

Rewriting retail: a sector in acceleration towards 2025

November 2016





Preface

Dutch retail – food and non-food retailers selling products and services across online and offline channels – has reached a turning point. Profitability is under pressure in both food and non-food retail, and online growth in non-food sales is not making up for offline declines. Offline, a rise in vacancies is negatively influencing shoppers' experience. Changing consumer preferences and behaviors, evolving technology, foreign competition and new business models are disrupting the industry, presenting profound challenges to established retailers – and opportunities to retailers who swiftly adapt to the new marketplace.

Detailhandel Nederland asked McKinsey & Company to write this report to provide a perspective on the (future of the) sector and potential topics to inform the Dutch Retail Agenda. We therefore address the following questions:

- What is the role of the Dutch retail sector in today's society?
- How is it performing? Why?
- What trends will shape its future, and what value is at stake?
- How could industry stakeholders proactively shape that future?

Our analyses show that Dutch retailers play vital economic and social roles but that their contributions are not growing in line with their potential and historic industry leadership or with their counterparts in other countries. If the sector does not adequately respond to future challenges, its contribution to GDP and employment, the attractiveness of offline shopping and the diversity of its stores will be at risk. The sector will need to restructure and invest to capture growth opportunities and to maintain or increase its contribution. To reach these goals, retailers will need to take individual action and work with other retailers, online market places and stakeholders in government and the real estate industry.

In writing this report, we have used the economic perspectives of McKinsey Global Institute and the knowledge of our colleagues in the Retail and other industry practices. We have also benefited from the insights of about 50 Dutch retail CEOs, shop owners and leaders in the financial and real estate sectors. To better understand the consumer point of view, we conducted focus groups and surveyed 1,155 Dutch citizens. Throughout our report we use examples of retailers to illustrate trends, innovations and collaborations. We have not conducted in-depth financial assessments of these retailers or their ability to adapt and scale their business models. As such, these examples should be considered illustrative.

This report would not have been possible without the valuable contributions of the Board and members of Detailhandel Nederland. We are also indebted to the members of our working group: Gerlant Lettinga (INretail), Kitty Koelemeijer (Nyenrode Business Universiteit), Renate de Vree (Detailhandelseconomie en Maatschappij), Sander van Golberdinge (Detailhandel Nederland), Wijnand Jongen (Thuiswinkel.org) and Jorij Abraham (Shopping Tomorrow).

We believe the retail sector can continue to play its essential role in Dutch life if its leaders take ownership of change, form new alliances and take bold action. We encourage readers to use our findings as a catalyst for creativity, innovation and action.

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Executive summary

The Dutch retail sector plays an important role in Dutch society. It provides 9% of the nation's jobs, generates 8% of its turnover and 3.4% of its GDP. It plays a vital role in social cohesion and provides consumers with a wide array of offerings. Internationally, it is recognized for its strength and density of online and offline infrastructure, innovation in products, formats and business models, the traceability and sustainability of the supply chain, collaboration across the sector, and high-quality food at low prices. These fundamentals place the sector in a strong position for capturing future omnichannel opportunities.

Success will not come easily, because sector performance is under pressure in terms of growth, profit and offline shopping experience. In non-food, decline in offline sales has not been offset by online growth, in part because foreign online players are winning share. The profits of most players are under pressure as consumers move to online shopping and the customer experience has deteriorated due to increased vacancies and decreased diversity of stores. In food, topline revenues are growing, but profits are under pressure due to the rise of discounters and online.

The underlying shifts in consumer demographics, consumer behavior, technology and industry competition will present opportunities and threats towards 2025. Some retailers will adapt quickly enough and thrive. However, without accelerated action of retailers and cross-sector stakeholders, substantial value is at stake:

- 55,000-130,000 jobs (about 10-25% of total retail employment) of mostly young and blue-collar employees are at risk due to automation and the growing share of foreign online players.
- 0.3-1 percentage points of the sector's contribution to GDP, or about 10-30% of the sector's current value add, is at risk due to automation and increasing (foreign) online penetration.
- Attractiveness of offline shopping areas could further erode as up to 20-35% of store space could become redundant. The effects will likely be largest in peripheral areas. While the need to reduce floor space is widely recognized, the annual reduction is 10 times lower than required.
- The diversity of retailers could diminish, as scale is becoming increasingly important to invest in improving the omnichannel customer value proposition.

To mitigate these adverse effects, the sector will need to accelerate restructuring and invest in innovation and differentiation to capture profitable growth, building on existing Retail Agenda initiatives.

To accelerate restructuring, structural barriers in real estate need to be removed and labor laws could be made more flexible, while individual retailers need to accelerate the adjustment of their store portfolio and work force:

- **The government could work with municipalities, real estate and retail players to accelerate rezoning and limit net retail space additions.** The government could adapt fiscal policies that prevent rezoning and municipalities could speed up rezoning processes. Furthermore, the government could work with real estate players and municipalities to address existing adverse incentives that stimulate development of new retail space. In the absence of sufficient progress or unintended effects on special planning, more coordinated efforts among the national government, real estate owners and retailers may be needed to accelerate store space reduction and maintain desired accessibility.
- **The government and social partners could improve the flexibility of labor laws and collective**

employment agreements. To allow proactive adjustment by retailers, labor laws and CAOs could be made more flexible and equal for competing retailers. Furthermore, effects on young blue collar workers due to changes in minimum wages in combination with decreasing demand for labor should be carefully monitored.

- **Individual retailers will need to optimize their physical store portfolio towards growth and adjust their work force accordingly.** This requires retailers to determine which stores to keep, close or reallocate. They will also need to rethink the future role of their remaining stores within the omnichannel reality.

To capture profitable growth, Dutch retail will need to create an innovative and differentiating omnichannel shopping experience. This will spur retail spending per capita, capture foreign shopper spend and help Dutch retailers outperform foreign online players:

- **Individual retailers will need to step up innovation, differentiation and efficiency.** To keep up with the industry shifts, retailers will need to 1) improve their customer value proposition, 2) improve efficiency along the value chain through effective partnering and outsourcing and 3) increase agility of the organization.
- **Online marketplaces and platforms will need to tap into local strengths.** Foreign (large) online market places and e-commerce platforms are growing and winning share from Dutch players. To compete, Dutch online marketplaces and e-commerce platforms will need to 1) expand their offering with locally relevant products and services, 2) exploit proximity to customers in omnichannel fulfilment, using innovative online to offline business models, and 3) leverage technology to improve the shopping experience.
- **Real estate owners and retailers will jointly need to create attractive shopping areas.** To induce consumers to shop for fun, real estate owners and retailers should work together to improve the attractiveness of shopping areas. To attract local shoppers to any shopping area, they will need to get the essentials right. To attract shoppers from further away, they will also need to excel in composition and experience. To reduce barriers to invest, they need to: 1) align on the future purpose of a particular area and 2) facilitate investment in promising areas by agreeing on rent agreements that align incentives for growth.
- **The sector could work together to promote Dutch retail products and services abroad.** To increase sales to foreign consumers, Dutch retailers could 1) draw shoppers to Dutch offering on foreign platforms and 2) work with the tourism sector to promote the Netherlands further as an international shopping destination.
- **The Dutch government could work together with the retail sector to create a more enabling environment for growth.** The government could facilitate innovation and growth by 1) levelling the international playing field, 2) adjusting and simplifying local regulations and 3) investigating options to improve access to capital for SMEs.

In short, the sector is at a crossroads with the opportunity to rewrite the future of the sector and drive acceleration towards 2025. For acceleration, all sector stakeholders need to take bold action, form new alliances and assume ownership for change.



Chapter 1

The Dutch retail sector plays a key role in the Netherlands and has internationally recognized strengths



The Dutch retail sector plays a key role in the Netherlands and has internationally recognized strengths

The Dutch retail sector is important to the Netherlands in terms of economic value, employment, social cohesion and diversity of offering, and demonstrates clear strengths by international standards.

The Dutch retail sector

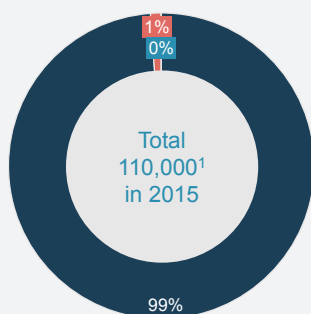
Many people and institutions (including CBS and Euromonitor) define the Dutch retail sector in the traditional sense: retailers are food and non-food players online and offline that sell products to end-consumers. Arguably, this definition is outdated given the blurring boundaries between retail, services, out-of-home consumption and entertainment. Consumers are moving from shopping for specific products, such as meat and potatoes, to solution-oriented shopping, such as arranging tonight's dinner. This results in retail concepts that include a combination of products and services and traditional non-retail players that become direct competitors, such as take-away delivery. For the purpose of this report, we therefore use a broader definition – despite the fact that most of the figures refer to retail in the traditional sense.

EXHIBIT 1

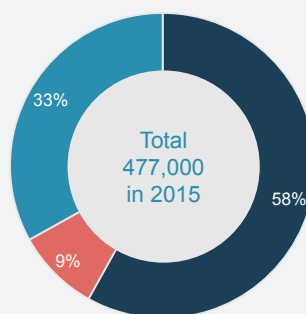
Small retailers account for 99% of companies, about 60% of FTEs and 40% of turnover

■ Small companies (<50 employees) ■ Medium companies (50-249 employees) ■ Large companies (≥250 employees)

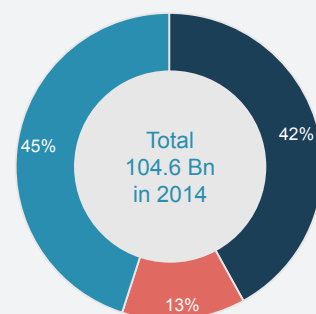
Share of retail companies



Share of full-time equivalent employees



Share of total turnover



¹ With a total of 98,000 physical store locations
Source: CBS Statline for total, Detailhandel.info for split in 2015

The Dutch retail sector is an important contributor to GDP and employer

The sector delivers around 8% of the nation's turnover and 3.4% of added value¹ (Exhibit 3), more than the food processing and machine manufacturing industries combined.² The sector creates about 9% of the country's jobs or 7% of full-time equivalent jobs, plus those created indirectly in other sectors such as transportation, logistics and advertisement. As shown in Exhibit 4, about 70% of all retail jobs are performed by blue-collar employees with low education levels (compared to 27% of jobs for all sectors) and 27% by part-timers who work fewer than 12 hours a week (compared to 16% for all sectors). More than 40% of retail employees are under 25 years old, strikingly more than the 17% share in all sectors.

The Dutch retail sector plays an important role in social cohesion

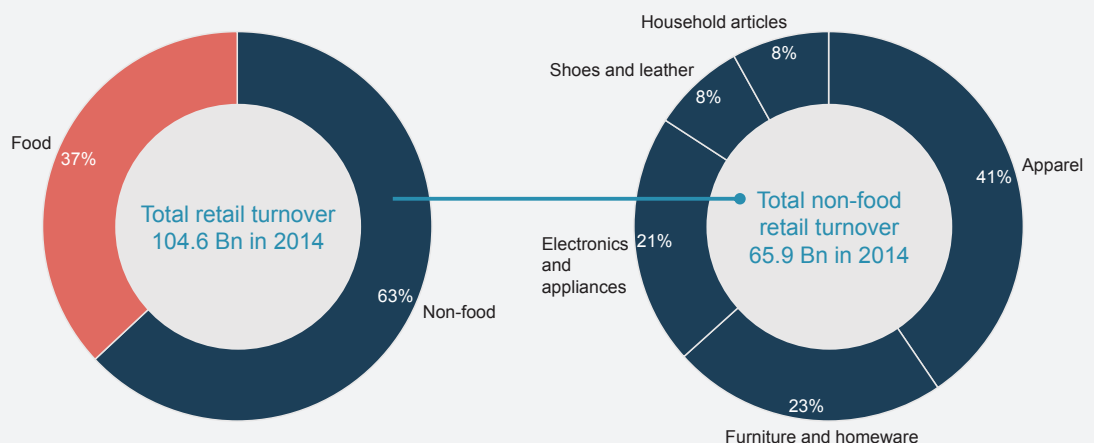
The sector's impact goes far beyond economics: retailers enable social contact and enhance cohesion. In quantitative research of 1,155 consumers, about a third said they shop in non-food stores to spend time with friends and family. Additionally, for both food and non-food shopping, about one in six respondents indicated they want to connect with people in stores. In eight focus groups across consumers from cities and peripheral areas, several participants explained that grocery shopping is their daily outing – helping them to stay socially connected and get physical exercise.

