Business relations in the EU clothing chain: from industry to retail and distribution

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2007

Abstract

INTRODUCTION

In the last five years, in the largest European markets, **clothing consumption has increased at a slow pace**; in the case of Germany – until very recently the largest European market – the clothing market has even reduced its level considerably. High growth rates have been registered in some of the new member states; yet, their size is still relatively small, and average consumption of clothing is still low.

Across Europe, **clothing prices have shown a relative stability**, in the face of rising overall price indexes. Whereas in some countries – such as Spain or Italy – clothing prices have been steadily increasing, in others – such as the United Kingdom and most Northern European countries – prices have displayed substantial reductions.

In part, the recent trend in clothing prices is likely to have been affected by the overall macro-economic context and, in particular, by the **slow growth of the EU economy**. In part, however, it can be ascribed to a number of specific factors, among which:

- **Changing patterns of consumption** (increasing concerns for price, increasing popularity of seasonal sales, outlets, increasing appeal of other product categories, etc.), which manifested in a declining share of consumption of clothing (and footwear) in the average spending of European families.

- The **liberalization of the international trade of clothing and textile**, which have exposed European manufacturers to the increasing pressure of low-cost Asian imports.

- The **consolidation of China as the world leading producer of clothing**, and its increasing weight on European imports.

- The **increasing appreciation of the European currency**, which might have negatively affected the international competitiveness of European goods.

Within the clothing industry, these changes have been associated with broad changes in international value chains and retail formats, resulting in increasing pressure for cost-reduction on European manufacturers.

- The rise of hypermarkets and specialty chains – at the expense of more traditional formats, such as department stores and small, independent stores:

    - Large **hypermarket chains are extending their non-food sales to clothing** (especially in areas such as hosiery, childrenswear and underwear) **in order to increase retail traffic and margins**; their relative low-cost strategies are inducing other retail formats to cut their prices to maintain a competitive position. In order to preserve their margins, large retailers are transferring cuts upstream, by demanding continuous price reductions from their suppliers.

    - **Specialty chains, such as Zara and H&M, are slowly replacing small and independent specialty stores in major downtown areas**. These large international players often dispose of their own productive structures – thus reducing access to the market for small and medium manufacturers serving traditional multi-brand stores – and, when they turn to external suppliers, their bargaining power is considerable.

- **The intensification of cross-border competition**; while department stores and other more traditional formats seemed to have faced considerable difficulties in engaging in successful international expansion of their commercial activities, many hypermarkets (such as Tesco, Carrefour and Metro) and specialty chains (Benetton, Zara and Hennes & Mauritz *in primis*) are now competing relentlessly with one another, and with local domestic players, in several European markets.

- **The reconfiguration of value chains and the diffusion of business models based on "vertical systems"**, according to which retailers take increasing responsibilities for upstream activities such as textile procurement, product design and logistics – with a related impoverishment of the range of activities required from suppliers, which are often relegated to the role of mere providers of production capacity. Manufacturers' response to this trend range from the enrichment of the range of services offered to their clients, to the extension in downstream activities such as branding and retailing.

- **Changing sourcing policies**; large, cost-conscious retailers are introducing changes in the organization and the implementation of purchasing activities (streamlining of the suppliers' portfolio, international centralization of procurement, high rotation of buyers, adoption of online auctions, etc.) aimed at systematically reducing purchasing costs.

The combined effect of these factors seems to have led to **rising tensions between European manufacturers of clothing and some of their main clients**, namely large, modern European retailers. Manufacturers across Europe blame their large clients for the adoption of unfair sourcing practices such as the imposition of **fixed entry fees**, the **automatic charge of promotional costs**, unjustified penalties for minor or unproven infringements of the contract (**"charge backs"**), the **imposed return of unsold goods**, **systematic delays in payments**, the **unfair appropriation of stylistic innovation** included in collections – rejected by the clients, but soon after commissioned with minor modifications to low-cost Asian producers – and the diffusion of **reverse auctions**.

While, in general, trade relationships seem to be tense, it is not infrequent to observe what retailers and manufacturers commonly refer to as **partnerships**: **informal patterns of collaboration between a producer and a retailer**, which may take various forms, ranging from trust-based commercial relationships where the parties exchange extra service for stability of orders, to tight integration of information systems and operational activities.

1.1. The European clothing retail industry

Retail trade (NACE 52) provides an interface between producers and consumers, representing the final segment of the T/C chain. While distributors act as intermediaries between manufacturers and retailers as importers and/or wholesales, retailers engage in retailing of clothing directly from manufacturers or from wholesalers, selling products directly to consumers, usually without developing or changing products further. Most retailers undertake sales and administrative activities such as customer service, product merchandising, advertising, inventory control, and cash handling. Retailers represent the largest proportion of enterprises within distributive trades (NACE Section G) activities, accounting for slightly over 60% of all distribution enterprises in the EU-25 in 2003. According to Eurostat[1], within retail sales a first distinction is made between non-specialised in-store retailers and specialised in-store retailers; with the latter further split between food and non-food retailers. Our research considered non-specialised and specialised/non food in-store retailers. Our focus was, in particular, on *large, modern retailers*, which – as we will see in the remainder of this section – are playing an increasingly central role in the clothing chain.

