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Management Report

Structural change in the German retail sector

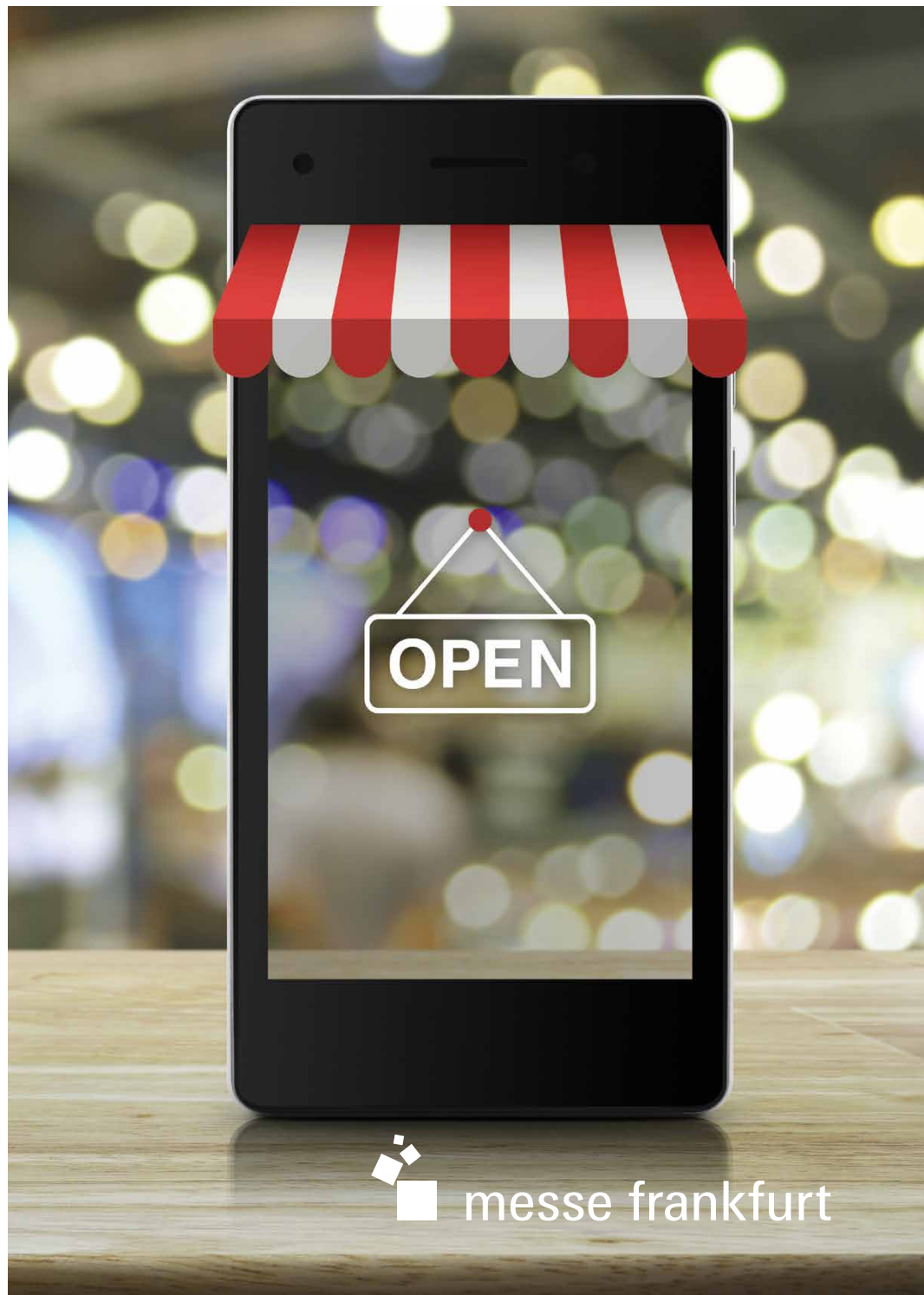


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MANAGEMENT REPORT

Structural change in the German retail sector



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FOREWORD



The retail sector has undergone huge changes over the past few years. The world around us is developing more and more into one that can be described using an acronym: VUCA. Volatile, uncertain, complex and ambiguous.

This is evident in the world of retail in particular with the increasing presence and constant march of digitalisation. Digital business models set new standards with regard to product availability, price transparency, service and advice. The stationary retail trade can and must learn from these if it wants to survive in the long term against online providers.

