What does the future of department stores hold?

Lingerie Waesche

Born as extraordinary places, a real Pandora's box where you could find anything, department stores are now facing a delicate situation being squeezed in between large specialty stores and budget prices. Over the last two years the strategy of department stores in Europe has undergone a complete transformation with the need for renewed choices in order to ensure a winning distribution formula over the next decades.

A number of questions

How are department stores in Europe evolving? Mintel published a detailed study on the subject which we considered of prime importance considering the significance of this circuit for lingerie and swimwear brands. "Department stores are coming under increasing pressure from outside of the sector from hypermarket operators on the one end and non-food specialists on the other. Having been caught in the middle profits are suffering", stated Ben Perkins, senior retail analyst at Mintel . "The fierce competition has over the last two years led to an evident change in the European department store sector, a change which has determined many key players to shift their product offer towards the high end." It is yet to be seen if the market will allow this. Investors are fully aware of these issues and thus main players have been forced to go from public to private, keeping into account their devaluation. In this changing scenario , "The year 2005 turned out to be a difficult one for European department stores in general: the global sales of mixed goods retails (the category nearest to department stores) only underwent a 0.1% increase, barely reaching 72.6 billion euros," states Ben Perkins, who adds, "In 2006 sales increased by 1.3 %, slightly better, with the French and British markets showing an increase in sales".

Rather than aiming for high end goods, several department stores have over the last two years carried out a redistribution of space and goods on offer cutting down on less profitable items and giving more space to what sells best. Mintel believes this is a logical but potentially dangerous solution: where is the level when a department store loses its "raison d'etre"? Will the loss of identity lead to a loss of sales? This is an important consideration to be made in the analysis of the European scenario.

Coin

KaDeWe

A large disparity between countries

The first fact which stands clear from table no. 1 is a certain disparity between European countries. If we take the "mixed goods retailers" (the category nearest to department stores) we can notice that, on the basis of comparable markets in France, Germany and Great Britain, the value of this last market is 5 times greater than the French one and twice the German one. This is due mainly to the importance of this type of distribution in GB and, conversely, the strength of hypermarkets in France. If we analyse the evolution of sales in table 2 we will notice Spain's positive trend as well as Ireland's excellent results, in both cases an offspring of their dynamic economies and the development of their store networks, not the case in Italy or France where growth is not so significant. Germany and The Netherlands registered as negative trend as did the UK on a lesser scale. While Germany's economic difficulties over the last years are well known, the cause of a decrease in sales in the UK is to be found in the strong competition of food distributors; the underperformance of The Netherlands, where food retailers aren't on average large enough to integrate a non-food offer, is less explicable. Between 2005 and 2006 however all countries underwent a more or less significant positive trend, except for Germany where main operators pruned their portfolios.

Growth forecasts

Mintel experts are quite optimistic about the future and announce an upturn of sales in all countries bar Germany, where new openings have become a rarity even though main stores are trying to upgrade their concept range in an effort to differentiate themselves. France presents a notable potential for growth which is partially limited by the increasing com-

Table 1 Europe: Retail sales through mixed goods retailers, 2001-06

(€ m excl.sales tax)

	2001	2002	2003	2004	2005	2006 (e)
France	4,718	4,829	4,835	5,037	4,971	5,066
Germany	18,122	16,792	16,193	15,951	15,401	14,859
Ireland	1,100	1,172	1,198	1,221	1,266	1,340
Italy	6,050	6,188	6,220	6,314	6,512	6,670
The Netherlands	6,873	7,437	6,509	6,054	5,891	5,943
Spain	8,655	9,293	10,250	11,128	11,983	12,447
UK	27,601	27,919	25,821	26,821	26,609	27,268
Total	**73,120**	**73,629**	**71,026**	**72,527**	**72,633**	**73,593**