The concept of "large retailing" usually refers to the average size of the stores ran by a company. Across Europe, there is not an absolute and widely agreed upon threshold that distinguishes "standard" from "large" shops. Frequently this decision will depend upon the particular size and style of the unit in comparison with its neighbouring facilities[2]. The boundaries of our research, however, were not drawn exclusively on the basis of the floor size of the average store: as the relative bargaining power of retailers was central to the ultimate purpose of our research, we included in our setting also large chains, composed by several relatively small shops, together reaching a considerable "economic" size.

A second criterion for the delimitation of our object of study was the application of "modern" managerial techniques. Following earlier research, we defined as "modern" those large retailers with several doors and multiple formats usually adopting information technologies enabling the so-called "lean retailing".

Box 1.1. The emergence of "lean retailing"

A central, distinctive feature of modern retailing is the so-called "lean retailing"[3]. The technological building blocks of lean retailing are bar codes and uniform product codes, scanning devices for product identification, electronic data interchange (EDI) and data processing, distribution centres and common standards across firms. These modern technologies for lean retailing are used by the retailer to place quick, accurate replenishment orders. More sophisticated, often automated distribution centres allow manufacturers to pick and pack small replenishment quantities based on EDI orders.

The growing urgency for retailers to maximize sales and profits by store, channel, customer, and even time of day – requires more precise merchandising decisions. The retailer's capacity to obtain high gross margins and adequate service levels, while containing unsold stocks to the lowest

[1] Eurostat. *European business*, 2006

[2] It is suggested that stores which are more than 5 times the normal size of neighbouring shops (in terms of reduced area) may be considered as a large shop. This will generally include stores that are over 1850 m^2 of gross internal area (GIA) in outlying areas and small towns. In city centres the standard size of retail units is much larger and units of up to 4500 m^2 GIA or more are the rule. In this context it will be appropriate to consider the size of the floor-plates. In general large shops will have a floor-plate in excess of 1000 m^2 GIA.

[3] Abernathy F, Dunlop J, Hammond J, Weil D, 1999 *A Stitch in Time: Lean Retailing and the Transformation of Manufacturing—Lessons from the Clothing and Textile Industries*. Oxford University Press, New York.

possible levels, derives from precision in forecasting demand so that the advantage of a global supply chain in terms of lower cost has to be set against the reduction in logistic costs, as well as the decrease in lost sales and reduction in the amount of merchandise sold at discounted prices that could derive from choice of a faster local supply chain. This is a wider theme as indicated by some emerging practices among retailers[4]:

1.1.1. Modern clothing retailing in Europe: the prevailing formats

Most European clothing retailers can be classified according to six main categories[5]:

- *non specialised*: department stores, variety stores, hyper- and supermarkets, mail-order retailers

- *specialised (clothing)*: specialty chains, independent stores

As the focus of our analysis was on large, modern retailers, our study did not include independent stores. What follows is a brief description of the remaining five categories.

Department stores

A department store is a retail establishment which specializes in selling a wide range of products organized into departments. Main important product categories usually are: clothing, accessories, fragrances, cosmetics and home collections with no predominating merchandise line. Additionally they may select other lines of products such as toiletries, electronics & photographic equipment, jewellery, toys, and sporting goods. Department stores mostly offer brands and they give those brands a dedicated space in terms of visual and merchandize (wall units, shop-in-shops, corners). Private labels represent a limited part of the offer. Department stores can be further divided into:

1. *Large Town Centre Stores / Small Department Stores:* Large town centre stores / small department stores may range from 3,500m^2 to 12,000m^2 of gross internal area (GIA). Larger units will display a wider range of goods including perfume, fashions, household items and, in some cases, a limited amount of sports goods, furniture and food. In modern shopping centres these stores frequently act as the main anchor tenant.

2. *Large Department Stores:* Large department stores in excess of 12,000m^2 GIA are included in this category. They offer the widest possible range of goods including, in addition to those mentioned above, extensive ranges of furniture, carpets, electrical items, sports items and household items etc. They may also include a number of cafés and restaurants. The precise location of these units is not always critical because they can be considered to be an attraction in their own right.

Examples include House of Fraser, La Rinascente, Coin, Printemps, Galeries Lafayette, Selfridges, El Corte Inglés, Kaufhof, Debenham and other

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[4] IBM Corporation, *Clothing Industry Brief*, 2002.