The increasing turnover and share of turnover in the online sector make it more difficult for stationary retailers to keep their inner city shops afloat. Many consumers prefer using Internet retailers as they offer factors such as comfort, independence from shop opening times and a varied product range. The consequences of this change are particularly clear when it comes to the specialist trade sector.

As Messe Frankfurt, we view securing the future viability of the retail sector and engaging in dialogue with the digital world as a central element of our mission. The Management Report 2019 will therefore give you an insight into the changes that have taken place in the recent past, as well as the current situation and the future. From the point of view of Messe, we want to provide the retail sector with impetus and highlight how you can win against online trade by crea-

ting shopping experiences. With this Management Report, we also want answer some of the most urgent questions surrounding the retail sector for you: how is digitalisation influencing the retail landscape?

Can we avoid the digital changes retail is undergoing? How can the digital transformation be used as an opportunity to strengthen your own business? On the following pages, you will learn how competitive or complementary the online retail sector and stationary retail trade can be.

We will also give you inspiration as to how you can position your company in a world where online channels are exerting an ever stronger influence. Our study partner, the renowned IFH Institute in Cologne, has undertaken a comprehensive evaluation of the data landscape.

In an interview, Boris Hedde, Managing Director of the IFH and leader of the study 'The Status Quo of the Retail Sector in Germany' explains his view of the things that are changing in the structure of the retail sector in Germany. You will learn at first hand what kinds of impetus could also prove decisive for your industry.

At Messe Frankfurt, we feel a sense of responsibility to support you in today's VUCA world. As a mirror for industry trends and market development, we want to help our visitors to actively shape the transformation and experience it. With our trade fair world for consumer goods, we provide clear perspectives for you in an ambiguous world. In this way, you can steer your companies in a confident manner, reduce complexity to central control levers and align the digital trading world with stationary trading.

We hope that you enjoy reading this Management Report.

A handwritten signature in black ink, appearing to read 'Detlef Braun'. The signature is fluid and stylized, with a long horizontal stroke at the end.

Detlef Braun

Member of the Executive Board of Messe Frankfurt

THE STATUS QUO OF THE GERMAN RETAIL SECTOR

Positive revenue development in the German retail sector

The mood as far as the German retail sector is concerned is a positive one because German consumers are happily spending their money and are in a buying mood. This is reflected in the development of total revenue for retailers in 2017. Domestic consumption amounted to 595 billion euros, accompanied by positive sales growth. This corresponds to a growth rate of 4.2 per cent compared to the previous year. In total, sales growth between 2000 and 2017 amounted to EUR 154 billion.

The perception in the stationary retail trade: the clear winner of this growth dynamic is the online retail sector, whose share of turnover accounted for EUR 58 billion (9.7 per cent) of total sales. However, the increasing share of turnover attributed to online trade leads to cannibalisation effects in the retail sector. It leads to a shift away from stationary trading to sales via online channels.

Digitalisation of communication

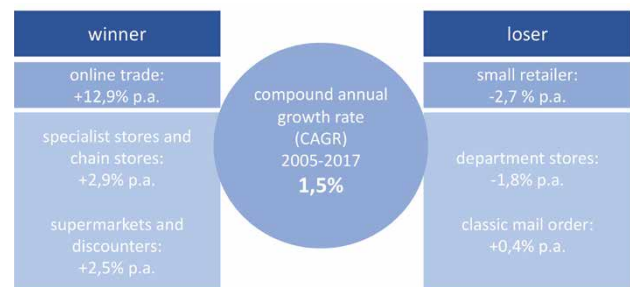
Online trade not only accelerates the change in the structure of the German retail sector, but also leads to decreasing shopping frequencies in stationary trade. The digitalisation of the retail landscape is bringing about a noticeable change in consumer and purchasing behaviour. Consumer demands on stationary purchases are increasing. The ubiquitous availability of smartphones gives customers a good overview of what's on offer and saves them valuable time when making specific purchases. Gaps in supply are closed by unimpeded access online, which is reflected in the falling demand in stationary retail.