- 1 3.4% added value refers to the direct contribution of the retail sector to Dutch GDP, leaving indirect and induced GDP contribution out of scope
- 2 CBS Statline (2015)

EXHIBIT 2

About two-thirds of retail turnover comes from non-food, in which apparel, furniture and homeware and electronics are the largest categories

Share of total

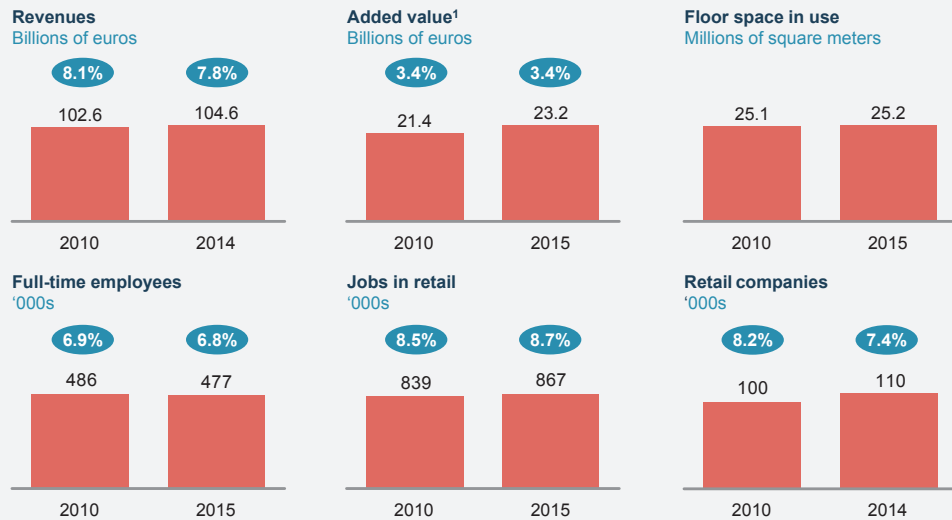


Source: CBS Statline

EXHIBIT 3

Retail makes major contributions to the Dutch economy

● Share of total

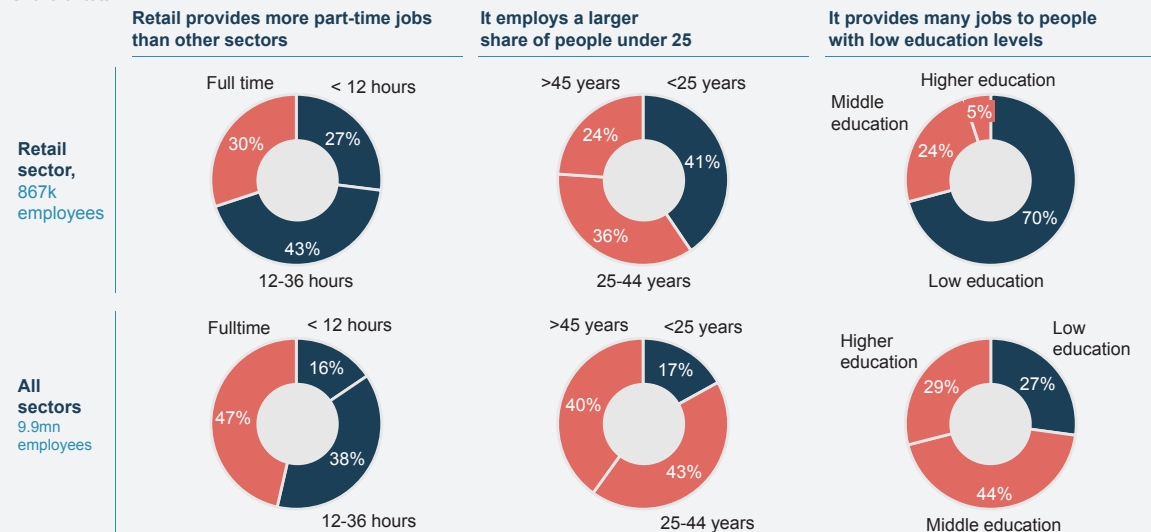


¹ Value added includes only the direct impact of the retail sector on the Dutch economy (excluding indirect and induced GDP impact)
Source: CBS Statline, Locatus

EXHIBIT 4

The sector is an important employer to people under 25 and with low education¹

Share of total



¹ Total FTE and employee figures based on 2015 CBS data; job characteristic data from 2013
Source: CBS, UWV Kenniscentrum handel (2013)

Some retailers acknowledge their role in driving social cohesion and help tackle societal challenges. Grocer Albert Heijn, for example, provides training to help store employees identify elderly customers who may suffer from loneliness or dementia, and its competitor Jumbo has piloted a kids' club on Wednesday afternoons that stimulates children to do physical exercise. Many retail players also contribute financially to local causes that promote social cohesion. For instance, optician Specsavers has established a foundation to financially support 121 local causes, including community centers and sports associations. There are also numerous examples of independent artisan retailers who help their communities, such as artisan butcher Bouwman in Zuidwolde where customers can save points and donate them to local associations and foundations.

The diversity of the Dutch retail sector caters to a wide set of different consumer needs

Of the roughly 98,000 physical store locations in the Netherlands, 63% are run by independent entrepreneurs, 14% work together in some form of cooperation (franchise, purchasing organizations or dealer organizations), including both SMEs (9%) and large companies (5%) and 23% are part of large companies.³ Many of the independent companies deliver specialty products, such as wooden toys or high-quality halal meat, or a particular experience or service that larger companies cannot. Shoppers appreciate this mix of independent players and chains: about 60% of survey respondents say the diversity in stores and a good mix of chains and unique stores are critical or important drivers in their decision to go to a specific shopping area. Online, Dutch consumers can satisfy specific needs thanks to the extensive assortment offered at competitive prices by national and foreign players. Dutch citizens can shop at 28,820 web stores⁴ and a number of online market places with large assortments, such as bol.com, which offers 13.5 million different products.

The Dutch retail sector demonstrates clear strengths by international standards

Being a trading nation for centuries, the Dutch retail sector has built many important strengths. Based on comparative research and interviews with industry stakeholders, we have identified five of them:

1. Strength and density of physical and online infrastructure

Among developed markets, the Netherlands offers a relatively high number of food and non-food stores and a high amount of retail floor space per resident. While this has led to an oversupply of retail space, Dutch shoppers enjoy easy access to stores. On average, Dutch citizens live 0.9 kilometers from the nearest large supermarket and 2.6 kilometers from a department store. The dense and high-quality Dutch road network also makes it easy for shoppers and deliveries to reach the stores and customers' homes. In contrast to countries such as the United States and the United Kingdom, the Netherlands' land use policy is based on the idea that shops should be located within cities with the exception of a few special cases. This has ensured proximity of retail to consumers.

Online and omnichannel retailers have special advantages in the Netherlands, including 96% internet penetration versus an 81% EU-28 average. About 70% of the Dutch use the mobile internet (versus 51% EU-28 average) and 71% have experience with online shopping (versus 50% EU-28 average). The country's high population density, especially in large cities, improves the economics of home delivery. Research shows that the average kilometers driven per delivery drops by approximately 37% when the number of customers in the delivery area rises from 500 to 4,000.⁵ Furthermore, the dense road network enables higher service levels online than in many other countries. In many product categories, such as consumer electronics, free next-day delivery has become the industry standard.

2. Innovative formats, products and business models

Several interviewees⁶ mentioned that the Netherlands has a reputation for being "the ideal test market" for new products, services, store formats and business, because Dutch shoppers quickly adopt new

3 Detailhandel Nederland (2015)

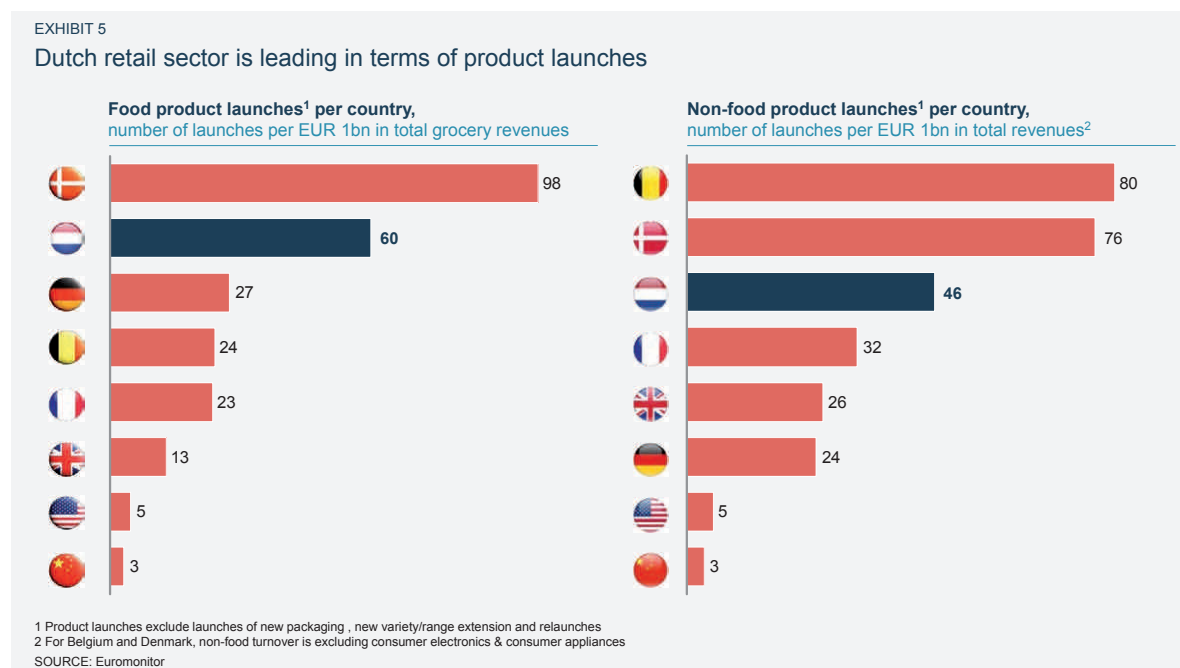
4 We estimated the total number of webstores from CBS Statline and based on the number of webshops registered at the Dutch Chamber of Commerce. Thuiswinkel.org estimates that the actual number is higher, as some webshops are registered under a different category.

5 Boyer, K.K., Chung, W., and Prud'homme, A.M. (2009), "The Last Mile Challenge: Evaluating the Effects of Customer Density and Delivery Window Patterns," *Journal of Business Logistics*

6 Interviewees included senior leaders and owners of pure online, omnichannel and pure offline companies from all large product segments.

innovations and are easy to reach both online and offline.

Dutch retailers are innovative in terms of products, launching about 2,000 food and 2,000 non-food products per year. In relative terms, this is significantly more than in most neighboring countries. Adjusting for market size, the number of product innovations is 2-5 times higher in food and 1.5-2 times higher in non-food than in Germany, the United Kingdom and France (Exhibit 5).



Dutch retailers are also innovating in store formats and business models. In food retail, these include the rebirth of market-like food stores (e.g., Marqt and Jumbo Foodmarkt), the surge in convenience stores in high-traffic locations (e.g., AH To Go), a shift from products to services (e.g., butchers who rent out food trucks and BBQs), subscription-based online business models (e.g., Odin for biological fruit and vegetables) and the emergence of a pure online grocery player that focuses on cities and offers free sustainable delivery and low prices (Picnic). In non-food retail, the fact base is less clear; despite the emergence of innovative concepts, the majority of players is struggling to adapt to quickly changing consumer demands and technological innovations. The most notable examples of innovation in non-food include “treasure hunt” discount stores (e.g. Action), subscription-based models (e.g., Boldking for razor blades and Bloomon for flowers), personalized offerings (e.g., Shirt by Hand and House of Einstein), online delivery models focusing on end-to-end experience (e.g., Coolblue), offline stores offering a unique assortment and experience (e.g., pop-up stores such as KEET Rotterdam) and companies combining their product assortments with services (e.g., Ritual’s urban spa or Electrostyling’s smart living solutions). While not all business models have proven to be profitable or broadly scalable, these innovations are expanding the set of choices for consumers.

3. A strong record of traceability and sustainability in the supply chain

Supply chains of Dutch retailers provide high traceability and sustainability. About 80% of Dutch environmental legislation is derived from EU legislation. Hence, in terms of legislation there is limited

difference with respect to other EU member states. The more distinctive feature of Dutch retail, according to industry leaders we interviewed, is the number of private sector initiatives in this area, including certification marks for sustainability (e.g., Max Havelaar for fair trade and UTZ for social and environmental protection), covenants between retailers and other players (e.g., covenant on Sustainable Clothing & Textile), tools to trace the origin of products (e.g., “Check de herkomst” van Albert Heijn) and business models and products aimed at reducing waste (e.g., Gerrard Street’s modular headphones allowing for easy replacement of all individual components).

4. A long history of collaboration across retailers to lower costs or jointly improve the shopping experience

In many countries, retailers collaborate to drive costs down, but not many collaborations go as far back as in the Netherlands. The roots of Euretco, a sector organization that facilitates joined purchasing and knowledge-sharing for its members, go back to 1916. Another example is buying organization Superunie, created over 50 years ago.

There are many more recent examples of partnerships to achieve lower costs, including Sligro, EMTÉ and PLUS’ partnership with logistical service provider Nabuurs to sync their delivery days. Some retailers also share stock (e.g., through Stockbase), while others combine their purchasing efforts in A-brand and private label bilateral agreements or buying alliances (e.g., AMS in food).