[5] Our classification follows Aspinall, K., *Long term scenarios for the EU textile and clothing industry*, OETH, Brussels, 1997. Aspinall identifies six main types of retail channel: independent stores, specialty multiples, department and variety stores, hyper- and supermarkets, and mail order. In some European countries *itinerant retailing* still accounts for a significant share of the market. Another rising form, the *retailers' outlets* was excluded from the boundaries of our study because they have no significant relationships with manufacturers.

Variety Stores

Frequently these stores will be located in high streets or covered shopping centres. In covered shopping centers variety stores can often be used in a secondary anchor role and are strategically placed to influence the pedestrian flow between the main anchor units. Examples include Woolworth's, Boots and W H Smith in the UK and Kiabi and Monoprix in France. It is a retail format which offers a wide range of product categories. Convenience is the common characteristic among the different product families. To give value for money they mostly offer private labels. The cosmetics department is less developed than in department stores: it is usually represented by mass market brands. Main sectors usually are: clothing, underwear and socks, home textile, childrenswear. Variety stores generally range from 1850m^2 GIA to 3500m^2 GIA etc.

Hypermarkets

Hypermarkets are superstores combining a supermarket and a department store. The result is a gigantic retail facility which carries an enormous range of products under one roof, including full lines of groceries and general merchandise. Hypermarkets, like other big-box stores, typically have business models focusing on high-volume, low-margin sales. Due to their large footprints and the need for many shoppers to carry large quantities of goods, many hypermarkets choose suburban or out-of-town locations that are easily accessible by automobile. Aggressive pricing is not only financed by high sales volumes, but also by the low cost of sales space, greater autonomy in terms of logistics when compared with smaller retail outlets, a faster turnover of goods and longer opening hours. Examples include Auchan, Carrefour, Tesco.

Mail order retailers

Mail order retailers, such as La Redoute in France and Otto Versand in Germany, sell products by mail delivery. The buyer places an order for the desired products with the merchant through some remote method such as through a telephone call or an internet website. Then, the products are typically delivered directly to an address supplied by the customer, such as a home address, but occasionally the orders are delivered to a nearby retail location for the customer to pick up. Some merchants also allow the goods to be shipped directly to a third party consumer, which is an effective way to send a gift to an out-of-town recipient.

Specialty chains

Specialty chains (or multiples) have a wider geographical reach, with some very large players, such as H&M, C&A and Zara (Grupo Inditex). Some are directly owned and operated (e.g. C&A) while others have a franchise structure (e.g. Benetton). The economics of sourcing and marketing differ from those faced by independent retailers. Specialty chains are also called verticals as their main characteristic is the control of these companies over the products they sell. Specialty chains sell their own branded production, produced by favoured suppliers. For larger chains, network economies are achieved through the use of advanced information and management systems (electronic point of sale, electronic data interchange and just-in-time) and national media advertising. They can be further classified as *single-industry specialists* (e.g. Promod, Mango, Pimkie, Benetton, Terranova, Gap, Zara, Kiabi, Top Shop, C&A), *single-product specialty* (e.g. Yamamay and Tezenis for lingerie or Tie Rack for accessories), *single-client specialty* (e.g. Prenatal for mothers-to-be), and *single-occasion of use specialists* (e.g. Decathlon and Sportscheck in sportswear and activewear).

Examples of local competitors, classified by format, in nine European countries are reported in Table 1.15.

Table 1.15. Large modern retailing in nine European countries: some examples (2006)