Online growth as a challenge for stationary retailers

In the year 2000, approximately 1 billion euros were traded in the online retail sector. In 2017, less than 20 years later, sales are already at 58 billion euros. These include not only newly tapped markets, but also substitutes for markets that were originally served via stationary trading. It can be assumed that online retailing, which so far has been successful

primarily in product categories such as clothing, books and electrical appliances, will increasingly expand to other industries in the coming years. This applies in particular to the specialist trade: with a 47 per cent share of turnover in 2017, it is still a major player in the retail sector, but is losing out proportionately. Stationary retailers are thus taking up the challenge of offering consumers emotional shopping experiences at the point of sale in order to counteract the cannibalisation that occurs due to online retailing.

The online/offline competition *



THE UPHEAVAL IN THE RETAIL LANDSCAPE AND THE CHALLENGES IT POSES

The structural change in retail sector

Following a pronounced period of stagnation since 2000, the German retail sector has exhibited positive growth since 2010. At the same time, online trade continues to grow at a double-digit rate to the tune of EUR 4-5 billion per annum. However, the initially strong online growth is declining noticeably. A comparison of the 2000-2009 and 2010-2017 periods shows that expectations of online business are becoming more realistic and that the initial boom is slowly abating. The absolute figures show that both retail and digital sales are

growing as a result of increasing consumer spending. Upon closer analysis, however, we see that this positive forecast conceals a structural change in the retail landscape. The structure of retailers is gradually changing. It is apparent that the number of retailers has been declining since 2000. In 2000 there were more than 400,000 retail companies, whereas in 2017 the number of retailers fell to less than 300,000.

In the stationary retail sector in particular, the number of companies is falling significantly as small companies are increasingly being replaced by medium-sized and large retailers or chain stores. This is mainly due to the fact that smaller business operations are less and less able to withstand the price and supply competition that is increasingly fuelled by the dynamic online world. Particularly noticeable is the decline in specialist trade. Since 2000, there has been a decline of more than 12 per cent in the number of specialist retail companies.

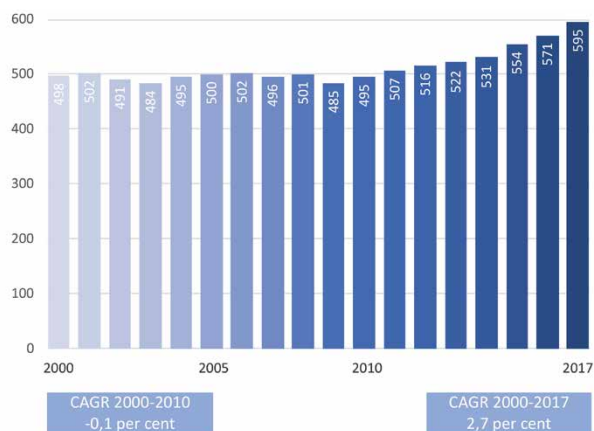
How online channels transform the stationary trade

The central catalyst for structural change is increasing digitalisation and the increasing share of turnover in the online sector. This share of turnover leads to the cannibalisation of sales in the retail sector. Consumers who were still buying from stationary retailers in the recent past are now increasingly making use of the substitutive offers of online market places and online retailers. A positive aspect, however, is that stationary retailers also know how to use online channels for their own purposes. Online shops are increasingly being established that correspond to local retail offerings and are integrated into their sales channels. This is reflected in the fact that the turnover of the online shops of stationary retailers has increased since 2010 from EUR 7 billion to EUR 18 billion in 2017.

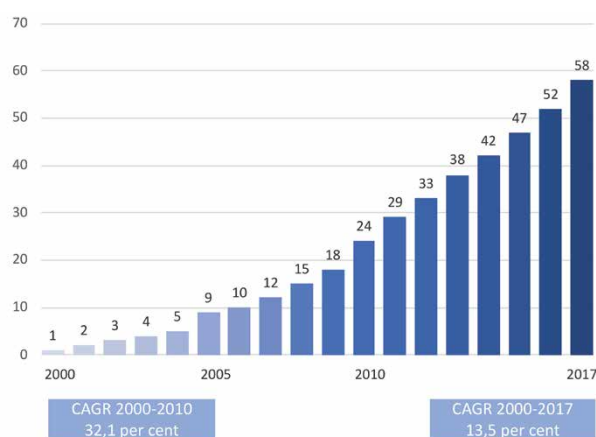
Nevertheless, it is difficult for small retailers to withstand the speed of digitalisation. The leap into the sales channels of the digital world is often marked by the generally predominant sector economy and the respective sector's affinity to online trading. Inner city areas are classically characterised by a high density of stationary retailers. Offline sales, and thus sales achieved through conventional stationary trading, have declined slightly in these areas. By integrating online