Offline and omnichannel retailers are also working together to improve the customer experience. For instance, Haarlemwinkelstad.nl, an online platform, lowers vacancy rates in Haarlem by finding temporary occupants for empty retail buildings. Topshoe.nl is an online shop for shoes where more than 40 independent shoe retailers sell their combined assortments.

5. Relatively low price for good quality food

By European standards, Dutch consumers pay relatively low prices for food and non-alcoholic beverages, especially compared to countries with similar GDPs per capita. A comparative study by Oxfam confirms this finding, ranking the Netherlands as the #1 place in the world for a plentiful, nutritious, healthy and affordable diet.

In short, the Dutch retail sector plays a key role in Dutch society in providing jobs, contributing to GDP and social cohesion, and meeting consumers’ diverse needs. By international standards, the sector has clear strengths including a strong and dense physical and online infrastructure, a relatively high level of innovation, a record of traceability and sustainability in the supply chain, strong examples of collaboration and relatively low prices for high-quality food.

That said, the performance of the sector has been under pressure – the topic of the next chapter.



Chapter 2

Dutch retail performance
is under pressure



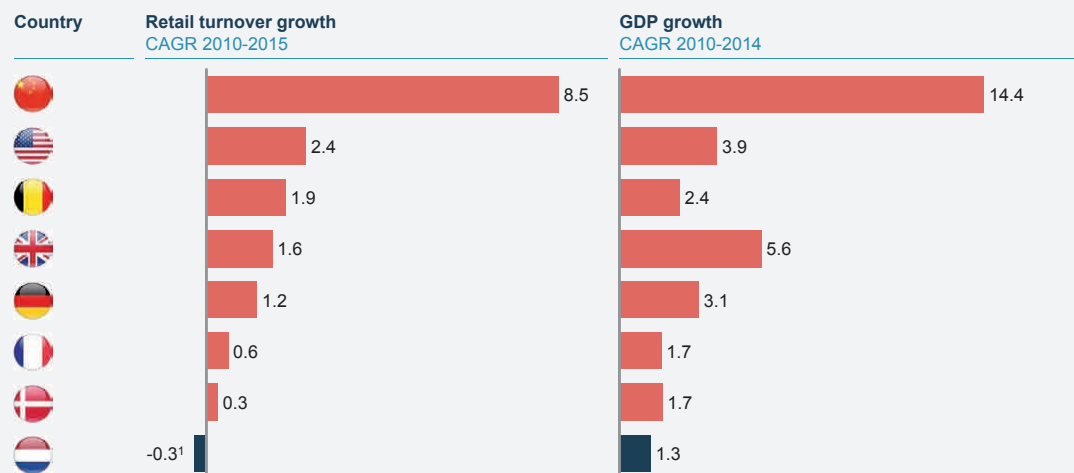
Dutch retail performance is under pressure

Despite its strengths, performance of the Dutch retail sector is under pressure. While the population grew annually by 0.4% and GDP by 1.3%, retail turnover growth stagnated with growth rates per annum between -0.3% and +0.5% depending on sources used.⁷ This stagnant growth is exceptional by international standards and cannot be fully explained by GDP differences (Exhibit 6). Although growth is lagging internationally in both the food and non-food subsectors (Exhibit 7), the magnitude and root causes of the weak performances differ. In non-food, consumer spend has decreased, the shift to online has put pressure on profitability and the offline shopping experience has deteriorated. In food, turnover has grown but profitability has been under pressure. In this chapter we discuss and explain recent performance gaps in more detail.

EXHIBIT 6

Growth in Dutch total retail turnover lags international peers and GDP growth

Percentage



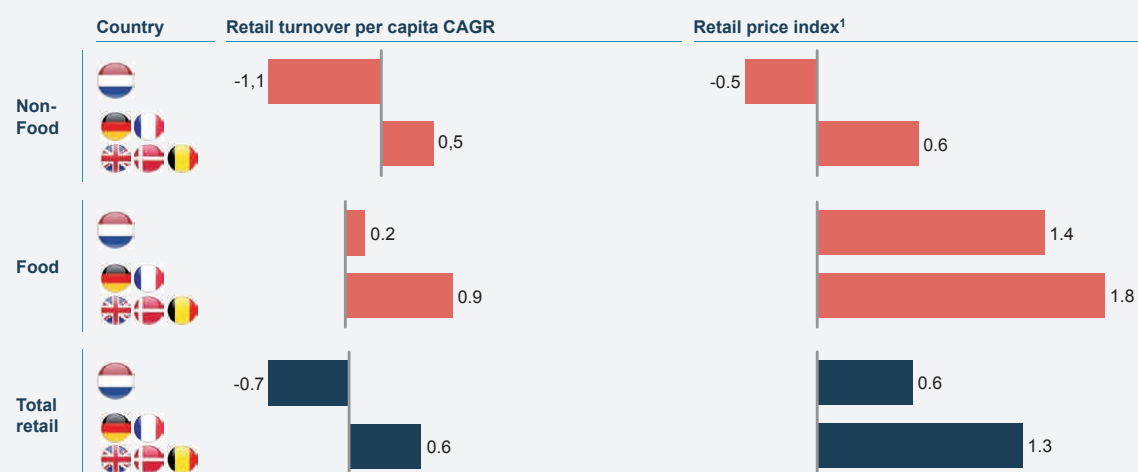
¹ To make international comparison possible, Euromonitor data was used rather than CBS data
Source: Euromonitor all retail categories, Worldbank GDP

⁷ CBS reports a growth per annum between 2010 and 2014 of +0.5%. For international comparison, however, we have used Euromonitor which reports a growth per annum between 2010 and 2015 of -0.3%. The difference seems to be driven by food (+2.3% in CBS for total food including specialty stores and +3% in CBS for supermarkets between 2010 and 2014 versus 0.6% in Euromonitor between 2010 and 2015). In non-food, differences are smaller (-0.5% in CBS between 2010 and 2014 and -0.7% in Euromonitor between 2010 and 2015).

EXHIBIT 7

Dutch retail turnover per capita lags international peers in food and non-food

Percentage of growth 2010-2015



¹ Weighted average based on sales and for non-food based on apparel and footwear, household appliances, and home and garden categories
Source: Euromonitor, Eurostat harmonized indices of consumer prices

Non-food performance has declined

Non-food retail spend per capita declined by 0.9%-1.1%⁸ annually depending on sources used, driven by a price decrease of 0.5% as well as volume declines (Exhibit 7). Root causes are an enduring shift in spending behavior following the crisis and the shift to online shopping.

Enduring spend shift has decreased turnover

The global financial crisis temporarily decreased disposable income and consumer confidence. As a result, consumers began to spend less on non-food items either by buying fewer products or by buying less expensive brands. Research shows that this “trading down” is lasting: the 2016 McKinsey Sentiment Survey⁹ found that 41% of Western European consumers who opted for less-expensive non-food brands no longer prefer the more expensive brands, while 36% prefer the more expensive brands but do not believe they are worth the price premium. We see that instead of spending on non-food retail, people spend more of their disposable income on housing and services, such as transportation, communication and financial services. Spending on restaurants, recreation and culture has remained relatively constant.¹⁰

⁸ Non-food turnover per capita growth in CBS (-0.9% p.a. between 2010 and 2014) differs slightly from Euromonitor (-1.1% p.a. between 2010 and 2015). The same holds for total non-food turnover (-0.5% in CBS between 2010 and 2014 and -0.7% in Euromonitor between 2010 and 2015).

⁹ McKinsey Sentiment Survey (2016), sample size for Western Europe is 4,000

¹⁰ CBS Statline, data available up to and including 2014

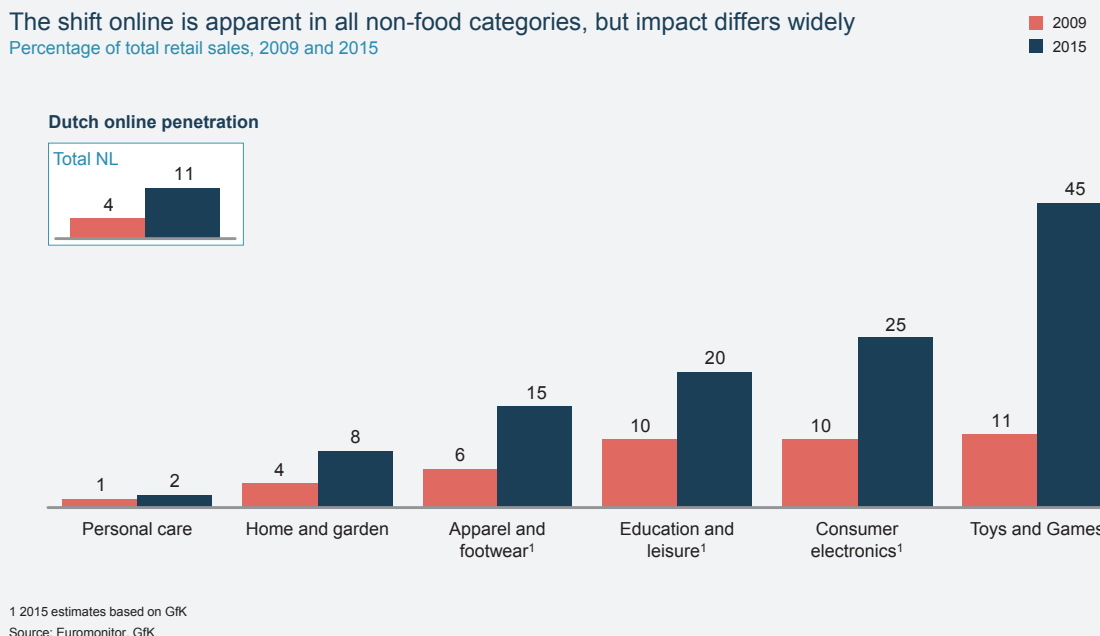
The rise of e-commerce

The rise of e-commerce has had a major impact on non-food retail spending. Online purchases now account for about 11% of non-food retail revenue in the Netherlands. While this is slightly lower than in comparable countries, online sales are growing faster than in neighboring countries (16% annually in the Netherlands vs. 12% in Germany, 10% in Belgium and 13% in France¹¹). This shift affects all non-food categories, but some are more impacted than others. Exhibit 8 shows sharp differences in the online penetration for the most important non-food categories. In general, products characterized by “high certainty” – where consumers know exactly what they are buying – and high value per purchase, such as consumer electronics, are moving online faster. For these products, consumers feel less need to check the quality offline, and the online channel makes it easy to optimize for price.

Marketplaces and platforms, including comparison sites, search engines and auction sites, are becoming increasingly important “gates” to the online world. The availability of information and rise of social media has changed how consumers identify and research products. US consumer research indicates that only about 20% of consumers use brand or retailer sites as their preferred starting point for product search. The rest uses Amazon (38%), Google (35%), or other marketplaces, search engines and comparison sites (6%).¹² These figures indicate that retailers should carefully assess how to best generate online traffic and where to partner with existing players.

EXHIBIT 8

The shift online is apparent in all non-food categories, but impact differs widely
Percentage of total retail sales, 2009 and 2015



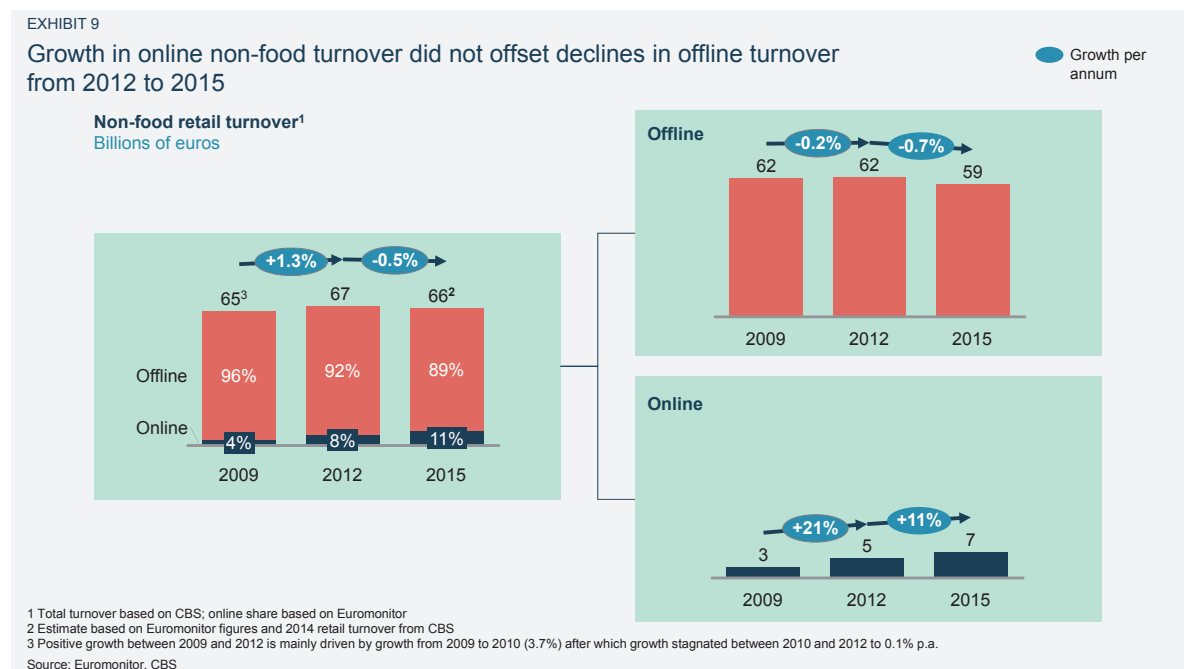
¹¹ Euromonitor, 2015

¹² PowerReviews, 2016

The shift to online has put pressure on profits and offline shopping experience

Although consumers and specific players are benefiting from the rise of online shopping, the sector is facing pressure on turnover and costs.