	Department stores	Specialty chains	Hypermarkets & supermarkets	Variety stores	Mail order
Czech Republic	-	Kenvelo New Yorker, H&M, C&A, Odevni Podnik, Terranova, Spar	Tesco Ahold Kaufland Globus, Sos	-	Quelle
France	Galeries Lafayette, Printemps	Zara, H&M, C&A, Etam, DPAM & Okaidi, Celio, Decathlon, Promod, Pimkie, Camaieu	Carrefour, Auchan, Casino, Centre Leclerc	Kiabi, Monoprix, Prisunic, Tati	La Redoute/ Redcats, Trois Suisses
Germany	Peek & Cloppenburg, Galeria Kaufhof, Karstadt	C&A, H&M, Takko, SinnLeffers, New Yorker, Mulliez-Gruppe, Esprit, Bonita, S. Oliver	Metro, Lidl, Aldi Gruppe, Tengelmann, Rewe	-	Quelle, Otto, QVC, Klingel, SE24
Hungary	Skala Corvin, Marks & Spencer	Emporium, Esprit, H&M, C&A, Transit-Outlet, Tom Tailor	Auchan, Cora, Tesco, Metro, Interspar, Plus	-	Quelle, Otto
Italy	La Rinascente, Coin Upim	All Inditex chains, H&M, Benetton, Stefanel, Promod, Mango, Pimkie, Calzedonia-Intimissimi-Tezenis, Prenatal, Oviesse	Carrefour, Iper, Auchan, Bennet, Coop	-	-
Poland	Galeria Centrum, Peek & Cloppenburg, Marks & Spencer	Vistula, Wólczanka, H&M, Zara, Re-reserved, Artman, C&A, Benetton, Warmia, Hexeline, Monnari, Stefanel	Tesco, Real, Geant, Makro, Carrefour	-	Bon Prix, Quelle, Neckerman, Allegro
Portugal	El Corte Inglés	All Inditex chains, C&A, Benetton, Mango, H&M, Cortefiel, Cenoura, Petit Patapon, Laranjinha, Girandola	Carrefour, Continente, Modalfa, Vêtimarche, Jumbo	-	La Redoute
Spain	El Corte Inglés	All Inditex chains, Mango, H&M, Neck&Neck, Cortefiel, C&A Modas, Prenatal	Carrefour, Mercadona, Hipercor (El Corte Inglés), Alcampo (Auchan)	Ekseption, Scooter, Chavala, Friki, Yusty, NAC	
UK	Debenhams, Fenwick, Fortnum & Mason, Harrod's, Harvey Nichols, Heal's, Hoopers, House of Fraser, John Lewis, Selfridges, Marks & Spencer	All Inditex chains, Mango, H&M, Gap, Dorothy Perkins, Miss Selfridge, Wallis, Topshop, Evans, Burton, Topman	Asda, Tesco, Sainsbury	Woolworth	

*Some retailers adopt different formats in different countries

1.2. Recent trends in the structure and strategies of large European retailers

In recent times, structural changes in the clothing retail industry have been occurring at three different levels:

- *Format changes*: similarly to what is occurring in food retailing, clothing retailing is displaying a tendency towards increasing store size and the diffusion of self-service. These two trends are associated to a re-configuration of formats whereby larger formats with lower price and less service are gaining market share (hypermarkets and specialty chains).

- *International competition*: the international scope of the commercial and sourcing activities of large retailers is increasing, along with the redefinition of supply policies. Specialty chains and hypermarkets are increasingly expanding the scope of their commercial activities; domestic players are facing an intensification of competition driven by the entry of large international retailers.

- *Reconfiguration of value-chains*: the international relocation of production is frequently accompanied by the increasing involvement of retailers in upstream activities such as product design; this process results in an asymmetric structure with the balance of power tipped towards those who manage the distribution process. The increased role of retailing in the textile-clothing pipeline derives not only from its bargaining power (which comes into play in transactions) but above all from its market power (its capacity to orient the final consumer's preferences).

In part, these changes are driven by a continuous search for cost reductions, economies of scale and efficient exploitation of corporate assets, pushed by rising pressure of financial markets on listed companies – a phenomenon which is more pronounced in the UK (where most large retailers are listed), but which seems to be spreading also to France and Scandinavia.

In this section, we will provide evidence of each of these phenomena and we will discuss its implications for changing business relationships between European manufacturers and distributors in the clothing industry.

1.2.1. The emergence of new formats

The European marketplace is rapidly transforming from a collection of local arenas, into an increasingly integrated retail market. Some common trends seem to affect several markets, such as price stagnation, shorter product lifecycles, and a declining share of consumer expenditure in clothing in mature markets. In addition, new retail concepts are progressing through the growth stage and reaching maturity in Europe.

According to recent estimates of Smi-Ati, based on data collected by the Institute Française de la Mode on the five largest European markets, the last fifteen years have witnessed the decline of independent retailers (going down on average from 46.8% to 27.1% of the five largest European markets), and the steady growth in the shares of specialty chains (from 18.7% to 25.1%), and hyper/supermarkets (5.1 to 6.8), along with the emerging formats of variety stores, discount, cash and carry and large sport chains (collectively accounting for 14% of the market in the early 90's, and now increased to 27.2%).

Data collected across nine countries[6], while revealing – on the one hand – a heterogeneous landscape, whereby some formats, such as itinerant retailing, still account for a significant share in some markets, while are virtually non-existent in others, essentially confirm – on the other hand this tendency (see Table 1.16).

A comparison of format distribution across Europe reveals some fundamental differences between countries, such as the United Kingdom and Germany, dominated by large department stores and specialty chains, where large hypermarkets and discounters command an increasing share of the market, and others, such as Italy and Hungary, whose clothing retail industries are fragmented and dominated by small, independent businesses. While some, such as France and Spain, have a rich hypermarket and retail warehousing heritage, others, such as Poland and the Czech Republic, have only recently witnessed fast growth of these formats. Mail order, finally, is still an important channel of distribution in some countries, such as France and Germany, but is virtually absent from many others such as Italy.