shops, the decline in turnover in stationary retail can be compensated for if factors such as quality and product selection as well as regional aspects are taken into account. Cumulative revenues from online and offline trading are therefore constant in these regions. Specialist trade is also more strongly affected by the effects of digitalisation in inner city areas than the retail trade in general. This can be attributed to the fact that customers or potential consumers today can make use of the wealth of information available on the Internet. There is therefore a declining need for advice from third parties. Direct access to products in the online shopping world, as well as the confidence gained through the advice and information offered on the Internet, are possible factors for the increasing tendency to purchase online.

Retail industry (in billion euros) *



Online trading (in billion euros) *



* Source: IFH Köln GmbH study 'The Status Quo of the Retail Sector in Germany', 2018

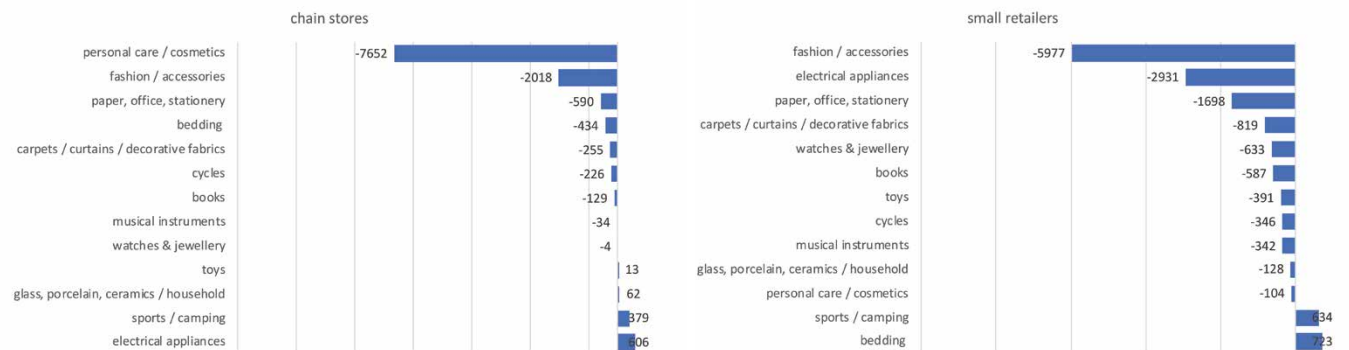


An in-depth and cross-industry analysis shows that fashion/accessories and consumer electronics/electrical appliances currently play a leading role in terms of absolute turnover and that the remaining sectors dominate the digital world. Going forward, however, the food, DIY and garden/living/furnishing sectors will show the strongest growth.

Parallel to the increasing growth of online trade, a significant decline in the number of points of sale can be seen. The assumption that online trading exerts an influence on the structure of stationary trading would thus appear to be confirmed to a certain extent. In the period from 2010 to 2017 there were over 100,000 shop closures in Germany. It is interesting to note, however, that there are individual niches in which small-scale specialist retailers and franchise concepts are in part resisting the trend of businesses closing down.



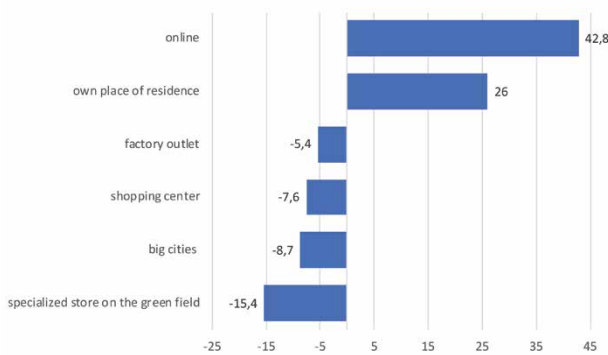
Number of points of sale (development of absolute figures) *



How does online business change consumer behaviour?