In terms of revenues, the more than 1.8 billion euros in online sales growth in the last three years was not enough to offset a 2.8-billion-euro decline in offline sales (Exhibit 9). We identified three root causes:

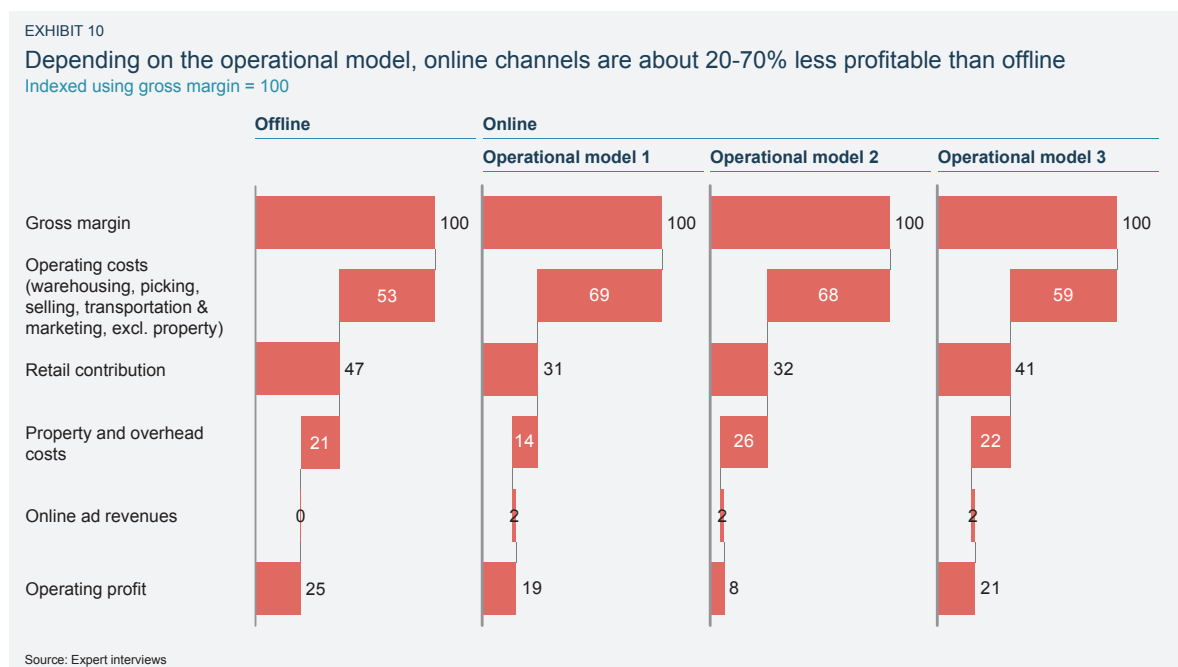


- Part of online spend goes to foreign retailers.** Retail sales by foreign players, about 14% of total online non-food sales in 2015, do not count as Dutch retail sales. The rise of foreign online players is happening remarkably fast – they grew their Dutch sales by 32% between 2014 and 2015. Companies like Amazon have the intention to further expand their share, as illustrated by the recent Dutch translation of its German website.
- Impulse purchases are generally lower online, limiting basket size.** In our survey, about 8% of respondents said they always or often purchased something they were not planning to buy when shopping online compared to 16% when shopping offline.
- Transparency, rise of discounters and itemization of shopping behavior drive prices down.** More and more shoppers shop for a particular need rather than for a particular store, in part because online players have made the marketplace more transparent. About 70% of US internet users start their searches online¹³ where they can more easily optimize for preferred product characteristics, prices, service level, delivery times and store locations. This comes at a cost – which cannot be compensated in full by prices, given the downward price pressure. Their expectations have risen accordingly, and many shoppers have become less loyal to individual retailers. This has put more price pressure on retailers – particularly as discounters are on the rise.

13 McKinsey iConsumer, 2014

In terms of costs, the non-food sector is worse off. We have identified three root causes:

- **Transparency and itemization of shopping behavior drive margins down.** Next to price pressure, the increased transparency drives retailers' need to invest in differentiation in terms of service, experience or convenience.
- **Online sales are often less profitable than offline sales.** Many retailers today offer the same prices online and offline. The picking, transportation and write-offs on the investments in ecommerce are combined as a share of sales typically higher than the store costs (Exhibit 10). Furthermore, building e-commerce capabilities requires substantial investments. Unless the additional costs are reflected in adequate delivery fees (often not the case in the Netherlands), migration of offline customers to online reduces profits.



- **Shift to online drives down offline profits.** Depending on the category, fixed costs represent 15-25% of total costs for an offline retailer, driven by store rents (multiyear) and overhead costs. A shift from store to online sales reduces profits, as the retailer cannot fully compensate for the offline sales decline with cost reductions. Depending on the category, a share of online as low as 15% can change the return on capital of a full store portfolio from positive to negative.

In terms of the shopping experience, offline shopping has become less attractive:

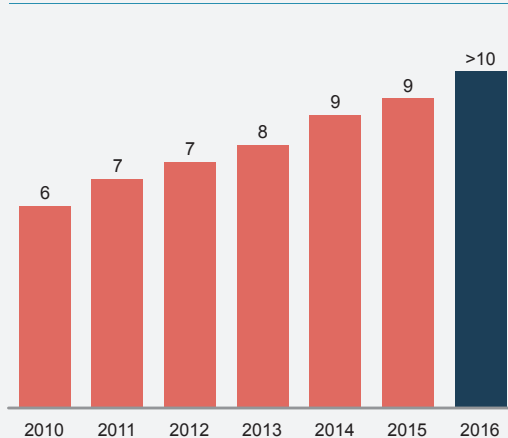
- **Vacancy rates rose from 6% in 2010 to more than 10% in 2016.** About half of survey respondents mentioned that the vacancy rate in their favorite shopping area has gotten worse in the past five years, and about one fifth rated the current vacancy situation as “bad” or “very bad.” About 40% said that low vacancy rates are a critical or important factor in their decision where to shop. It is therefore not surprising to see that foot traffic has declined, albeit with different effects in different types of shopping areas (Exhibit 11).

EXHIBIT 11

Vacancy rates have risen and foot traffic has declined

Empty retail space in the Netherlands

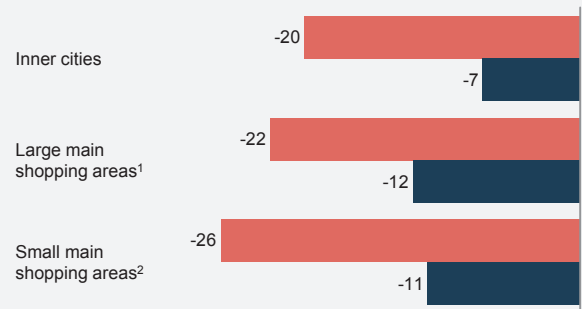
Percentage of total retail space available for rent



1 Shopping areas with 200-400 stores
2 Shopping areas with 100-200 stores
Source: Locatus, ABN AMRO based on Locatus

Foot traffic and vacancy rates differ by type of shopping area

Percentage decline in foot traffic since 2005 (Red bar) | Vacancy rates in 2015 (Dark blue bar)



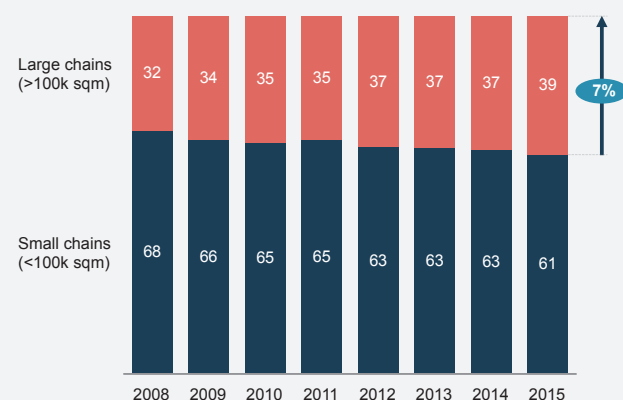
- Diversity of store offer has declined.** In comparison, more small players have faltered because of declining offline sales and increased competition from larger players that leverage their scale and invest large sums in their value propositions, either by lowering costs and prices or by improving their products or shopping experience. This has resulted in consolidation and a decline in store variety. The number of small players decreased by 9% and the number of medium players by 26% between 2007 and 2016. Meanwhile, large players took up 39% of total retail space in 2015, up from 32% in 2007 (Exhibit 12). However, some larger players have also been unable to adjust their value propositions fast enough to the shift in online, resulting in bankruptcies such as department store V&D, electronics store Scheer & Foppen and sportswear store Perry Sport – just to name a few. This also contributed to a decline in diversity.

EXHIBIT 12

Dutch shoppers have fewer choices today in terms of store variety

Large players are taking an increasing share of retail space ...

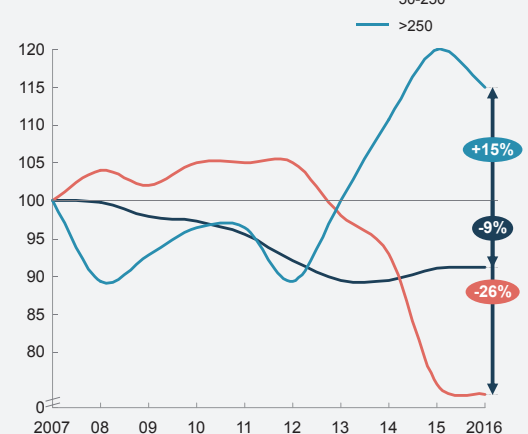
Retail space of chains in the Netherlands (excl. small individual shops)
Percentage



Source: Euromonitor, CBS

... and the number of SMEs has declined sharply

Index of offline non-food companies
2007 = 100



How consumers decide where to shop

Survey respondents indicated that many “hygiene factors” are important in their decision where to shop: a shopping center should be easy to navigate, accessible, close by, clean and well-maintained and have a variety of stores with friendly store personnel. Only if these hygiene factors are addressed, which is not the case in many shopping centers, “inspiration factors” can make the difference. Focus group participants cited several “wow factors” for non-food shopping areas: 1) store owners going the extra mile to provide innovative, relevant products and services, such as installing wireless solutions to connect different electronic devices; 2) excellent in-store experience, such as in-store trials of new products or festive drinks in a clothing store; and 3) joint events or initiatives in shopping centers, such as activities for kids, fashion shows or food markets.

The effects are palpable. Many focus group participants complained that they find the same stores in every inner city or shopping area they visit, eliminating much of the inspiration and surprise they used to feel when shopping. Our consumer survey confirmed this picture: one in five respondents said the diversity in offering and the mix between non-food chains and unique local stores have deteriorated over the past five years, negatively affecting their shopping experience. Respondents have moved from fun shopping (e.g., for social purposes, contact, inspiration and relaxation) to more goal-oriented shopping (aimed, planned, urgent and bargain-hunting shopping).

Given these developments, it might not come as a surprise that only about 55% of Dutch shoppers shopped for fun in 2014, down from 77% in 2007. Those who still shop for fun do so less often than the average fun shopper a few years ago: in 2007, 47% of the fun shoppers went at least once or twice every quarter versus 39% in 2014; for those who go at least once a month, the share dropped from 23% to 18%.¹⁴

Food retail spend has increased, but profits are under pressure

Despite the emergence of non-retail food players such as HelloFresh, Deliveroo and Foodora in out-of-home, Urban Salad and Broodzaak in ready-to-eat and Picnic in online delivery, food retail spend per capita has grown by 0.2%-1.9%¹⁵ annually depending on sources used. This growth is partly driven by commodity price increases and shifts in spending behavior.

Respondents to our consumer survey indicated that 33% buy more healthy products than two years ago, vs. 5% who buy less of them. We see similar trends for organic products (20% vs. 13%), cooking a wide variety of meals (27% vs. 8%), all of which are likely to increase the total spend on food retail. People also said that they shop for groceries more often (18% vs 15%). At the same time, respondents shop more price-consciously (33% vs. 7%) and visit discount stores more often (22% vs 12%), in part mitigating the upward price pressure. Interestingly, many of the same people who optimize for healthier and premium

¹⁴ GfK (2015)

¹⁵ Food turnover per capita growth in CBS (+1.9% p.a. between 2010 and 2014) differs significantly from Euromonitor (0.2% p.a. between 2010 and 2015). The same holds for total food turnover (+2.3% for all food including specialty stores and +3% for supermarkets in CBS between 2010 and 2014 and 0.6% in Euromonitor between 2010 and 2015).

food also seek better value for their money. Of all people who that buy more premium quality, 45% also optimize more for the lowest price. Similarly, 44% of those who shop more price-consciously also buy more premium products.