Table 1.16. Clothing distribution in Europe 1999-2005: market shares by retail format

Country	Year	Indep. stores	Specialty chains	Dep. & variety st.	Hyper and supermkts	Mail order	Others
Italy	1999	55.7%	14%	N/A	15%(a)	N/A	15.3% (b)
	2005	47.8%	19.3%	N/A	18.4%	N/A	14.5%
France	2000	24%	34% (c)	6%	16%	8%	12% (d)
	2005	18.7%	38.2%	5.4%	15.3%	8.7%	13.7%
Germany	2000	39%	26%	13%	8%(c)	14%	-
	2005	28%	29%	14%	14%	15%	-
UK	1998	11%	25%	31.5%	10%	8%	14.5% (d)
	2003	9%	27.5%	26.5%	11.5%	6%	19.5%
Spain	1999	43.1%	18.9%	15.8%	14%	1%	7.2%
	2005	34%	24%	15%	20%	1%	6%
Portugal	2000	70% (e)	N/A	3.6%	12.5%	2%	11.9%
	2005	75%	N/A	5%	17%	2%	1%
Poland	2000	45%	38%	4%	10%	3%	-
	2006	25%	55%	3%	13%	4%	-

[6] In Europe, there is not a source of official, comparable data about the distribution of retail formats; the investigation of the evolution of retail formats must rely on local sources. Local sources, however, tend to adopt various methods (panel data, sales figures, knowledgeable estimates, national statistics, etc.), often providing different indications for the same formats in the same country in the same year. At times, local studies change the methodology over time, so that data from different years cannot always be compared. As we reviewed available sources, we favoured those which: i) ensured comparability over a reasonably ample time frame (four-five years), ii) were based on – or at least were coherent with – available figures about retailers' clothing sales, and iii) were corroborated by other sources or classifications. This procedure brought us to select different sources for different countries, which referred to different time spans. The resulting data, therefore, are not so much comparable across country, but longitudinally within countries. Yet, the purpose of this analysis was not to compare the structure of clothing distribution across Europe, but to provide evidence of and track changes over time.

Hungary	2000 2003	35.1% (e) 38.9%	N/A N/A	6% 5.5%	7.8% 9.8%	1.9% 1.6%	49.2% (f) 44.2%

(a) Including department stores (b) Including itinerant markets, (c) Including variety stores
(d) Including sports chains (e) Including specialty chains (f) Including street markets and sports chains
Source: Various (see country reports in Part II)

As displayed in Table 1.16, however, some trends are common to several European markets, and can be considered as the reflections of a more general re-configuration of the competitive landscape of the clothing retail industry:

- The increasing share of hypermarkets
- The increasing share of specialty chains
- The decreasing share of department stores

The increasing share of hypermarkets

According to a recent study by A.T. Kearney[7], in the last few years, price-focused retailers, such as discount retailers and hypermarkets, have been growing at a much higher pace (15% and 9% respectively) than the other retail formats (6%). The study included all product categories and described a phenomenon that seems to be occurring worldwide. In the United States, Wal-Mart and Target attract value-conscious consumers, while in Europe this role is largely played by large chains, such as Tesco, Metro and Carrefour (see Table 1.17), which have developed a multi-channel structure around the hypermarket business (cash & carry, supermarket, discount, etc).

Table 1.17. The largest hypermarkets in Europe (total sales, food and non-food)

	Company	Country	2005 retail sales (Mio EUR)	5 yr retail sales CAGR% (local currency)
1	Carrefour	France	74 574	2.8%
2	Metro	Germany	55 569	5%
3	Tesco	UK	55 354	12.8%
4	Schwarz	Germany	36 886	13.0%
5	Aldi	Germany	36 247*	4.5%
6	Rewe-Zentral	Germany	35 398	3%
7	Group Auchan	France	33 100	7.1%
8	Edeka Zentrale	Germany	31 705*	4.9%
9	Ahold	Netherlands	29 654	-3.4%
10	Centres Distributeurs E. Leclerc	France	35 494	6.1%

* Estimate
Source: Deloitte, *Global power of retailing*, 2007

In the specific field of clothing, price competition is intensifying as the elimination of textile quotas facilitates further reductions in prices. In fact, hypermarkets are now posing a severe threat to other

[7] A.T. Kearney, *The Global Retail Development Index* 2006.

clothing retail formats for two main reasons: i) the increasing share of clothing in the assortment, and ii) the increasing share of private labels.

Since the price of fresh and packaged food has remained static and food is increasingly difficult to add value to, many hypermarkets are now trying to expand non-grocery sales. Non-food departments improve company profitability and fulfil the important role of traffic-maker. Clothing, in particular, is the section offering the highest margins (up to 20-25% with an average between 15% and 18%), although the section is less positive from the standpoint of area to sales ratio (around 50%), and stock turnover (5, compared with an average of 15-17). Therefore, the number of non-food sections in hypermarkets is growing. In Europe, for instance, UK-based chain Tesco has recently announced the intention to invest heavily in clothing and home furnishings, expecting reach sales of £1 billion in 2007 – with an overall increase of 33% compared to its 2005 sales.