It is undisputed that online trade contributes significantly to the erosion of the specialist trade landscape. However, the question arises as to what motivates customers to support the shift to online trading and strengthen it, whether consciously or unconsciously? For the modern customer who likes using the Internet, there are three main reasons why they allow their shopping experience to take place in the digital world:

Change in purchasing frequency in per cent *



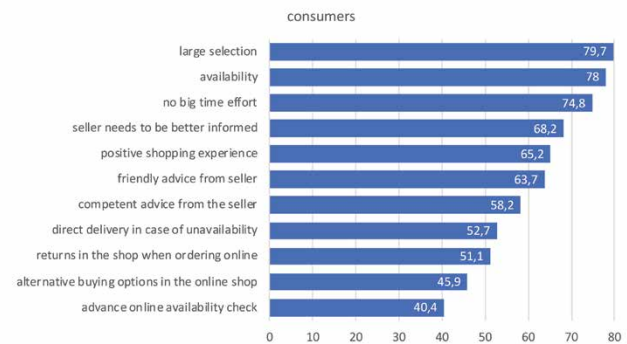
1. Delivery service: customers can get their needs met regardless of time and place. It is the responsibility of the online provider to make the products and services available where the customer needs them.

2. Time savings: in the world of stationary retail, local conditions per se assume that the customer is prepared to make the journey to the stationary retailer for the shopping experience. In the digital world, on the other hand, the customer saves the journey and the time associated with it.

3. Simplicity and speed: an aspect very closely linked to the time savings is the speed at which a customer can place an order in today's digital world. In just a few mouse clicks, customers can navigate intuitively from the product portfolio to the shopping basket to a completed order process.

It can be assumed that a comparable effect can also be achieved if shopping facilities are available in the vicinity of the customer's home. Here, too, customers experience their desired time savings along with the simplicity and speed that consumers are accustomed to experiencing on the Internet in this day and age. By way of comparison, the targeted concentration of shopping opportunities that are found in e.g. shopping centres are used less frequently. An additional challenge for the retail trade that arises from consumer behaviour is the change in the sense of entitlement and a change in consumer expectations. It is apparent that young demographic groups such as the 'Smart Natives' place much higher demands on companies and their services. The factors of information, variety and availability as well as shopping experience and advice have considerable leverage on the decision as to whether customers visit stationary retailers or not. These are typical aspects that, due to the ubiquitous access to avoidable shopping and product worlds on the Internet, place even higher expectations on the retailer/specialist retailer.

Level of aspiration for stationary purchases in per cent *



This could lead to the impression that online trading should only be perceived as negative. However, retail in the digital world is not an exclusive substitute for stationary retail. In many cases, digital merchants open up markets that were previously not at all accessible or only accessible after overcoming extreme hurdles. Online trading is able to compensate for regional disparities and gaps in supply thanks to its ubiquitous nature. However, there remains a minor disadvantage in this respect too. The already low demand in stationary retailing in less densely populated regions is even lower than has been the case to date.

* Source: IFH Köln GmbH study 'The Status Quo of the Retail Sector in Germany', 2018

THE DEVELOPMENT OF TRADE – A PERSPECTIVE UNTIL 2025

Germany benefits from a stable economy and development in consumer spending

The most important influencing factor here is the economic development in relation to private consumer spending. After GDP exceeded the three per cent mark again, the German economy continues to grow. Since German consumers show little evidence of being influenced by international political and economic crises when it comes to consumption, the forecast for private consumption shows an average growth rate of 2 per cent. The growth rate of the retail sector will therefore also be strengthened in the future, with consumers not only investing in meeting their basic needs, but also placing a high value on consumption as an emotional experience.

The continuing double-digit annual growth rates for online trade show that there is also no end in sight to this development in the digital world. Online sales will continue to rise and thus endanger those of stationary retailers. In addition, the development of the respective markets and industries and the decline in the importance of the specialist trade also have an influence on the development of stationary sales.



Three scenarios for the development of online trade

Assuming that the growth gap between retail spending and consumer spending does not widen any further, there are three possible scenarios when it comes to the sales development of the stationary retail trade.

Growth in trade in the digital world

One assumption is that the growth momentum of online trading will remain high. This is the case when providers in the online sector present strong, innovative drivers that are accepted by consumers. At the same time, stationary providers are not exploiting their opportunities and possibilities in terms of generating new impetus. Thus significantly more and older consumers are starting to use online shopping.

The balance between the digital world and stationary trade

Based on the fact that we repeatedly see innovative providers providing impetus on the part of both online and stationary retailers, a balanced picture emerges for the future of online and offline sales. By linking the channels, cross-channel services (e.g. Click & Collect) can help providers to increase stationary purchases. The use of smartphones and mobile commerce should support online shopping and stationary shopping. Ultimately, this growth dynamic in the digital world is also supported by generational development, whereby new groups of buyers continue to be acquired. As people grow older, online shopping increasingly becomes a matter in terms of consumer habits.

