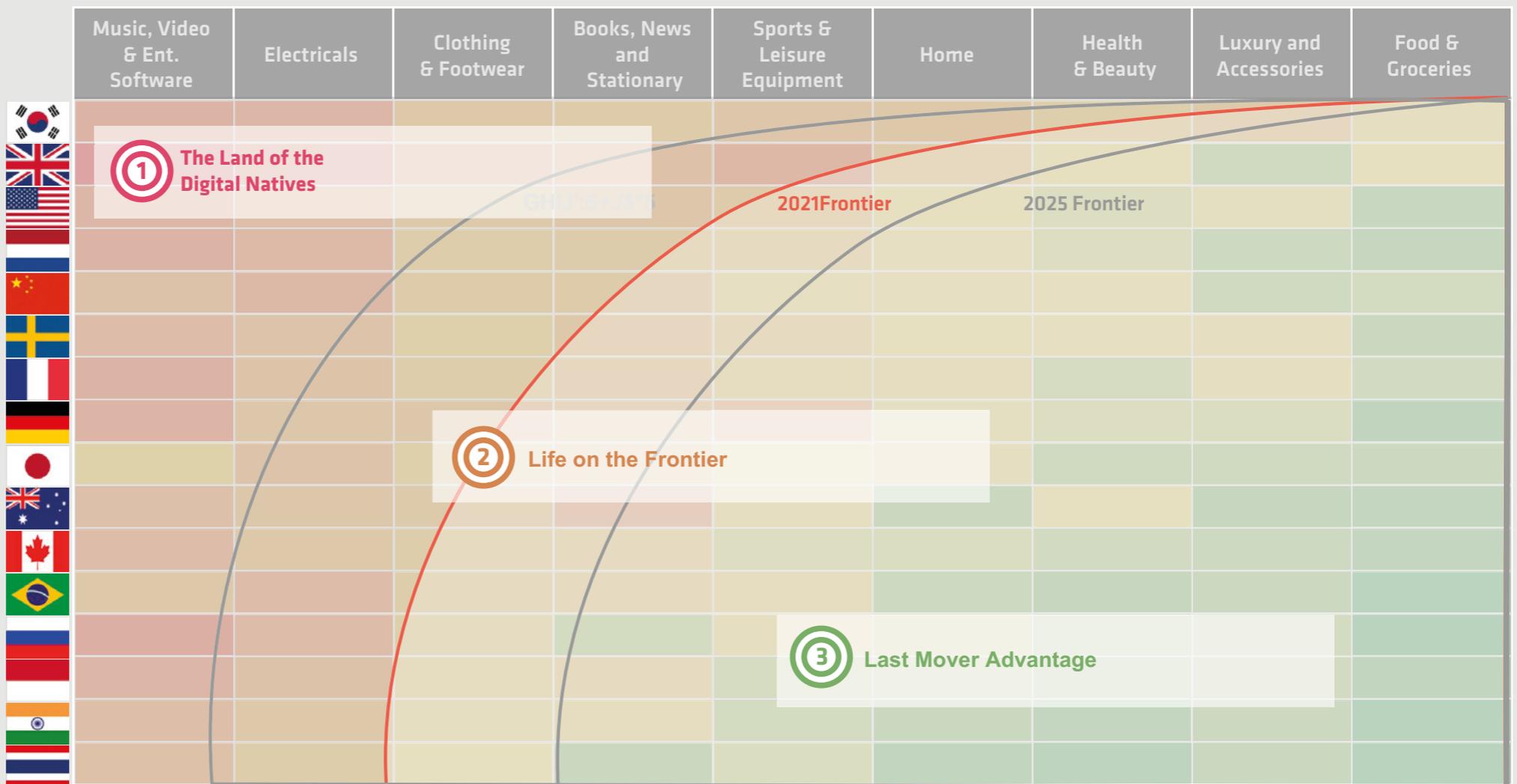
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WINNING RETAIL STRATEGIES

WINNING RETAIL STRATEGIES

Our research suggests that business model imperatives for retailers varies according to their sector's specific position relative to this frontier. That's not to suggest that different models won't exist, however we see a clear set of factors that are critical to success at each stage.