Despite their potential, the textile/clothing sections often reveal numerous shortcomings in terms of layout and care taken over display, the lack of an appropriate visual merchandising policy, and the application of aggressive pricing. These factors reflect hypermarkets' choice to focus on the down-market segment and to adopt a discount policy even for higher quality items. Conversely, Carrefour's leading position in clothing sales in France is partly attributable to the success encountered by its private label Tex, which Carrefour supported with considerable investments in design and promotion, as well as in up-grading the clothing section of its stores, both in terms of surface and design, aimed at distancing itself from the traditional negative image of clothing merchandising in hypermarkets. UK-based Tesco is undergoing a similar upgrade of its offer, based on the introduction of a more upmarket range, based on carefully segmented collections.

As retail strategies converge and price pressures intensify, the need for differentiation is likely to rise. Retailers are already squeezing their space to make room for their own private labels, which provide higher profits than branded merchandise. Private labels can be defined as exclusive products only available at a specific chain of stores. The important point is that private labels are not anymore defined by geography but are increasingly sold across European markets[8]. Proprietary brands – such as F&F, One Body, Elevation Snow, Cherokee, and Petite for Tesco, or Tex and French Touch for Carrefour – are a way for retailers to stand out from their competitors, regain some pricing power, and improve profitability; in doing so, however, they take on risks that have historically been the suppliers'.

A consequence of the relentless increase in the market share of so-called "value retailers" is the expanding range of product categories that are increasingly distributed through hypermarkets and private labels. Among those categories that have already "gone to value" are underwear, hosiery and fleece and children's wear. This process is now affecting also jeans and casual pants, while a premium price is still charged on branded, service intensive and tailored categories (e.g. formal menswear).

The increasing share of speciality chains

While people routinely shop at hypermarkets, they simultaneously look for variety and fashionability at specialty retailers organised into chains. Over the last ten years specialty chains have captured a chunk of department stores' market by targeting and tailoring offerings to well-defined customer segments and then improving operations to increase efficiency.

[8] ACNielsen, *Power of Private Label*, 2005

Within specialty chains some retailers were able to grow at an impressive rate, at the expenses of more traditional players inside the same category: those chains were competing on the fast fashion model, such as Hennes & Mauritz (H&M) of Sweden and Inditex (Zara) of Spain, ranking number one and two in terms of 2005 retail sales (see Table 1.18).

Table 1.18. The largest clothing specialty chains in Europe

	Company	Country	2005 retail sales (Mio EUR)	5 yr retail sales CAGR% (local currency)
1	Hennes & Mauritz	Sweden	6 717	15%
2	Inditex	Spain	6 631	22.1%
3	C&A	Belgium	5 005	-5.1%
4	Next	UK	4 280	15.3%
5	Decathlon	France	3 744	8.4%
6	Arcadia group	UK	2 529	- 2.7%

Source: Deloitte, *Global power of retailing*, 2007

A recent trend followed by most specialty chains is that of "verticalisation". It implies that retailers do not restrict their activity to actual retail distribution: rather, they go as far as to conceive the design of the collection and thus bring about a process of integration of the research and development functions for production of collections. They take over some of the functions that are typical of the clothing industry. In fact, the very term 'retailer' risks becoming inadequate, as these firms sell something different from the source articles they purchase, thus combining the competences of various different suppliers. This change involves a more direct relationship with manufacturers of semi-finished textile products that therefore see a greater integration.

The development of vertical systems within the value chain is one of the most relevant changes occurred in the clothing industry in the last decade. The core features of vertical systems can be characterized as follows:

- Complete control over the whole value chain (design, manufacturing, logistics and distribution).
- Standardized store concepts and coincidence between the retailer and the product brand; collections and models are designed by own design teams and sold under the company's brand (and sub-labels).
- Quick responses to market and fashion trends are ensured by the fact that quantitative and qualitative information from the point-of-sales is quickly passed backwards to the design and procurement teams.
- Sales risks of fashionable items are minimized by the acceleration of all processes within the value chain.
- Higher profitability is achieved by gathering margins normally shared between producer and retailer, and by low tied capital within the value chain

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In several European countries, specialty chains adopting a vertical system are increasingly eroding the market shares of traditional players, such as department stores and family-owned independent stores. Indirectly, the spread of these chains is restricting access to market for small and medium clothing producers, who traditionally relied on independent stores for the distribution of their products. The undisputable success of vertical specialty chains seems to have pushed other players in the value chain – both retailers and manufacturers – to adopt business models based on similar features. The resulting "vertical" models include a variety of forms with different risk and responsibility sharing between the producer and the retailer.