Digital opportunities invigorate stationary trade

If new impetus from the stationary retail trade meets little impetus from online retail trade, a further variation of the future sales development of online commerce becomes apparent. More stationary purchases are achieved through cross-channel services and smartphones. Since hardly any new online shoppers are being acquired, online buying intensity is increasing only slightly here.

SOLUTIONS FOR THE RETAIL SECTOR

For many retailers, the time has come to rethink their business concepts as part of the march of digitalisation. Here, it is not only new services and high-quality design in terms of shop construction that needs to convince, but individual multi-channel concepts that can help withstand the pressure of online competition also need to be introduced. However, the individuality of the trader must not be lost in the process. Offline and online offerings should therefore go hand in hand.

An increasing number of stationary retailers are reinventing themselves, and it is local department stores managed by their owners in particular that are making their mark here. Modifications to the shop design are intended to appeal to young and affluent consumers. Conversely, this means that there is a risk of alienating older customer groups who grew up with traditional department stores. In an era whose hallmark is technological progress, however, many people are known to yearn for personal encounters and special experiences, and they should be able to rediscover these in modern store concepts.

In addition to innovative shop fittings, consumers in the stationary retail sector should also experience improved service. Customer events, gastronomic offerings and services such as personal shoppers increase retailers' revenues, which are in turn invested in further attractive customer campaigns. This shows that only those who invest in existing store concepts, events and services can survive under the pressure of online trade.



However, multi-channel concepts can also combine the advantages of stationary trading with the advantages of the online world. Innovative retailers have recognised this opportunity and present their products in digital shop windows. This enables passers-by to browse through product ranges and discover items on the spot via a digital display. A smartphone can then be used to scan a QR code, which in turn links back to a mobile shop and allows customers to complete their purchases right there and then. The shop window and the online shop thus combine to form a 24/7 shopping experience.

The development of online retailers who supplement their online platforms with stationary sales outlets is also interesting. This primarily involves the interlocking of online and stationary retail to create an omnipresent purchase offer that is available around the clock. The challenge for retailers is to create ecosystems in which customers, brands and products can communicate with each other. This ensures that consumers have access to an authentic world of experience that a purely online platform could never provide. The stores can also be used for personal consultations and local events that arouse emotions and build trust.

INTERVIEW WITH BORIS HEDDE

The stationary retail trade today must be more than just a point of sale, because shopping needs to become more and more of an experience for the customer. Traders must therefore differentiate themselves from the masses and counter their competitors' online trading offer. The study 'The Status Quo of Retailing in Germany' by the IFH Institute in Cologne, which was commissioned exclusively for Messe Frankfurt's consumer goods fairs, answers the relevant questions and highlights opportunities for development. Boris Hedde, Managing Director of IFH Köln GmbH, answers further questions.

As an experienced trade researcher, what was the most surprising result of this study for you?

In the often subjective discussion about the importance of digitalisation and the future of retail, the current study makes it possible to support our gut feelings with numbers. For me, the decisive finding here was that the retail sector as a whole has experienced growth thanks to a boost from increased consumer spending, particularly in the last three years, and this applies to both online and offline business. This runs contrary to the forecasts that applied a few years ago. Only in the case of small-scale retailers is the time window for adapting to developments in digitalisation bigger than the forecast in 2014. Despite this, if we look at the forecasts in the study, there is ever-increasing pressure to take action. The industry would be well advised to step up its efforts in the context of digitalisation.

In your study you talk a lot about online/offline competition. What does the future look like in this respect? Is online trading the enemy of stationary trading or are there completely new developments?

At a time when consumer behaviour must be the strategic guideline, it is important to take consumer cross-channel behaviour into account. It is necessary to become aware of the strategy with which one can participate in the development. The advancement of online platforms means that providers are not only faced with the question of whether they need a strategy with their own online shop and what it might look like. Much more pertinent is to examine how customers can be reached digitally and at the same time be guided into visiting the stationary shop. Growth may also be possible through the strategic use of sales platforms. There is a broad spectrum of options, which means an analysis of the competition with a focus on online/offline is not sufficient. The consumer is demonstrably becoming more comfortable. As a result, even stationary locations are now much more in competition with each other. This development is challenging for all providers, but it does also offer space for new cooperation strategies.