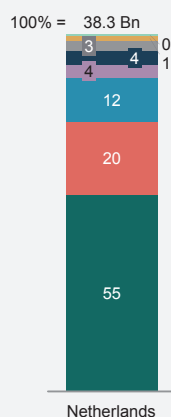
Despite the positive revenue trend, food profits are under pressure driven by the growth of Lidl and the shift from more profitable offline to less profitable or unprofitable online sales.

- The rise of discounters puts pressure on prices.** While sales in wholesale and shop-in-shop formats declined from 2010 to 2015, sales rose in discount, online, organic, specialty, convenience and supermarket channels. In absolute numbers, discounters display the biggest growth in offline food (Exhibit 13). Lidl is especially successful, growing its market share from 5.8% to 8.7%, surpassing Aldi as the largest discounter as its share decreased from 7.8% to 7.3%. Focus group participants indicated that their trust in (soft) discounters has grown: shopping at discounters like Lidl is “the smart thing to do,” because it offers affordable essentials. Participants also mentioned the high quality of Lidl’s private label and its attractive promotions in non-food.
- The shift online challenges profitability.** The shift to online is not as pronounced in food as it is in non-food retail: online spend represented only about 1% of total food retail turnover in supermarkets in 2015 (Exhibit 14). This share has been rising at 20% per annum, but the shift to online is not nearly as disrupting (yet) as it is in the non-food retail sector. Key barriers today include not having products immediately after the purchase (59% of survey respondents said this is an important or decisive reason not to buy more groceries online), quality concerns (58%) and worry about purchase costs (50%). Focus group participants added that the proximity of supermarkets and the ad hoc nature of grocery shopping also reduce the need to shop online. There are some exceptions: many working parents, for example, see online grocery solutions as “lifesavers” for their families.

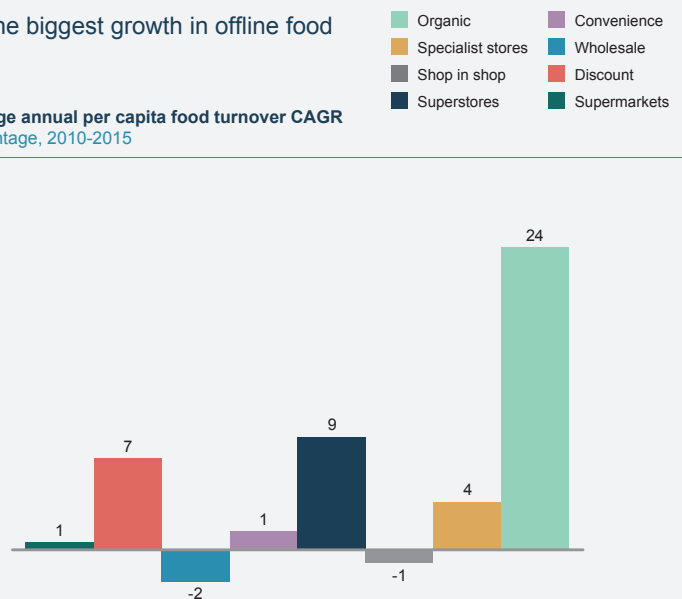
EXHIBIT 13

In absolute numbers, discounters display the biggest growth in offline food

Total food offline turnover, split per format
Percentage of total, 2015



Average annual per capita food turnover CAGR
Percentage, 2010-2015

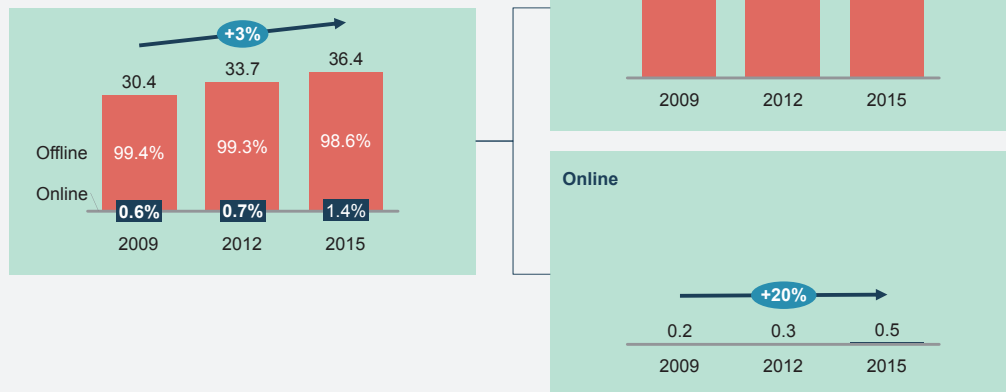


Source: Planet retail

EXHIBIT 14

Online supermarket spending is still small but growing fast

Compound annual growth in food retail turnover
of supermarkets¹
Billions of euros



¹ Excludes food spend in stores other than supermarkets
Source: Planet Retail

It is noteworthy that the Dutch spend less on food than their neighbors. Belgians spent about 20% more per person, the Danish 45%, the French 60% and the Germans 65% more in 2015¹⁶. While this is driven in part by the relatively low prices for high-quality food, the Dutch in general spend less money and time on eating. Historically, they have less of an “eating culture” than some neighboring countries.

To summarize, the Dutch retail sector is under pressure. In terms of growth, profitability and offline shopping experience, its performance has fallen short in the last five years, especially in non-food. In food, we see growth, but profitability is under pressure.



ROYAL DELFTWARE

Chapter 3

Without action, the role of Dutch retail will erode



Without action, the role of Dutch retail will erode

As we have seen in the previous chapter, growth in the Dutch retail sector has fallen short. In the years ahead, powerful on-going and new trends will provide opportunities to individual players and the sector as a whole, but also put additional pressure on the sector. To create transparency on what is at stake if no additional individual or collective efforts are made, we have assessed the impact of these trends on the sector's contributions to GDP, employment, social cohesion and fulfilment of diverse consumer needs in that particular scenario.

Major trends are disrupting the sector

A look back at 2005 shows how quickly the world can change in just a decade. Facebook was new and WhatsApp did not exist, but each of them now have almost 10 million Dutch users. Only 12% of households in the Netherlands owned a mobile phone with a connection to the internet; now, more than 78% do. These and other developments have changed how consumers live, think and shop – and the changes will only accelerate. The next ten years, too, will bring their share of industry disruptions. Certain trends will follow a pattern of predictable growth; others will take more surprising paths.

Based on consumer research¹⁷ and interviews with about 50 retail CEOs, shop owners and other stakeholders in the financial and real estate sectors, we have identified several trends that will impact the Dutch retail sector towards 2025 (Exhibit 15). Depending on the timing and adequacy of the industry's reaction, these trends could present either new opportunities or threats.

17 McKinsey (2015), "Consumer 2030: The future of the consumer industry and what it means for retail and CPG companies"

EXHIBIT 15

Four major trends are driving changes in the sector

Included in
quantificationsChanging face of
the consumer

- Aging population
- **Urbanization**
- Women in workforce
- Multicultural society
- Shrinking households
- Millennials

Advances in
technology

- Big data
- Advanced analytics
- **Automation and advanced robotics**
- Omni-present internet and connectivity devices
- 3D printing
- Artificial intelligence
- Internet of things
- Virtual reality and gaming
- Machine learning
- Social media

Patterns in personal
consumption

- Convenience
- **Online and omnichannel**
- Shift in discretionary spending
- Sharing economy
- Focus on shopping experience
- Simplification of choice
- Decreasing brand loyalty
- Full information transparency
- More fragmented shopping
- Health and wellness
- Personalization
- Local and fresh
- Value for money
- Polarization – increase in discount and premium

Retail industry-
specific trends

- Blurring channels and sectors
- Direct-to-consumer models
- Continued consolidation & selective collaboration
- Platforms and marketplaces online
- **International entrants**

Source: Interviews with ~50 retail stakeholders, GfK Shopping 2020, McKinsey research

The changing face of the consumer

Dutch consumers are changing – the population is aging and becoming more multicultural. Household size is declining and women's participation in the workforce continues to increase. Urbanization is continuing and millennials are taking over. The changing face of the consumer will offer opportunities to retailers who are first in adapting their value propositions accordingly. It will make the role of retail in catering to diverse consumer needs and supporting social cohesion even more important. Pressure on the sector to innovate its products, formats and business models to serve these needs – a historic strength of the Dutch sector – will increase.

Advances in technology

Advances in technology, such as big data, machine learning, the internet of things and advanced robotics will all change the nature of retailing. The extent of disruption and speed of these trends is uncertain, but their impact on the sector could be profound. Individual players who are able to provide a more relevant offer to consumers by integrating and exploiting technological innovations first will outperform the others. Those who cannot make these advances on their own will need to partner with or outsource to players who can, or risk falling behind. At a macro level, technology will further affect all contributions of the sector: GDP, employment, social cohesion and the fulfilment of diverse consumer needs. A few examples:

- **Advances in technology can significantly improve customer value, but also threaten the retail sector's contributions to GDP and employment.** Automation and robotization will reduce the total number of jobs and the sector's contribution to GDP as the increased demand for employees with complex skills will likely not offset the reduction in blue-collar jobs. That said, consumers will benefit from greater value-for-money offerings as labor-related savings are likely to be passed on to customers as competition rises.

Dutch shoppers have increasingly fluid lives

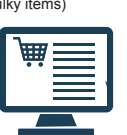
Dutch consumers have fewer daily routines than a decade ago (Exhibit 16). Work and personal lives are blurring, leading people to organize their lives in different ways. Instead of spending more time dedicated to a particular activity, people increasingly cut their days into smaller blocks with more unpredictable patterns. Grocery shopping in particular has become more fragmented. People fit it in whenever and however it is most convenient. The traditional model of weekly big-box shopping is in decline – it requires too much organization and planning. Instead, retailers need to adapt to people's lives and offer simple, efficient solutions at the right moment and the right time.

- **Advances in technology could change retail's social role.** Voice technology, the internet of things, 3D printing and virtual reality could reduce people's need to go to shops in person. Reduction in retail store networks will mean fewer stores close by, reducing opportunities for people to meet each other in "the physical marketplace" as they have been doing for centuries. At the same time, technological advances offer retailers the opportunity to stay closely connected to consumers through social media and other online channels. Technology could also increase the quality of interactions by freeing up personnel and improve the by improving human and automated customer service.
- **Advances in technology may threaten diversity.** Digital tools will play larger roles in customer decision journeys. As transparency increases, consumers will search for exactly what they want, how they want it and when they want it – increasing pressure on price, service and experience. Meeting these needs requires investments in technology and skills that are beyond the reach of many smaller companies. At the same time, online marketplaces and platforms have opened a whole new channel for those players previously lacking reach.

Other sectors that have been disrupted by technological advances show that there are several ways to adapt. Following the rise of disrupting platforms in the travel branch (e.g., Airbnb, TripAdvisor), most physical travel agencies have either disappeared (e.g., Oad Reizen) or successfully made the shift to online (e.g., TUI). In the music industry, subscription models such as Spotify are replacing illegal downloading, the original disruptor of the business model of record labels. Retail banks have reduced their store portfolios and repurposed the remaining physical branches, as customers prefer to do most of their banking activities online.

EXHIBIT 16

Many new customer journeys¹ for “food online” – Increasingly fluid and unpredictable lifestyles have led to more fragmented shopping behavior and less loyalty to channels and brands

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY	SATURDAY	SUNDAY
Caffeine fix Click & collect a coffee on my way to work 	Working lunch My meeting is running over – let's order some food 	Quick top-up We're out of milk and eggs. Let's order and collect them on the way home 	Party planning For the big party next month, let's order the food and drinks online today 	Birthday treat Sending chocolates to a friend's desk on her birthday 	Weekly shop Doing weekly grocery shopping online (especially the bulky items) 	Lazy Sunday Let's treat ourselves to take-away from a fancy restaurant and a good bottle of wine 
Need inspiration Plenty of leftovers! Check my app to see what I can make and what other ingredients to order 	Fridge grazing Nothing appealing in the fridge. I can order a quick and healthy meal online 	Monthly treat Delivery of my monthly wine box – introducing me to new flavors 	Dinnertime The kids really want pizza tonight! Let's order on the app and drive through to collect 	Happy hour Barbeque at home but we're out of beer. Let's have it delivered 	Last-minute dinner party Impromptu dinner with friends, need something quick but impressive to pop in the oven 	Stock-up Need to replenish my supplies of household items 

¹ Example based on experiences of focus group participants

Changing consumption patterns and specific industry trends

Changing consumption patterns and industry-specific trends include channel shifts (e.g., more convenience and online, blurring across channels and sectors, direct-to-consumer D2C business models), consumption shifts (e.g., decreasing brand loyalty and increased value for money orientation), shifts in the shopping experience (e.g., fragmentation of shopping behavior and omnichannel) and competitive shifts (e.g., consolidation and growing international entrants).