SOURCE: National Statistical Offices/Mintel

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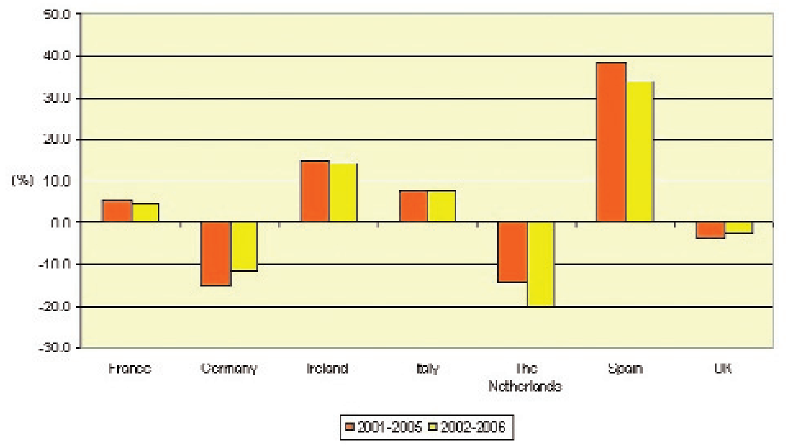
Tableau 2

Europe: Mixed goods retailers' sales growth, 2001-05 & 2002-06 (e)



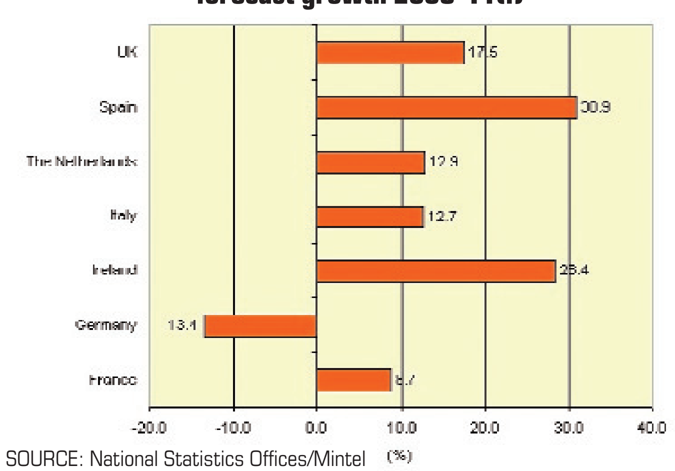
petition of out of town shopping malls and leisure centres. However Spain and Ireland present the two most interesting growth scenarios. In Spain El Corte Inglès dominates the market on a business model very similar to that of M&S in the UK, with a significant presence of food in its offer. As for Ireland, wealth and its small size are ideal characteristics for the growth of department stores. However this is a small consolation because if we take a global view of the distribution market, department stores are set to lose a share of their market in all countries except Spain, as shown in Table 4.

Circuit Leaders

Can M&S be considered the European leader for this type of distribution circuit? Table 5 indicates the chain's global sales, including food stores and smaller retail points. As it is impossible to compare these figures with other department stores taken into consideration, Mintel identified 72 retail points meeting department store criteria in terms of size and product variety; it is estimated that the group totalled a 6,6 billion euro turnover in 2005, setting the UK tycoon at the top of the European chart with el Corte Inglès, followed by Galeries Lafayette – the first French Group with BHV, Nouvelles Galeries and Monoprix – then the two major German department stores (Karstadt and Kaufhof) which have cut down on stores to increase profits. The table provides an even wider picture of the European market with the Swiss stores Manor, Coop, Schweiz, Globus and Jelmoli; the Finnish Stockman and Sokos; the Danish Magasin du Nord and the Estonian Tallinna Kaubamaia. One need only read the names to realize there has been very little internationalisation, a trend which cannot last, because the level of market maturity in major European countries will force leaders to cross frontiers for new growth opportunities, as Stockmann is doing in Russia.

Table 3

Europe: Mixed goods retailers' sales by country, forecast growth 2006-11(f)



SOURCE: National Statistics Offices/Mintel

Table 4

Europe: Mixed goods retailers sales as % of all retail sales by country, 2001, 2005 and 2011

	2001	2005	2011
France (a)	1.4	1.3	1.2
Germany	5.5	4.7	3.3
Ireland (b)	5.2	5.1	5.1
Italy	2.9	3.0	2.9
The Netherlands	9.2	8.0	7.8
Spain	5.9	6.6	6.8
UK (c)	8.7	8.1	7.9
Total	**5.1**	**4.8**	**4.4**

(a) Excludes Monoprix
(b) Excludes Dunnes Stores
(c) Excludes M&S, Debenhams and Harvey Nichols