- 1) **The land of the digital natives (40%+ category online penetration)**
- 2) **Life on the frontier (20-40%)**
- 3) **Last mover advantage (<20%)**



Source: GlobalData, OC&C analysis

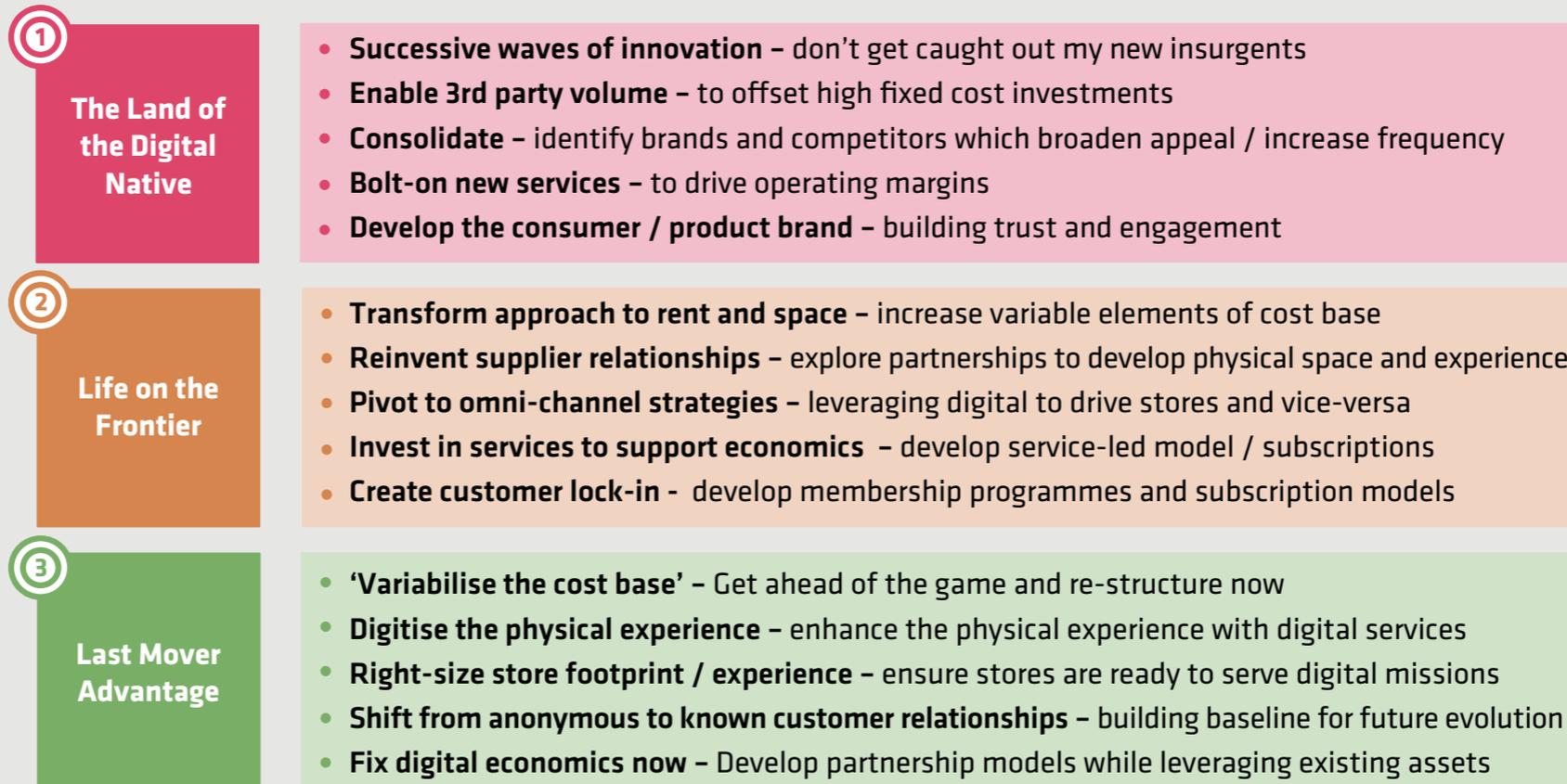
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SECTION 4

WINNING RETAIL STRATEGIES

The relative positioning to the Frontier will impact the strategic actions that retailers should take which are summarised in the exhibit below and the appendix which demonstrates a range of case studies on retailers who are expertly positioning themselves in these different positions.



SO WHAT?

The digitalisation of the retail industry will continue to be the most profound change impacting the industry for the next 5 years (sustainability may pick up that mantle thereafter). Despite this being 'old news' we estimate that only 30% of our markets (sector x country combinations) have actually reached the critical tipping point where 'bad things happen to the unprepared'.

The good news is that the trailblazers in this great transformation have helped to create some very clear playbooks for those yet to experience this evolution.

Covid has given many of us a 'looking glass' into this future digitally accelerated world, and we have learned that in the teeth of a crisis we can act decisively to reshape our businesses.