Individual retailers will need to adjust to new consumption patterns, continue to innovate their offers and operating models to keep up – especially as consumers become less loyal. Given the transparency in the market, superior players can grow faster than ever before.

Retailers are facing "new competition" from foreign companies and D2C business models. Foreign online players will try to increase their market shares. If they perform a large share of their activities abroad, this will undermine Dutch GDP and employment. It will also put more pressure on individual Dutch players and may reduce the diversity of the Dutch retail offering. In addition, stakeholders often mention the growing importance of direct-to-consumer models. Consumer product companies like Nike and Nestlé are increasingly reaching out to customers directly to control the end-to-end customer experience, build their brands and collect omnichannel customer data to optimize their propositions.

In short, the sector is facing strong headwinds. To understand what is at stake and calibrate the need for action, we have quantified what could happen if the sector does not adequately respond to changes in the industry.

Dutch retail employment could fall by about 10-25%, affecting mostly young and blue-collar workers

Of the highlighted trends, two will impact Dutch retail employment most: automation and the growth of foreign online players. Technology has changed the nature of work and raised productivity for decades, and it will continue to do so. A large share of routine production work is already automated, with information processing and routine transactions in stores close behind. Due to advances in robotics and machine learning, more complex activities requiring judgment and experience will become automatable in the next few years. In addition, the share of foreign players in the Dutch online retail market has increased rapidly and is expected to further grow. Some foreign players enjoy larger scale and easier access to talent and capital than Dutch players, making them tough competitors.

As a result of these two trends, up to about 10-25% of retail employment, or about 55,000-130,000 full-time jobs, will be at risk, including 50,000-85,000 due to automation and 5,000-45,000 due to a shift to foreign online players (Exhibit 17). These figures are estimates informed by McKinsey Global Institute research¹⁸ and expert judgments, supplemented by a number of assumptions. They are therefore only indicative, but they do show the urgency to act and to prepare for a transition. Specific assumptions include:

- An average of 30-35% of retail activities are at risk of automation. The automation potential is high for activities in warehouses (around 70%) and lower in headquarters (25-35%) and in stores (25%).
- Only 30-50% of the full automation potential will materialize by 2025. Automation of certain activities is already possible, but the business case is not profitable yet. Few companies will be able to make the required investments quickly; many will have to wait until the prices for new technologies become more affordable.
- Foreign online players represented 14% of total online spend in 2015, and we assume that their share will increase to 20-40% by 2025 (4-11% annual growth). When turnover shifts from a Dutch online player to a foreign online player, the Dutch labor required could be 50-90% lower since only limited parts of the value chain remain in the Netherlands (Exhibit 18).
- Depending on the efficiency, automation and scale of online activities, online sales could either be more or less labor-intensive than offline sales. We therefore assume that offline and online Dutch players require about the same labor.

Blue-collar jobs are at higher risk than white-collar jobs; most of the jobs that can be automated require relatively low levels of education, while most jobs created by automation, such as designing, building and maintaining machines, require complex skills. Given that 41% of all workers in retail are younger than 25, this age group will be particularly impacted.

18 McKinsey Global Institute (2015), "The impact of Automation on the Future of Enterprise and Nature of Work," estimates that 55% of FTE-weighted activities in grocery can be automated using currently available technology. Including non-food and adjusting for the fact that not all technologies will have a profitable business case, we use a lower estimate of the automation potential in the industry.

EXHIBIT 17

Automation and shifts to online foreign retailers put 55,000-130,000 full-time retail jobs at risk

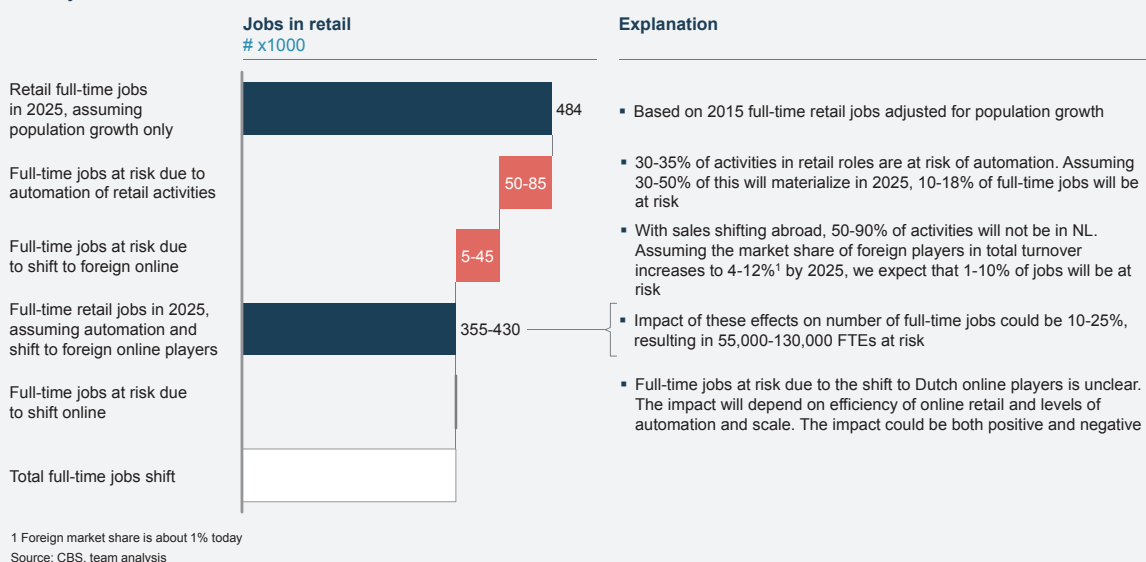
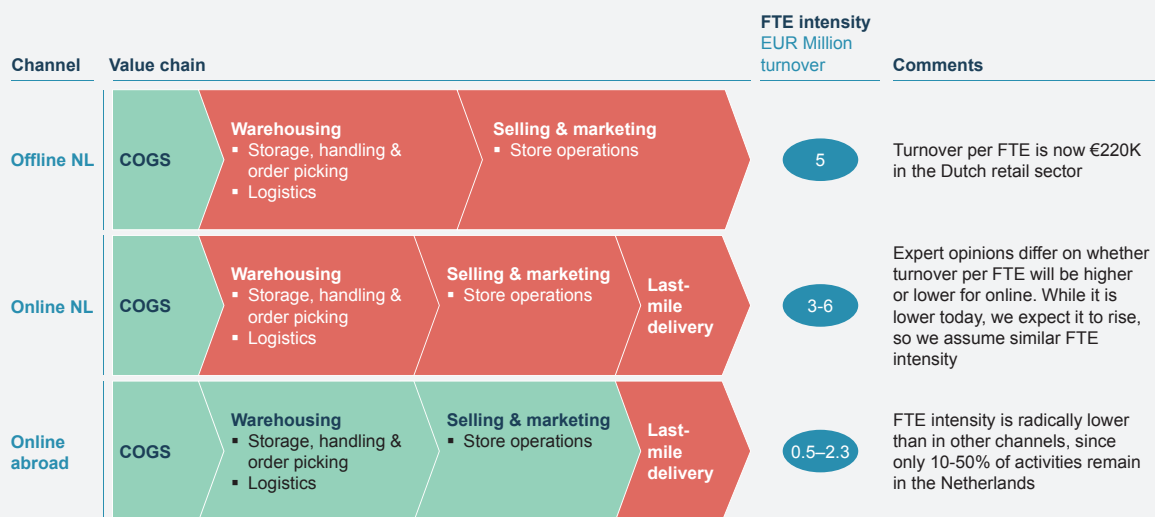


EXHIBIT 18

As shoppers move online and switch to foreign online players, less need for Dutch labour remains



Dutch retail sector's contribution to GDP could drop by 0.3-1 percentage points as foreign online players expand and levels of automation increase

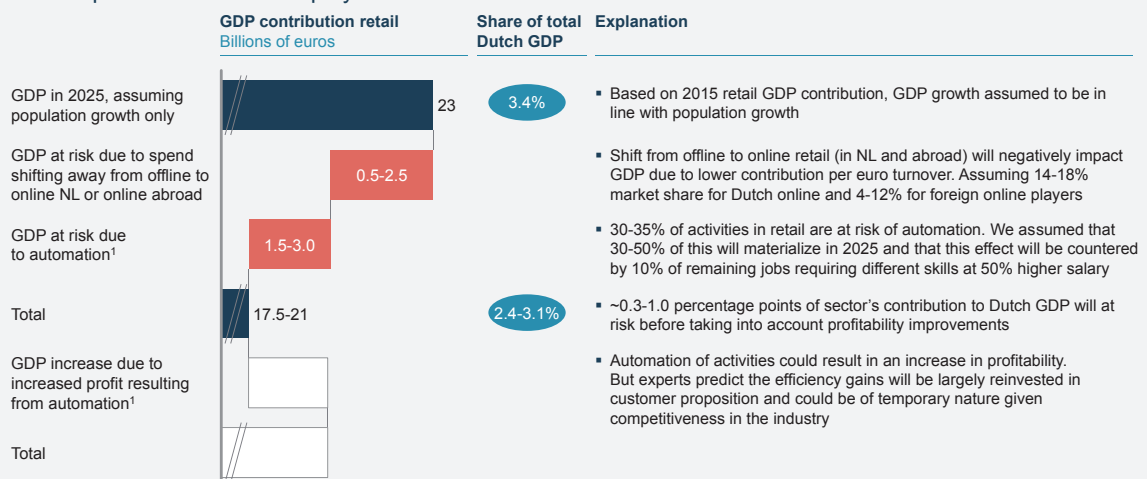
Automation and growth of foreign online players will not only put retail jobs at risk but also the sector's contribution to Dutch GDP. Depending on future operating models, the growth of foreign online players could shift a substantial part of the activities in the retail value chain to other countries. In a worst-case scenario, only the last-mile delivery will stay in the Netherlands, significantly lowering the contribution to GDP. While automation may have a positive impact on the Dutch economy, by raising productivity and the contribution of other sectors to Dutch GDP, the direct contributions of the retail sector are likely to decrease for two reasons. First, automation will result in fewer retail jobs and thus lower GDP contribution through salaries. Second, we expect that retailers will pass on (part of) the automation benefits to customers in the form of lower prices to keep up with the fierce competition. In the past few years, lower prices have not stimulated volume growth – so the consumer benefit is unlikely to translate into higher turnover. As a result, Dutch retail contribution to GDP could drop by 0.3-1 percentage points (Exhibit 19). As before, these numbers are indicative and based on the same assumptions used for the impact on employment. We made three other assumptions:

- The added value of offline sales is around 22% of turnover. For online sales by Dutch players this is 18%, while for foreign online players this is only about 2-9% of turnover (Exhibit 20). If only the last-mile delivery of online sales of foreign players stays in the Netherlands, the direct impact of a euro turnover online will decrease from 18 to 2 cents. If some warehousing and service support remain in the Netherlands, the estimated decrease is from 18 to 9 cents per euro turnover.
- We expect automation to put a total of 50,000-85,000 FTEs at risk, that 10% of the remaining jobs will require more skill, and that the corresponding salaries will be 50% higher than before.
- All productivity benefits will be passed through to end consumers with no volume increase.

(Since we have not assessed the impact of the growth of the automation sector on Dutch GDP or the effects of automation on other sectors, we did not assess the total GDP impact.)

EXHIBIT 19

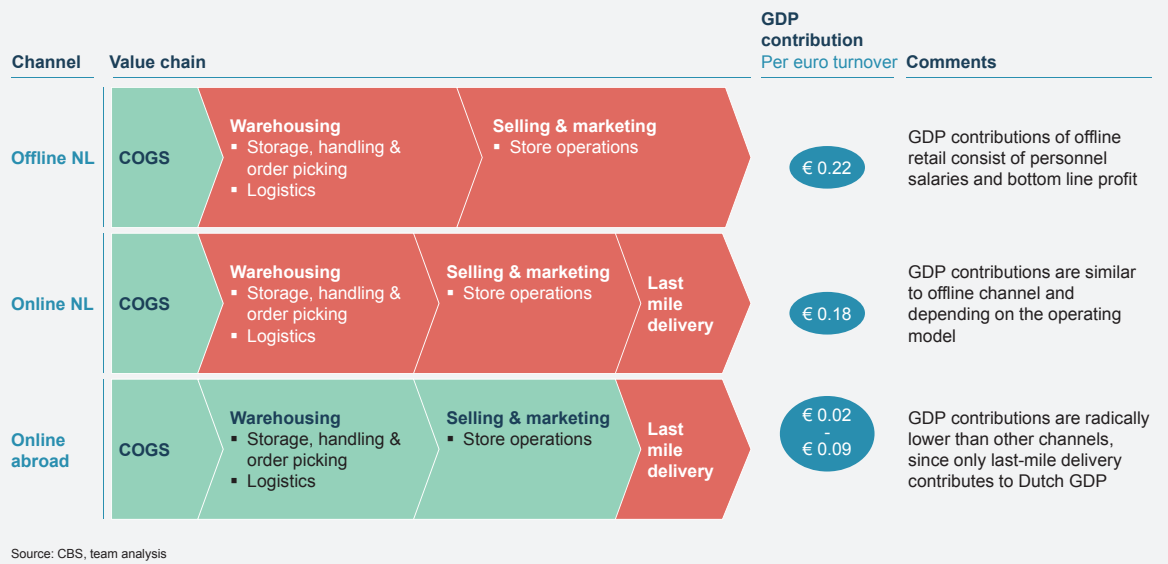
~0.3-1 percentage point of sector's GDP contribution is at risk, driven primarily by consumption shifts to online players from outside the Netherlands



¹ Assumed investments in automation will flow to foreign countries
Source: CBS, team analysis

EXHIBIT 20

Foreign online retail sales contribute less to Dutch retail GDP than Dutch retailers' sales



Attractiveness of offline shopping areas could erode due to slow market adjustments in floor space

Empty storefronts make shopping areas less attractive, as noted in chapter 2. As floor productivity has declined since 2009, we expect new vacancies to arise and further erode the shopping experience. A return to 2009 productivity levels¹⁹ would require reducing retail floor space by 20-35%, or 7-9 million square meters, by 2025. This estimate is based on three elements: current vacant retail space (structural vacancy is 6-8%)²⁰, planned additional capacity (6%)²¹ and the continuing shift from offline to online (13-21%) (Exhibit 21). This estimate is in line with the Retail Agenda – an initiative of the Minister of Economic Affairs and sector stakeholders – which refers to 30% overcapacity in the market. While demand for offline shopping could increase, it seems unlikely that this would compensate the expected future overcapacity. The impact on vacancy rates and the erosion of shopping areas is already dramatic at the national level, but regional shifts can be even stronger given demographic developments in Randstad versus rural areas (Exhibit 22).