SOURCE: National Statistics Offices/Mintel

Table 5 **Leading department store retailers in Europe, 2005**

	Company	Sales (€ m) 2005/06
1	Marks & Spencer (UK)	7,275.0 (a)
2	El Corte Inglés Department Stores (Spain)	6,900.0
3	Galeries Lafayette Group (France)	4,943.6(b)
4	Karstadt Department Stores (KarstadtQuelle, Germany)	4,734.1
5	Kaufhof (Metro, Germany)	3,575.0
6	John Lewis (UK)	2,909.0
7	Debenhams (UK)	2,351.2(c)
8	Manor department stores (Switzerland)	1,683.7
9	House of Fraser (UK)	1,036.4
10	Stockmann Department Stores (Finland)	899.4
11	France Printemps (France)	752.0(d)
12	Coop Schweiz Department stores (Switzerland)	563.5
13	Ahlens (Sweden)	534.6
14	Harrods Ltd (UK)	504.2
15	Breuninger (Germany)	500.0
16	Selfridges (UK)	451.6
17	Globus department stores (Migros, Switzerland)	420.8
18	Fenwick Ltd (UK)	400.3
19	Coin (Gruppo Coin, Italy)	339.0
20	TJ Hughes Plc (UK)	313.5
21	Roches (Ireland)	310.0 (e) (g)
22	Illum/Magasin du Nord (Baugur, Iceland)	255.8
23	Sokos Department Stores (SOK, Finland)	255.7
24	Arnotts (Ireland)	224.0(e)
25	Harvey Nichols Group Ltd (UK)	201.9
26	Brown Thomas (Ireland)	188.0 (e) (h)
27	Tallinna Kaubamaja (Estonia)	183.9
28	Jelmoli Zurich (Switzerland)	110.8

NB.: Includes operations and operators in markets not covered by this report

(a) Total sales including non-department stores.
(b) Includes 50% of Monoprix sales.
(c) Year to August 2005. Sales for year to August 2006 were €2,502m.
(d) Includes sports retail business.
(g) Roches effectively withdrew from retailing in August 2006 selling 9 of its 11 stores to Debenhams
(h) 2004/05 data

SOURCE: Company Reports and Accounts/Mintel

Insufficient openings

According to Mintel the registered growth of department stores in the last five years is predominantly due to new openings; however these are well below the number registered by other distribution fields. The main reasons for this are: the change from public to private ownership with a consequent decrease in expansion in favour of increased profits; the growing cost of new openings; the difficulty in finding suitable buildings and warehouses for the mix of products. Table 6 shows the changes in the ensemble of stores owned by major European operators nearly all of which, between 2001 and 2005, increased the number of retail points. However, according to Mintel, the trend is destined to turn due to the a slow down in growth.

Towards greater consolidation

In a context of limited physical expansion and strong competition from other distribution circuits, consolidation looks like a valid alternative which is taking place throughout Europe.

Between 2005 and 2006, the department store sector in the UK underwent several changes. In 2005 House of Fraser went through an acquisition frenzy, buying up Jenners and James Beattie before being incorporated in the Finnish group Baugur in 2006. The biggest event saw the introduction of the Debenhams group refloated for £1,675 billion pounds, but with £1,2 billion of debt on the balance sheet as its private equity owners simultaneously stripped assets and tried to drive profits up to gain a better valuation. Subsequently, in the attempt to accelerate expansion in Ireland, Debenhams purchased Roches Stores for 29 million euros.

In Italy, the Borletti family, together with the RREEF and other investors, created a new group of European departement stores in 15 months. In March 2005 they bought La Rinascente and Upim