We urge all retailers to face into the reality of this ongoing transformation, realising that for many the real force of it has yet to be felt.

CASE STUDIES



CASE STUDY #1

Next
40%+
CATEGORY
ONLINE
PENETRATION

LAND OF THE DIGITAL NATIVES

SCALE CAN BE A CRITICAL DRIVER OF SUCCESS FOR RETAIL BUSINESSES OPERATING WITHIN THE FRONTIER, HELPING RETAILERS INVEST IN TECHNOLOGY, SUPPLY CHAINS AND CUSTOMER ACQUISITION.

Next offers a 'Total Platform' for 1000 3rd party brands, including Nike, Levi's and Ralph Lauren - which offers market-leading end to end ecommerce capabilities and attractive commission rates.

By allowing 3rd party brands access to Next's customer base and capabilities, Next has been able to capture a greater share of customer wallet, increase repeat rates, reduce customer acquisition costs and invest ahead of peers in technology and supply chain capabilities. Meanwhile, 3rd party brands can access a relatively low cost and fast-growth route to market, supported with extensive real-time data insights which underpin product development.

NEXT has pivoted from a private-label store-based model to an omnichannel marketplace



NEXT have executed a successfully pivot to online



NEXT invested heavily in back-end capabilities from an early stage



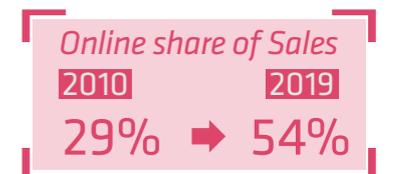
The introduction of 3rd party brands has been incremental to their own-label revenue



NEXT is an exemplar of how retail stores can be leveraged to support an online platform



... ultimately leading to a significant improvement in valuation



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CASE STUDY #2

Alipay: Ant Forest

40%+
CATEGORY
ONLINE
PENETRATION

LAND OF DIGITAL NATIVE

REINFORCING THE CONSUMER BRAND AND FRONT OF MIND AWARENESS AND ENGAGEMENT IS ESSENTIAL FOR BUSINESSES BEYOND THE FRONTIER.

Alipay's Ant Forest was launched in 2016. The game is designed to encourage consumers to live a healthier lifestyle, and through activity tracking, translates real-world activities (such as walking), into a virtual and real-world forest. 500m Chinese consumers have played the game, 'earning' 100m trees planted by Alipay across China.

Develop the consumer brand

Alipay's Ant forest has burnished the company's sustainability credentials, while achieving regular engagement



'Earn' green energy by completing sustainable tasks (eg walking)



Plant a virtual tree on the Alipay app



Alipay plants a real tree

500m users

100m trees planted

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CASE STUDY #3

Naked Wines

20-40%
CATEGORY
ONLINE
PENETRATION

LIVING ON THE FRONTIER

IMPROVING CUSTOMER STICKINESS IS ESSENTIAL AROUND THE FRONTIER - AS RAPID INNOVATION AND A DIGITAL LANDGRAB INCREASES CUSTOMER PROMISCUITY.

Naked Wines - a US based direct to consumer wine club, offers a monthly subscription service from which members can access wine direct from the vineyard, at lower prices than through retail. The combination of market-leading value, community reviews and exclusive products supports high retention customer repeat rates of xx% - substantially higher than other ecommerce wine retailers

Subscription

Discover the best way to enjoy great wine

Your direct access to the world's best winemakers

Ana Diogo-Draper
nakedwines.com winemaker
California, USA

- ~900k monthly subscribers, deposit £25 each - providing working capital to invest in producers
- 30m+ customer reviews and peer based recommendation engine underpins discovery based proposition

88%
customer annual
retention rate

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CASE STUDY #4

Pets at Home

20-40%

CATEGORY

ONLINE

PENETRATION

LIVING ON THE FRONTIER

ADDITIONAL CUSTOMER SERVICES ARE USED BY RETAILERS WITHIN THE FRONTIER TO GROW MARGINS AND CAPTURE INCREMENTAL SPEND FROM CUSTOMERS

Pets at Home has shifted from a traditional store based retail model to an omnichannel pet-car business, with integrated grooming and pet medical services. Since 2018, services have grown as a share of revenue from 15% to 33%, many of which are sold through subscription.