19 To proxy productivity levels before relevant levels of online sales, we looked at historical productivity. Due to a lack of available data for the years before, we use 2009 productivity levels

20 Healthy friction vacancy lies between 2% and 4% to allow for a dynamic market; the remaining vacancy is structural (Detailhandel Nederland, 2014)

21 According to Vastgoedmarkt (2014), developers are planning to expand capacity by 5.8% in the coming years

EXHIBIT 21

Retail space needs to be reduced by 20-35 percent by 2025 to sustain 2009 floor productivity levels

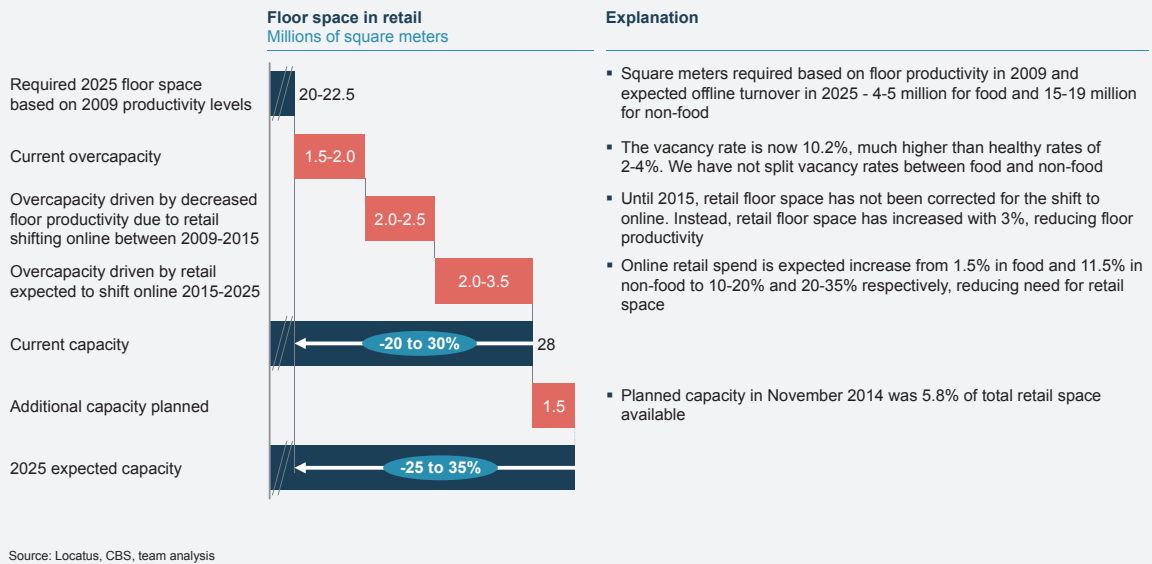
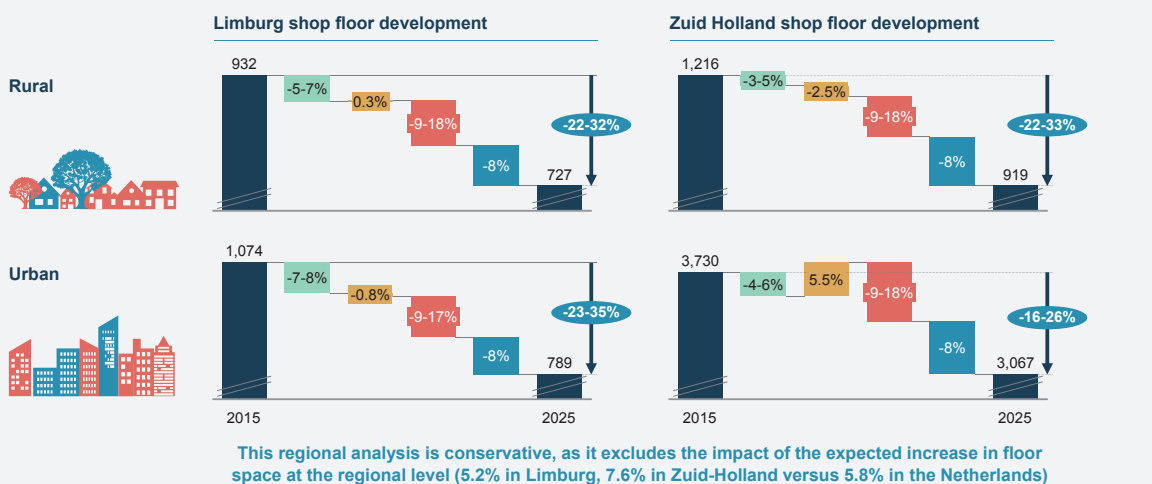


EXHIBIT 22

Conservative estimate shows anticipated impact for urban areas is less than for more rural areas

Thousands of square meters



While the required net reduction in retail space is a widely recognized phenomenon, some new retail locations are being considered despite high vacancy rates in neighboring shopping areas. These situations do not happen in isolation. In the past five years, about a million²² more square meters of retail space have been added to the market than withdrawn. Between April 2015 and April 2016 – for the first time in at least ten years – retail floor space declined by a net of 73,000 square meters. This is an important first step, but to solve overcapacity by 2025 the market needs to reduce retail floor space ten times faster.

22 Locatus, adjustments made by planbureau voor de leefomgeving (PBL)

The diversity of retailers could further fall, as scale is becoming increasingly important to invest in improving the omnichannel customer value propositions

Dutch retailers are facing a double squeeze: increased transparency amplifies the need to deliver unique value to consumers and the technological advances needed to keep up with their expectations require capital investments and scale.

Increased transparency provided by technology has amplified the need to offer unique value propositions to shoppers. With one mouse click, they can evaluate retailers on price, assortment, service, customer experience and convenience. As a result, they have become more demanding, less loyal to brands and retailers, and have fragmented their shopping, requiring retailers to continuously improve their value propositions and differentiate themselves from competitors.

Technological advancements provide great opportunities to improve the value proposition at competitive prices. In a customer-centric environment, retailers who are better in leveraging consumer data, creating an omnichannel presence, capturing technology-enabled efficiency gains and attracting talent will be better able to add value to the consumer. However, capturing these opportunities requires investments (e.g. in warehousing and logistics, IT databases and infrastructure) and people with skills to use these new technologies. Such investments are often difficult for small players. Small players could try to tap into scale, skill and expertise of other companies through effective outsourcing and partnering. Unless they find ways to tap into third parties' services, technologies and skills, Dutch retail might lose its diversity as smaller retailers fall further behind.

In short, trends in the marketplace open a world of opportunities. But if the retail sector and other stakeholders take no action, about 55,000-130,000 jobs and 0.3-1 percentage points of the sector's contribution to GDP will be at risk. Retailing's social role could erode and the character of the nation's inner cities and villages will change profoundly. The market could continue to consolidate which would further erode the diversity in the physical store network.

The Dutch retail sector has the opportunity to mitigate this risk and create a brighter future by building on its inherent strengths. The next chapter explores what retailers and other relevant stakeholders could do to achieve this.



Chapter 4

A new future for the Dutch
retail sector



A new future for the Dutch retail sector

Chapters 2 and 3 describe the challenges and opportunities in Dutch retail. Without concerted action by the industry, real estate investors and the government, we expect the offline shopping experience to further deteriorate, foreign online companies to win more share and profitability to continue to erode.

If individual and collective action is taken by the sector and other relevant stakeholders, we envision an alternative scenario where sector stakeholders will accelerate the required restructuring and invest in capturing growth through three levers:

- **Increasing spend per capita.** Spur shopper spending by providing more customer value through innovation, differentiation and an improved omnichannel shopping experience.
- **Outperforming foreign online players.** Dutch marketplaces, platforms and retailers could gain share from foreign players by using their local strengths to optimize their offers, improve omnichannel fulfilment and leverage technology applications.
- **Capturing spend of foreign consumers.** The sector could attract more foreign consumer spend, by creating a cross-border online platform for exports and by promoting the Netherlands as a great shopping destination.

By focusing on these three dimensions in parallel, the sector could at least mitigate the value at stake. This chapter will first outline actions required to accelerate the restructuring, followed by opportunities to capture profitable growth, building on existing Retail Agenda initiatives.

Accelerate the restructuring of the sector

The sector will need to be restructured as future shopping behaviors will require less retail store space and an adjusted work force. The current pace of restructuring is insufficient due to structural barriers in real estate, limited flexibility of labor laws and insufficient action by individual retailers. As a result, retail space reduction²³ is at around 10% of the required annual level and retailers are delaying required adjustments in their work forces.

Remove structural barriers in retail real estate

Slow rezoning of retail space and adverse incentives driving additions hinder a net reduction in retail space, requiring authorities and the sector to act in two areas:

- **Stimulate rezoning of retail space.** According to the stakeholders we interviewed, rezoning is slow amongst others due to adverse tax effects and lengthy and uncertain administrative rezoning processes. The government could investigate options to 1) reduce the negative tax consequences of rezoning

²³ Retail space reduction refers to floor space that was previously destined for retail purposes that is either taken out of the real estate market or rezoned to another purpose

commercial real estate to other uses, 2) speed up the municipal process of rezoning. With these structural barriers removed, real estate owners and retailers need to address the remaining hurdles.

- **Address adverse incentives that drive net additions**, especially in regions with high vacancy levels. Municipalities have financial incentives to attract new shopping areas. Although individual cases of expansion of retail space could be valuable for consumers, they aggravate the problem if not counterbalanced. Municipalities could consider to follow the example of the office market, where some municipalities allow new development only when the same real estate players make equivalent withdrawals to prevent net additions.

In case of limited and slow market response or unintended effects on spatial planning (e.g., too scattered retail landscape or loss of accessibility), the national government could consider taking on a coordinating role on top of the existing coordination at the level of provinces and municipalities. For example, in line with the Retail Agenda, the national government could align municipalities and other stakeholders on where to maintain, grow and slim down retail space. The current initiatives could be strengthened by using geospatial modeling to inform optimization in combination with more rigorous “performance management” – ensuring clear and time-bound targets for all stakeholders. In addition, the sector could use solutions such as re-allotment – as observed in the greenhouse industry²⁴ – to stimulate concentration of retail. In such joint action, the sector would need to focus on clustering retail space that will be re-allocated to another purpose and retail space that will be maintained to ensure stronger remaining shopping centers.

24 For instance, the province of Gelderland stimulates concentration of remaining areas in the greenhouse industry by facilitating re-allotment and movement to new locations

Dutch Retail Agenda engages stakeholders to make sector future-proof

The Retail Agenda is an agreement among the major stakeholders in Dutch retail (retail sector organizations, real estate owners, the national government, local governments and labor unions). In March 2015, these organizations committed themselves to a three-year program that prepares Dutch retail for big changes in the coming years. Important topics are reducing floor space overcapacity, promoting regulations that enable new retail concepts, building an international level playing field and a knowledge platform to increase exports, providing SMEs with more access to capital, and making collective efforts to develop new competencies in retail.

A national committee is monitoring progress and a Retail Team is providing local support to execute these initiatives. Intermediate results presented in May 2016 show that progress has been made in a number of areas. Representatives of the retail and real estate sectors have agreed to improve the dynamics of the rental market. Local pilots to ease regulations are showing positive intermediate results. Municipalities are engaging local stakeholders in discussions about promising and unpromising shopping areas and coordinating plans for action with neighboring municipalities. However, given that in real estate only 10% of retail space was reduced from April 2015 to April 2016, we believe these initiatives could and should be accelerated.