What can or must the trader, whether department store or specialist retailer, pay attention to today in order to be competitive?

The customer holds all the power. Understand them and their behaviour and you'll understand how to serve them better. The strategy of product range diversity can no longer be a purely stationary one. A wide range of products can be found on the net. It is therefore important to consider other aspects. It is on the one hand about convenience, where the focus is on process transparency, simplification and service – all in the name of convenience. However, on the other hand, it is also about the shopping experience. The focus here is on the themes of inspiration, involvement, emotionalisation and local ties. Pulling all these elements together in the correct way, tailor-made for the target group, will be crucial for long-term success.

What are your conclusions about the industries involved in consumer goods trade fairs?

We have seen in the study that it is particularly small specialist trades that are affected by these developments. It has also become apparent that products ranges in inner cities in particular have been exhibiting declining growth rates. The smaller the retail formats, the greater the reduction process. This is important for consumer goods fairs because their visitors are wholesalers, online retailers, distance sellers and also smaller specialist retailers. Based on the tradition and verifiable relevance of the trade fairs for the trading world that is dominated by SMEs, there is great potential to offer support. This is because, as a point of contact for information and as a networking platform, trade fairs can take on new functions and offer participants new added value.

What can trade fairs do to support trade and how can traders benefit from trade fairs?

Similar to the development that we see in the overall retail market, the focus will no longer be limited to the breadth of products. Rather, the aim is to make visitors to the trade fairs aware of the strategies with which to counter structural change. On the one hand, we have social megatrends as strategic starting points, but on the other hand digitalisation in general and at the POS have to be addressed in order to show trade fair visitors, who include predominantly SMEs, options they can use to secure their future.



*Boris Hedde,
Managing Director of IFH Köln GmbH*

WITH TRADITION FOR THE FUTURE

Messe Frankfurt – world trade with tradition

Due to its favourable geographical location, known to be at the crossroads of important long-distance trading routes, the first trade fairs in Frankfurt were established in the early Middle Ages. Many people from different countries came to Frankfurt to trade in various goods such as wine, cloths, furs, metal and spices. Visits to trade fairs in the Middle Ages already served the purpose of allowing people to see and touch new products and to haggle and have face-to-face discussions with international dealers. At that time, merchants tended to visit Frankfurt in the spring and autumn, thus laying the foundation for the basic scheduling structure of modern consumer goods fairs even as early as the 14th century. A tradition that has been maintained to the present day while also incorporating the most modern aspects of trading.

Consumer goods fairs are important for the retail trade

When it comes to presenting innovations and new developments to a broad audience, trade fairs are of high priority for companies. Trade fairs offer an excellent platform to present products and give them the attention they deserve. Over the course of time, trade fairs have undergone some changes. This is due to the fact that in the digital age, many marketing methods such as the presentation of the product portfolio, the customer approach or customer interaction have been shifted to the Internet.



Trade fairs offer solutions to the issues faced by stationary trade

As can be deduced from the developments described above, retailers today face the daily challenges of arousing desire and creating incentives to buy. Consumer goods fairs can provide innovative and novel concepts that aim to develop new shopping experiences in stationary retail. Trade fairs, for example, offer innovative concept solutions for the point of sale and present business models that are characterised by experiences. Platforms and special shows reveal how retailers can transform their own businesses into a concept store. Lectures and workshops provide exciting practise-based insights and highlight best-practice models and lifestyle trends that visitors can transfer to their own corporate world.

Background information on Messe Frankfurt

Messe Frankfurt is the world's largest trade fair, congress and event organiser with its own exhibition grounds. With more than 2,500* employees at 30 locations, the company generates annual sales of around €715* million. Thanks to its far-reaching ties with the relevant sectors and to its international sales network, the Group looks after the business interests of its customers effectively. A comprehensive range of services – both onsite and online – ensures that customers worldwide enjoy consistently high quality and flexibility when planning, organising and running their events. The wide range of services includes renting exhibition grounds, trade fair construction and marketing, personnel and food services. With its headquarters in Frankfurt am Main, the company is owned by the City of Frankfurt (60 percent) and the State of Hesse (40 percent). For more information, please visit our website at: www.messefrankfurt.com

** Preliminary figures for (2018)*



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