Box 1.2. Specialty chains and fast fashion

So-called "fast fashion" is not a retail format, but a new strategy adopted by leading specialty chains based on shorter and shorter product lifecycles and a tight and efficient supply chain allowing for fast turnover on the shelves. European specialty chains adopting a fast-fashion model are growing at about three to four times the rate of the sluggish apparel industry as a whole, as indicated in Table 1.19.

Table 1.19. Total sales of fast fashion retailers: change from previous year (%)

	01/02	02/03	03/04	04/05	05/06	5 yr retail sales CAGR%
Inditex *	15%	6%	11%	14%	12%	15%
H&M**	22%	16%	23%	26%	22%	22%

Source: Annual Reports and Deloitte, *Global powers of retailing*, 2007
* sales excluding VAT; ** net sales; all sales in local currency

These results are possible because leaders in fast fashion experience better inventory turns (5-7), net margins (15-20%), and full price sell through (>80%). At the heart of any fast-fashion retailer is speed. In order to implement this strategy, retailers need a flexible supply chain, possibly forsaking low-cost production in Asia in favour of fast but higher-cost local production. Since fast fashion retailers are setting the rules of the game in the European clothing market, it is possible that, in the future, factors such as improved speed, flexibility, lean production and design modularity may become fundamental requirements to compete.

The decreasing share of department stores

The increasing market share of speciality chains at the expenses of departments is not just a European phenomenon. A similar process started long before in the US. In 1993, six of the top 10 clothing retailers in the United States were department stores; by 2003, only two were in the top 10. According from recent data released by Mintel, in Europe, the mixed goods sector (which includes department stores) in the seven most sophisticated European department-store markets grew by less than 1% (0.6%) between 2001 and 2006. This slow growth has been explained with the increasing competition from other types of retailers, such as grocery chains, discounters and hypermarkets[9].

The largest European retailers operating in the department store format are presented in Table 1.20. It is important to notice, however, that most of these companies manage different retail channels in addition to department stores.

[9] Mintel European Retail Intelligence, *Department Store Retailing – Europe*, 2007

Table 1.20. The largest department stores in Europe (total sales)

	Name	Country	2005 retail sales (Mio EUR)	5 yr retail sales CAGR%
1	Metro (Galeria Kaufhof)	Germany	55 569	5%
2	El Cortes Inglés	Spain	12 695	7.6%
3	KarstadQuelle	Germany	11 498	- 5.4%
4	Marks & Spencer	UK	11 196	-0.7%
5	John Lewis Partnership	UK	7 493	6.7%
6	LVMH (Le Bon Marché, Samaritaine)	France	3 651	2.1%
7	Groupe Galerie Lafayette	France	3 632	- 8.3%
8	Debenhams	UK	3 100	8.4%

Source: Deloitte, *Global powers of retailing*, 2007

A possible explanation of the loss of appeal of department stores lies in the fact that department stores are product emporiums filled with too much merchandise. Consumers often see them as having high prices, not being very innovative, and offering mediocre service and product knowledge. Furthermore, the availability of an increasing number of product categories at affordable prices in hypermarkets (the "shift to value" described earlier) is having substantial implications for the space allocation and the carried merchandise of premium clothing retailers, such as department stores. On the one hand, as some of our interviewees observed, department stores are skewing the mix of their merchandise in these categories away from basics to fast-growth micro-categories (e.g., high-end designer jeans) and exclusive brands. On the other hand, in order to achieve assortment distinctiveness at competitive prices and to defend and increase shares in the "battleground" categories, some retailers, such as La Rinascente in Italy and Marks & Spencer in the United Kingdom, are partnering with their suppliers to carry even more proprietary brands and merchandise, radically enhancing the fashion sensibility and quality of their private label, and re-assorting their stores to drive a better in-store experience for their customer and drive conversion. It is likely that, in the future, a place will remain for "destination stores", the appeal of which is based also on the theatricality of their shopping experience. These premium department stores – such as Harrods and Harvey Nichols in London, and Galeries Lafayette and Printemps in Paris – still offer consumers a 'dream world' reminiscent of the golden age of department stores. La Rinascente and Coin of Italy are also upgrading their positioning in this direction.

1.2.2. The intensification of international competition

According to Deloitte/Stores[10], in 2005, foreign operations accounted only for 14.4% of the top 250 global retailers sales (food and non-food), up 1.8% points from 12.5% in 2004. Of the ten largest retailers in the world, four are European: Carrefour of France (2nd position in 2005), Metro of Germany (3), Tesco of UK (5), Schwartz of Germany (10). All of them are actively expanding their clothing departments, and all of them have been actively engaged in the expansion of the international scope of their commercial activities.

In fact, a number of factors – such as limited expansion opportunities on many mature markets, decreasing price and increasing competition, public policy constraint in the domestic market and the

[10] Deloitte, *Global powers of retailing*, 2007

need for global diversification – are all driving the international expansion of large retailers – a strategy which is likely to intensify starting from the European food businesses. Table 1.21 indicates the international development of the leading European hypermarkets in ten years.