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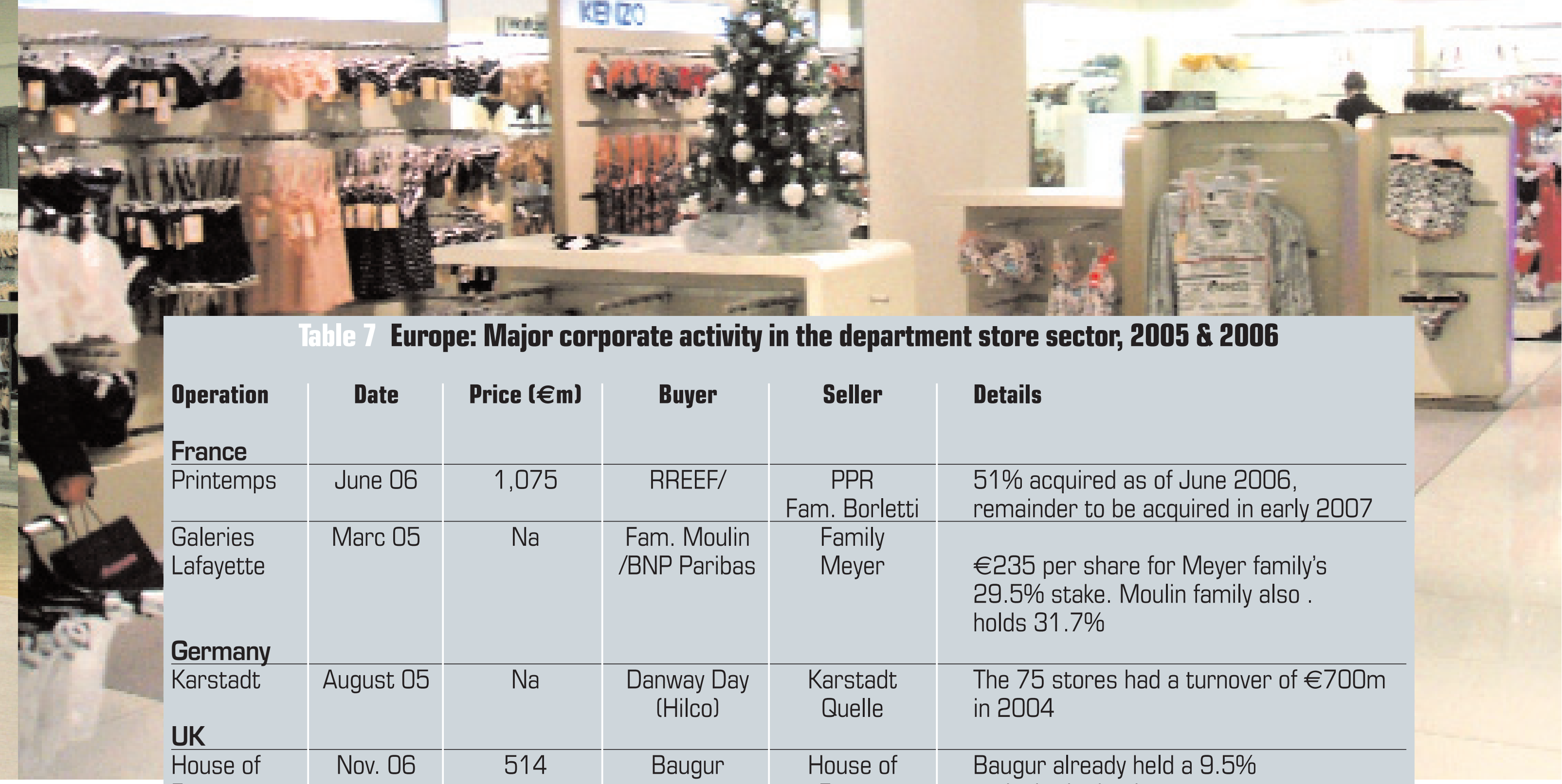


(clothes) from the Auchan group for 888 million euros; then, in June 2006, the French number two, Printemps was added for 1,075 billion euros. The two structures currently operate as two distinct entities, but in future the situation could change to optimize strategies. In France the Galeries Lafayette went private when one of the founding families, the Moulins, bought the shares of the other family, the Meyers, so increasing their total to 61.2%.

The e-commerce option

In theory department stores should be in a favourable position to gain advantage from e-commerce thanks to their vast product offer and their store divisions; in actual fact the retail points often use websites to compete against each other. While it is true that some department stores have a greater interest than others in being on the Internet, it is assumed that they will all adapt to current changes in consumers' purchase habits offering them also the online alternative.

One of the more efficient tools which have enabled department stores to ride the e-commerce wave in a relatively fast and profitable manner has been the introduction of certain online services, such as wedding lists and travel options. The advantage is twofold: the use of services more accessible to customers and increased space for other products in the store. Sales and store image will both benefit from an attuning of the two channels.