Make labor market more flexible

Existing retailers need to quickly adapt their physical footprints and organizational models to changing consumer needs and outperform new (online) competitors. Interviewees point out three barriers to achieving this: 1) According to research done by Erasmus University²⁵, the Dutch law “Wet Werk en Zekerheid” has made it more difficult to shrink the labor force and reduce labor costs; 2) The planned 10-40% staged increases of minimum youth wages starting in 2017 is expected to increase labor costs despite planned subsidies, as many Dutch retailers rely heavily on younger workers; 3) Collective labor agreements (CAO) disproportionally affect incumbents with physical store networks, as some online competitors register parts of their organization (e.g., logistics) as “non-retail,” which allows them to pay lower wages. To keep pace in a changing world, interviewed Dutch retailers mentioned they would benefit from more flexible and comparable labor laws, more flexible CAOs and a careful assessment of the long-term effects of changes in minimum wages.

Step up individual portfolio optimization and labor adjustments

While the online channel will continue to grow, we expect that most shoppers will still want to visit physical stores. To adapt to changing market circumstances, retailers will need to rethink the role of the physical store. In non-food, we see that retailers start to use smaller stores as “showrooms” where customers can try products and get personalized advice (e.g., Coolblue). Furthermore, department stores like UK-based John Lewis are also creating a stronger sensory experience in store by using visualization and 3D printing to help customers choose furniture. Most retailers will need to adjust their store portfolio and staffing levels, requiring a network optimization effort to determine where to keep, close and reallocate stores.

Invest to capture profitable growth

To grow, the sector needs to accelerate innovation and differentiation. This will require individual retailers, online market places, real estate and government to take action and enrich and accelerate the Retail Agenda initiatives.

Individual retailers will need to step up their innovation, differentiation and efficiency

Individual retailers will need to step up their game to improve their omnichannel customer value propositions, adapt their value chain and make their organizations more agile:

- **Improve the customer value proposition.** As transparency rises, there is an increasing need to differentiate in terms of pricing, assortment, experience, service and convenience. Despite lagging growth in the sector as a whole, retailers who provide unique value in the eyes of the customer are still growing. Some potential success stories include value players (Action), premium organic retailers (Ekoplaza), unique shopping experiences (Apple and Asics’ “foot ID”), superior food inspiration and quality (Marqt), additional services (Meneer Paprika, Primera), subscription models (HelloFresh, Boldking) and direct to consumer models (Nespresso). Winning retailers understand that customer journeys differ per shopper and shift over online and offline channels. Winners also know that to innovate in products, services and experiences they need to seek inspiration from other sectors and foreign players. Winners of today will only be winners of tomorrow if they continue to adjust – which is not a given, even for the examples outlined above.
- **Improve efficiency along the value chain through effective partnering and outsourcing.** Companies must meet rising consumer expectations and offer consumers what they want, when,

25 Erasmus University et al. (2016), VAAN-VvA Evaluatieonderzoek WWZ 2016

where and how they want it – and still make a profit. In online, being visible on search engines, marketplaces and comparison sites (in the Netherlands and abroad) is crucial, since ~80% of online shoppers start their searches there. Furthermore, shoppers care about a trustworthy payment method (83% think this is important or decisive), a large offering (76%), low delivery costs (76%) and short delivery time (76%). To both meet these demands and make money is not straightforward. Many companies will need to outsource or partner for elements of the value chain that are not core to their business, such as attracting traffic through digital marketing, developing unique customer insights and personalizing offers through big data analytics, creating efficient warehousing solutions or delivery logistics and returns-handling solutions.

- **Increase agility of the organization.** The winners of the future will rapidly respond to, or even drive, changing consumer needs. This will require dynamic capabilities and operating models that can be adapted quickly and a stable backbone of core processes, governance and structures. To create a dynamic innovation capability, retailers will need to rely on superior customer insights (e.g., Mercadona co-creates private label products with suppliers and customers), iterative processes to quickly pilot and improve before scale-up (e.g., Inditex's Zara uses pilot stores) and/or personalization at scale (e.g., Amazon constantly tests different personal offers and versions of their website). Retailers will also need to rethink what capabilities are required to win in an omnichannel world (e.g., digital marketing, data science and advanced analytics skills). To ensure a stable backbone, retailers will need to standardize and optimize core processes, provide full transparency on performance and create a strong culture and governance structure.

Dutch online marketplaces will need to tap into local strengths

Foreign online marketplaces and e-commerce platforms are growing rapidly and winning share. Many of these foreign players have attained a larger scale than Dutch players. To compete, Dutch online marketplaces and e-commerce platforms will need to leverage their local strengths:

- **Expand offering with locally relevant products and services:** Offering the most relevant and comprehensive assortment, lowers shoppers' incentive to switch to other marketplaces or e-commerce platforms. For instance, major Chinese internet players such as Alibaba Group, Tencent and Baidu have created ecosystems that attempt to serve every consumption need. Their e-commerce websites' offering includes taxi services, instant messaging, online games, at home cleaning and beauty care services and auction platforms among others. Similarly, Dutch players could leverage their deep understanding of the Dutch consumer to improve their offerings and partner with relevant local brands, service providers and store owners to complement their offerings.
- **Exploit proximity to customers in omnichannel fulfilment using innovative online to offline business models:** By combining the benefits of a well-developed online platform or ecosystem and a dense store network, Dutch retailers could work together to create a unique omnichannel experience. Dutch players across retail and transportation industries could together offer the most efficient and flexible end-to-end supply chain, using a combination of their fleet, warehousing and retailers' physical store space. By integrating offline stock in stores and logistics services of partners, they could offer faster, more convenient delivery or better accessibility to products and services. An example could be Chinese e-commerce player JD.com, which offers 2 hour delivery of products and services from nearby merchants, convenience stores and restaurants.
- **Leverage technology to improve the shopping experience:** Online retailers, market places

and platforms could make use of the fast adoption curve of the Dutch consumer to pilot new retail technology applications. Examples of these applications in other sectors or countries include artificial intelligence chatbots, 3D avatars to test clothing and makeup, “Siri-like” voice ordering and automatic ordering solutions like the “Tide button”.

Real estate owners and retailers will jointly need to create more attractive shopping areas

To induce customers to shop for fun, shopping areas will need to invest in differentiating experiences.²⁶ Consumers’ expectations are different for nearby shopping areas than for shopping areas further away:

- **To attract local shoppers, retailers need to “get the essentials right”.** For most consumers, “hygiene factors” like ease of navigation, accessibility and distance, personnel in shops, cleanliness and maintenance, enough diversity in stores and easy parking are very important. The city of Veenendaal outperforms on these hygiene factors and delights shoppers by offering free parking on Saturdays and an easily navigable website. Consumers call it the best shopping area in the Gelderland province.²⁷
- **To tempt shoppers to travel further, retailers need to also excel in composition and experience.** Shoppers have greater expectations for composition and experience for shopping areas that are further away. Focus group participants said that when visiting shopping areas in cities, they search for areas with a unique identity that hosts large range of chains, independent stores and hospitality options. A good example is the “Negen Straatjes district” in Amsterdam. Its mix of small retailers, chains and many bars and restaurants in the midst of canals and 17th-century houses offers a great atmosphere for social shopping. In Bad Münstereifel, the historic city center has been changed into a permanent “outlet shopping street.” The combination of strolling through a romantic city and discount shopping is a unique experience that attracts shoppers from across the Dutch-German border. Another good example is Maastricht, which ranked first in the Retail Gemeente Atlas 2016. The city offers a comprehensive mix of different purposes, including culture, entertainment, hospitality and personal health and beauty services, creating multiple reasons to visit. It attracts shoppers from the whole of the Netherlands and abroad. Shoppers cited Gelderlandplein as a shopping center that goes beyond essentials and composition. It enhances shoppers’ experience through seasonal festivities (e.g., for Halloween), kidsdays and attractions like an ice-skating rink – giving shoppers reasons to come back to discover new things. Stadshart Amstelveen also goes the extra mile by organizing special events (e.g., for Sinterklaas) and offering an omnichannel experience with a mobile application through which consumers can find stores, friends and can get personalized offerings.

Uncertainty, dispersed ownership and misaligned incentives currently hinder investments in several shopping areas. To overcome these hurdles, real estate owners and retailers need to work together in two ways. First, they should align on the future purpose of a particular area to increase certainty. We have observed this in the Leidse Regio, where stakeholders have identified promising and unpromising shopping areas. Second, they could facilitate investment by creating rent agreements that align incentives for growth i.e., with rents tied to store performance or shopping area traffic, rather than long-term fixed contracts. They could also consider creating an “investment zone” (Bedrijfsinvesteringszones or BIZ) to align financial incentives, and implement professional management to centralize decision-making.

26 CBRE “How customers shop 2014”; including Austria, Belgium, France, Germany, UK, Greece, Hungary, Netherlands, Poland, Russia, Switzerland, Sweden, Norway, Denmark, Czech Republic, Turkey, Spain, Romania, Italy, Ireland; 2016 McKinsey Survey and focus groups

27 Retail Gemeente Atlas (2016)

The sector could work together to promote Dutch retail products and services abroad

The sector could join forces to create a buzz around Dutch retail products and services among foreign consumers. This could be done by drawing shoppers to Dutch offerings on foreign online platforms and by promoting the Netherlands as an international shopping destination.

- **Draw shoppers to Dutch offerings on foreign online platforms.** Danish cooperation between the postal service company PostNord and Alibaba's shopping portal Tmall Global has helped to promote Danish retailers' offerings in China. PostNord started a Nordic platform on the shopping portal, making it easier and cheaper for Danish online retailers to sell to Chinese consumers. The government facilitated workshops for Danish companies to help them tap into these export opportunities. We believe a similar effort could accelerate Dutch retail export and promote Dutch brands. The idea of a cross-border pipeline is not new and inspiration for implementation can be drawn from existing initiatives, such as the Shopping 2020 recommendations made in 2014.
- **Promote the Netherlands as an international shopping destination.** Between 2009 and 2015 the number of tourists visiting the Netherlands increased from 10 to 15 million, presenting another opportunity for Dutch retail to attract more customers to offline stores. Dubai could serve as an inspiration, as it has created a vision on how to optimize the omnichannel customer journey for tourists across the tourism, hospitality, entertainment, healthcare and retail sectors. The Dubai Mall attracts many visitors, for example, with its enormous array of shops, restaurants and brands supplemented by attractions like an aquarium and a theme park. While the Netherlands has no city like Dubai, we believe that Dutch retailers could work more systematically with leaders in tourism and other industries to attract and direct more foreign consumers towards shopping areas. A good example of a shopping area that is working with tourist organizations to attract tourists is Outlet Roermond, which is a popular destination among Asian tourists.

The Dutch government could work with the retail sector to create a more enabling environment for growth

Entrepreneurship, innovation and competitiveness of individual companies are at the heart of a healthy future for Dutch retail – and elements that the Dutch government can promote. Some of the required government actions are already part of the Retail Agenda. We reiterate three of them:

- **Level the international playing field.** In coordination with other EU member states and retailers, the Dutch government should investigate how to level the playing field for Dutch and foreign retailers. Interviewees mentioned for example, that non EU orders below a certain basket size benefit from VAT exemptions. Furthermore they indicated that the Netherlands often implements new EU legislation faster than other member countries. To keep adjustments to new EU legislation (e.g., sustainability, packaging, labeling) manageable for individual retailers, in particular for SMEs, the government could align speed and timing of implementation more with other member countries.
- **Adjust and simplify local regulations.** Many local regulations were adopted before online shopping existed. With the introduction of 24/7 shopping behavior, local legislators and regulators should investigate which rules, such as opening and closing times, are no longer in line with today's reality. The same holds true for regulations that favor some channels over others, e.g., constraining non-food retailers' ability to improve the in-store experience with snacks and drinks. Moreover, many retailers find it difficult to master the patchwork of different rules and policies across municipalities.

- **Investigate options to improve access to funding.** Since 2014, the rate of successful funding applications for Dutch SMEs has been on the rise again, although it still trails the European average. Furthermore, alternative financing sources have seen stronger growth. Despite these developments, many retail SME owners and representatives told us that they find it difficult to get access to financing. Some heard in their applications that access to financing was constrained based on industry performance, not on the basis of their business plan or historic track records. It is worthwhile to investigate what drives this and what can be done to help SMEs get access to funding based on the merits of their plans and track records. One option could be to standardize information about SMEs' financials in a national business register. This would decrease the relatively high costs of risk analysis and make it easier for creditors to finance SMEs. Most neighboring countries have such registers, and research shows that in those countries the chances of getting funding are higher.²⁸

In short, we believe that the sector can “Rewrite retail” to make it more attractive for shoppers and accelerate growth towards 2025. This will require restructuring (real estate, labor market and individual company portfolios) and innovation and differentiation by individual companies, online market places and shopping centers. The government could accelerate restructuring by removing structural barriers and facilitate growth by creating a more enabling environment. It is up to all of these stakeholders to take ownership and drive change.

28 McKinsey (2014), “Het Kleinbedrijf, Grote Motor van Nederland”

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