Additional Customer Services



- Repositioned as an **omnichannel 'pet care destination'**
- 50%+ stores offer **vet and grooming services**
- Loyalty supported through **membership schemes and pet health plan subscriptions**

**c.33% of sales
in 2021 from
services
(vs 15% 2018)**

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CASE STUDY #5

Lidl

<20%
CATEGORY
ONLINE
PENETRATION

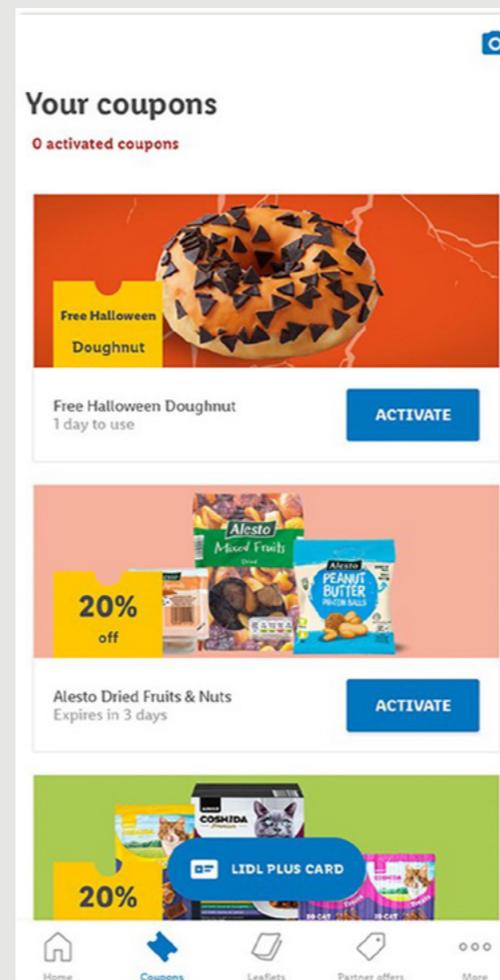
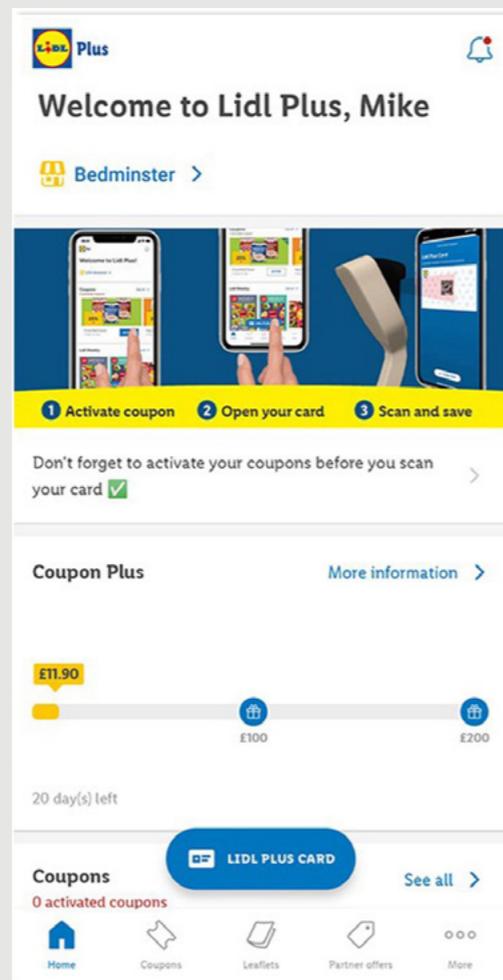
LAST MOVER ADVANTAGE

A large proportion of retail spend will remain outside of the frontier into and beyond 2025. However, there remain a series of actions which should be perused for retailers aiming to get ahead of the digital curve, improve the store experience and deepen relationships with customers.

Lidl Plus launched in 2018. Downloaded by 25m customers the app supports the customer journey through planning tools and stimulates baskets through targeted discounts.

By bringing digital to the in-store shop Lidl have enhanced data capture, while maintaining a low-cost operating model.

Subscription



App Overview

- Launched in 2018
- Available in 25 countries
- 25m+ app downloads



Supports Customer Journey

- Store locator
- Lists
- Digital receipts

Stimulates Shops & Basket Size

- Digital "Scratch & Win" prize draw
- Weekly Lidl Plus offers
- Personalised vouchers

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WORLD RETAIL CONGRESS

AN ASCENTIAL COMPANY

JAMES GEORGE

PARTNER

James.george@occstrategy.com

MAIRI FAIRLEY

PARTNER

Mairi.Fairley@occstrategy.com

MARCO OCCHETTA

PARTNER

Marco.Occhetta@occstrategy.com

SIMONA DOSSENA

PARTNER

Simona.Dossena@occstrategy.com

TOM CHARLICK

PARTNER

Tom.charlick@occstrategy.com

www.occstrategy.com

Pillar Partner



OC&C
Strategy consultants