Table 6 Leading department store retailers store development, 2001 & 2005

Company	Number of stores 2001		Up/down	Comments
Marks & Spencer	312	408	Up	
El Corte Inglès	50	66	Up	
Galleries Lafayette Group	390	422	Up	Store network peaked at 508
Karstadt	188	143	Down	
Kaufhof	148	142	Down	
John Lewis	26	27	Up	Plans for 11 new stores in short term
Debenhams	97	118	Up	
Manor	72	72	Stable	Store network peaked at 74
House of Fraser	51	61	Up	Store chain had been cut back dramatically before opportunistic acquisitions of Jenners and Beatties chains
Stockmann	11	36	Up	Growth driven by expansion in Russian marketplace
Printemps	29	26	Down	

SOURCE: Company Report and Accounts/Mintel

Table 7 Europe: Major corporate activity in the department store sector, 2005 & 2006

Operation	Date	Price (€m)	Buyer	Seller	Details
France					
Printemps	June 06	1,075	RREEF/	PPR Fam. Borletti	51% acquired as of June 2006, remainder to be acquired in early 2007
Galeries Lafayette	Marc 05	Na	Fam. Moulin /BNP Paribas	Family Meyer	€235 per share for Meyer family's 29.5% stake. Moulin family also . holds 31.7%
Germany					
Karstadt	August 05	Na	Danway Day (Hilco)	Karstadt Quelle	The 75 stores had a turnover of €700m in 2004
UK					
House of Fraser	Nov. 06	514	Baugur	House of Fraser	Baugur already held a 9.5% stake in the business
Debenhams	May 06	Na	Na	Na	Flotation at 195p valuing the company at £1.675bn
Beatties	June 05	102	House of Fraser	Beatties	
Jenners	Marc 05	68	House of Fraser	Jenners	
Ireland					
Roches Stores	August 06	29	Debenhams	Roches Stores	9 stores
Italy					
Rinascente	Marc 05	888	RREEF/ Fam. Borletti/ Pirelli Re/ Investitori Associati SGR	Auchan	Borletti Family had previously acquired Rinascente in 1917

SOURCE: Company Report & Accounts/Mintel

The upmarket option

Traditionally department stores have above all aimed at the heart of the market in the attempt to maximize activity. Debenhams and House of Fraser in the UK, Kaufhof and Karstadt in Germany or Printemps in France are prime examples.

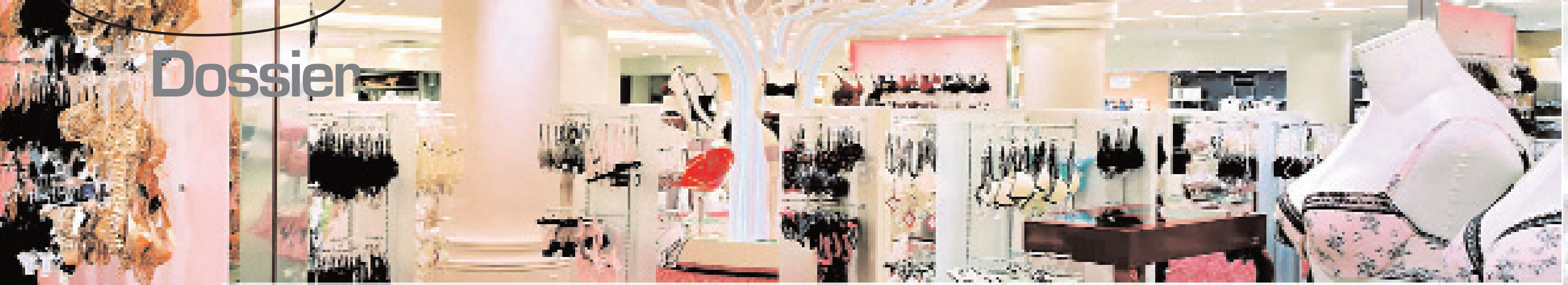
However the department store concept is not a new one and the threat of other types of distribution is becoming stronger. In the UK, supermarkets such as Tesco, Sainsbury and Asda have widened their non-food offer with the latter becoming a real competitor to department stores in low end products.