Table 1.21. Number of countries with stores (at year-end) for top 5 international hypermarkets

Company	Home country	1995	2000	2005
Carrefour	France	15	26	31
Tesco	UK	6	9	14
Metro	Germany	20	22	30
Ahold	Netherland	5	27	11

Source: CIES – The Food Business Forum, Internationalisation of Food Retailing

On the purely non-food side, truly global retailers are few. While some clothing brands (e.g. Benetton, Burberry, Ermenegildo Zegna) may operate globally through licensing agreements and franchise operations, clothing retailers tend to be far less international. However, Inditex, which includes the flagship Zara brand (over 900 stores, including franchises across over 60 countries) and Hennes & Mauritz (over 900 stores across countries) are proof that it can be achieved (see Tables 1.22, 1.23).

Table 1.22. The leading European specialty chains: number of countries with stores (1995-2005)

Company	Home country	1995	2000	2005
Benetton	Italy	100	120	120
Inditex (Zara)	Spain	21	33	62
Hennes & Mauritz	Sweden	10	12	25

Table 1.23. The leading European specialty chains: number of stores in the US (2000-2005)

Company	Home country	2000	2005	Variation 2000-2005
Hennes & Mauritz	Sweden	10	91	+ 81
Inditex (Zara)	Spain	6	18	+ 12
Mango	Spain	0	13	+ 13

The gradual expansion of specialty chains across Europe and the U.S. is likely to have contributed to a certain amount of convergence in terms of fashion and price range.

The level of penetration of international retailers into European markets varies considerably from country to country (see table 1.24). As the largest retail sub-sector, the structure of the grocery market invariably has a significant bearing on these figures. If the indigenous grocery market is strong and consolidated, penetration from overseas retailers is likely to be lower (e.g. France, the Netherlands). It is interesting to note that although the UK falls into this category and has an overseas penetration rate of around 13%, around half of this (six percentage points) is accounted for by a single company – Asda, the country's third largest retailer, owned by Wal-Mart of the US.

Conversely, emerging markets and new European member states are becoming battlegrounds in the large retail-internationalisation process. In Europe, the Czech Republic already has the highest level of international penetration (54.3%), while Hungary (32.9%) and Poland (15.5%) are some way behind their Czech neighbour. Among the largest regional players, Metro/Makro and Tesco are retail leaders in all three countries, while France's Auchan Group — ranked no. 8 in Hungary and no. 7 in Poland — has no Czech presence at all. Similarly, the French hypermarket chain Carrefour, which is no. 5 in Poland and no. 9 in the Czech Republic, appears to have cancelled or at least postponed its entry onto the Hungarian market.

Table 1.24. Penetration of international players in retail sales (food and non-food)

Country	Market share of international retailers
Czech Republic	54.3%
Austria	44.0%
Hungary	32 .9%
Denmark	27.7%
Luxembourg	24.6%
Belgium	21.3%
Spain	17.6%
Portugal	15.8%
Poland	15.5%
United Kingdom	12.6%
Ireland	12.6%
Netherlands	9.7%
Italy	9.7%
Germany	8.3%
France	7.7%
Finland	6.7%
Sweden	6.0%

Source: King Sturge, Mintel 2006

1.2.3. Converging evidence of increasing concentration in the clothing retail industry.

Along with the changes we have described in the previous section, a fundamental trend affecting – albeit to a different extent – most European markets is the increasing concentration of economic power in the hands of large organized retailers.
According to the Deloitte/Stores survey "Global powers of retailing", the ten largest retailers continue to capture market share each year. These retailers reported in 2005 combined sales of 885 billion dollars and 29.40% of total top 250 retail sales with an increase of 11.7% over 2004. The American Wal-Mart alone accounted for more than 10% of the total. The majority of top 250 retailers are involved in the food sector. However, as we have discussed earlier, some are also

aggressively increasing their clothing sections. In addition specialty chains are increasing their market share.
In Europe, the increasing concentration of market shares among large retailers (food and non-food) was pioneered by the Northern countries between 1988 and 1996. Since then, concentration has increased slowly but steadily in most of the largest European markets (Table 1.26).

Table 1.26. Concentration in general retailing in Europe (food and non-food)

Country	Market share of the top 5 retailers	Presence of international players
Switzerland	86%	Low
France	81%	Medium (Aldi, Lidl, Nroma)
Germany	65%	Low
UK	65%	Medium (Wal-Mart, Aldi, Lidl, Costo)
Netherland	64%	Medium (Ahold, Lidl)
Spain	60%	Medium (Carrefour, Auchan, Leclerc)

Source: Largo consumo, *Pianeta distribuzione 2006*, based on data Ac Nielsen