Germany and to a lesser extent France have had to deal with the extremely competitive prices offered by discounters such as Aldi or Lidl with their sporadic offer of items sold by department stores. French department stores also have to deal with the advantageous prices offered by hypermarkets. How can the impact of these developments be countered?

According to a number of players the solution lies in going upmarket, with all the risks that this choice encompasses. "In the UK, House of Fraser has over the last few years gone upmarket but efforts have not as yet been rewarded," declared Ben Perkins. If French and German consumers were to appreciate more upmarket products would the number of stores be justified?

In Germany if the two leaders (Karstadt and Kaufhof) were to upgrade their offer , this would mean 230 extra stores in this sector. With so many stores wanting to enter the category there will not be place for everyone.

"Unfortunately most department stores don't have a choice. They either accept an inevitable decline or try going upmarket," comments Ben Perkins.



The private label appeal

As medium range department stores throughout Europe come increasingly under threat from supermarkets and discounters, we can predict that they will aim to constitute a private label product offer to guarantee themselves a place in the medium range offer with two main advantages: lower stock costs, resulting in greater profits or lower retail prices, and the opportunity to create an exclusive and differentiated offer giving buyers an extra reason to select a certain store. The first option is the most profitable in the short term, but the creation of exclusive product lines can prove advantageous in the long run. John Lewis in the UK clearly illustrates this with the creation of its range of high end products based on the brand's good reputation. Furthermore the products span a variety of categories, especially linen and articles for the home which are particularly appreciated by customers. Still in the UK, Debenhams has introduced its line of products and recently House of Fraser relaunched the brand Linea, founded in 1997. In Germany Kaufhoh and Karstadt have already prepared their private label to help their transition upscale.

Table 8 Subdivision of product offer at Debenhams for 2006

Product category	Percentage of offer (approx. value)
Women's clothing (includes lingerie and accessories)	45%
Men's clothing	17%
Articles for the home (including presents and furniture)	16%
Cosmetics	14%
Children's clothing	5%
Other (including services)	3%

Source: Company Accounts and Annual Report/Mintel

An endangered concept

The department store concept is based on an ample but not too select offer. Large scale economies are generally derived from bulk purchases of a single product rather than smaller ones of a greater variety. Which is why the department store business model has suffered from specialists which buy in huge quantities and keep prices lower. The most logical reaction would be to get rid of those products more subject to competition and focus on those offering greater possibility of success, which is what most department stores have done, in different ways. In the UK John Lewis is the only one which continues to offer a complete range of products while Debenhams has specialized in women's clothing and underwear (about 45% of the offer, table 8). The same phenomenon is visible in France where department stores are increasingly specializing in clothes and beauty products. In Germany the trend is not so evident while in Spain El Corte Inglès continues to sell a wide variety in most stores. The problem is that by eliminating certain sections department stores risk losing their initial attraction, that of offering everything. And by eliminating complex sections such as household appliances, stores will have to become more competitive in other product lines, such as clothes or underwear, then facing the competition of specialized chains.

Possible scenarios

Mintel forecasts that the sales of mixed goods retailers will increase by 12.3% between 2006 and 2011, to top 82,7 billion euros. However, compared to the forecast for global European growth (estimated at +18.8%) on the long run the market would lose out. Forced to go upmarket and eliminate ranges subject to heavy competition from specialists, and with expansion limited by the market's maturity, department stores run the risk of moving to other countries. Some have already done so. Over the last 25 years the Finnish Stockmann has been expanding in the Russian market, initially with small concessions in State stores, more recently with the opening of 3 retail stores and more to come. Debenhams has initiated an international expansion through franchisings in amongst others Cyprus, The Czech Republic, Russia and Sweden. The aging European population offers yet another possibility for expansion. Northern countries being particularly subject to this phenomenon department stores could find space for opportunity.

Older people appreciate assistance and are prone to shop for higher quality goods. For these consumers, shopping is also a pleasant moment for socializing. In order to ensure the necessary flow of shoppers to contrast the competition of other stores in town, department stores must be creative: develop their services and make them available on-line, find personalized shopping solutions, improve dining areas, modernize spaces and organize events. There are innumerable possibilities. We shall see which work best. It is certain however that in such a context, lingerie, with its high-end brands and strong attraction, will find a place of all due respect.

Gruppo Karstadt

Breuninger

La Rinascente

La Rinascente

La Rinascente