FOR RETAIL TRANSFORMATION

LOOK TO STRATEGIC PARTNERSHIPS AND M&A

javelin group

Digital Retail by Accenture Strategy

ORGANIC INNOVATION IS NO LONGER ENOUGH FOR RETAILERS

Most store-based retailers are in low- or zero-growth markets, have declining margins and are losing market share. Without significant renewal, many of today's store-based retailers will cease to exist within a decade.

But despite this urgency, most such retailers struggle with strategic innovation. Some strong retailers implicitly recognise the challenge of mastering internally the diverse array of emerging technologies that are driving retail change, and so partner enthusiastically with outside parties. This 'openness' is now an essential element of the retail innovation agenda.

We believe that leading retailers will become even more open in their search for strategic innovation, going beyond partnering to embrace also mergers and acquisitions as a way of driving fundamental and rapid business model change.

This M&A trend is already in evidence, and will accelerate. The volume of such deals will increase significantly in the next few years as retailers recognise that a meaningful strategic shift cannot come internally alone.

A DESPERATE NEED TO INNOVATE *STRATEGICALLY*

The crisis in retail and the market share shift in favour of relatively recent "digital" arrivals has been well-rehearsed elsewhere. This shift is being driven by the seemingly endless innovation and transformation of these digital native retailers like Amazon, Zalando, ASOS, Alibaba, AO.com and hundreds of others.

In its most recent annual report, Amazon stated that 12% of its revenues (or $16bn) were spent on R&D,[1] placing it among the top R&D spenders in the world. It is also by far the most prolific deal-maker of any retailer, hoovering up over 70 businesses since 1998[2] – a figure which dwarfs traditional retailers' M&A. These acquisitions span a broad spectrum across Amazon's value chain and beyond, from ecommerce business (e.g. Souk.com, 2017, or Zappos, 2009) to gaming (Twitch, 2014), to robotics and automation (like KIVA, 2012) to artificial intelligence and analytics (Orbeus, 2015).

Amazon views itself as an "invention and innovation" business, mentioning the words (or their derivations) no fewer than 34 times in its most recent annual report.[1] Over 15 years, Amazon has transformed itself multiple times from an online bookseller to – now – a multiple platform operator covering everything from marketplace management to global cloud-based hosting to logistics and beyond, while many store-based retailers have managed little more than to launch a digital channel in parallel with their store channel in the same timeframe.

Given this relative pace, it is little surprise that Amazon (and its similarly innovative dotcom peers like ASOS and Zalando) are taking market share from a growing list of retailers.

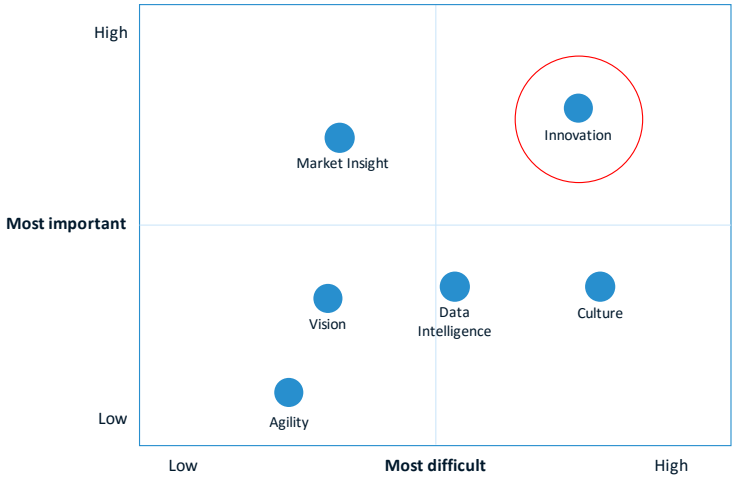
Sebastian James, CEO of the UK's largest electricals and telecommunications retailer Dixons Carphone, articulates this as an innovation challenge, stating that his goal is for his business to be "unrecognizable in five years' time". This, we believe, is an appropriate motto for almost all retail CEOs today.

Our goal is that Dixons Carphone will be unrecognizable in five years' time. And, if you ask me the same question five years from now, I will say that our goal is for Dixons Carphone to be unrecognizable in five years' time. The pace of change led by this technology revolution means that businesses that are not unrecognizable every five years are going to be in trouble.

Sebastian James
CEO of Dixons Carphone

RETAILERS STRUGGLE WITH INNOVATION

An Accenture survey across 135 large retailers shows that store-based retailers consider innovation to be the single most important factor in their transformation – more important even than cultural alignment or agility. But these same retailers also consider innovation to be the single hardest transformation to realise.



Accenture Survey of 135 Retailers, Fall 2016

Rate the following factors according to their importance for your strategic transformation, and their difficulty

The main reason why retailers struggle with innovation is that the kinds of innovation that are transforming – or will soon transform – retail are quite alien to traditional retailers, lying well outside of their core skills. Digital technology, big data, robotics and IoT, for example, are capabilities not found in abundance within legacy retailers. To develop or acquire these skills requires tremendous effort. By contrast, competitors like Amazon and ASOS are natively good at some of these, at least.

We believe this *alienness* gives an important clue about the methods of innovation that are most likely to succeed, for a store-based retailer.

IoT, autonomous vehicles, drones, robotics and AI are predicted to be most transformational for retail… [and] In the future, ecommerce penetration is projected to grow from c.10% today to greater than 40% in 2026.

Shaping the Future of Retail for Consumer Industries, a World Economic Forum project in collaboration with Accenture, January 2017

OPENNESS IS ESSENTIAL

Strategic innovation in propitious, albeit often alien, areas is far more likely to be spawned with a strong degree of outside inspiration and influence.

Most retailers cannot manage innovation at the necessary pace as a solo endeavour, and so they are turning increasingly to "strategic partnering" to deliver new capabilities (e.g. US supermarket chain Sprouts partnering with Amazon for US home delivery,[2] UK supermarket retailer Morrisons partnering with its competitor UK grocery ecommerce firm Ocado in the UK,[3] Dick's Sporting Goods partnering with Uber and Fitbit).[4,5] And as "content" increasingly becomes a channel for direct commerce, we expect to see much more partnering with the controllers of that content such as Facebook, Google, Pinterest, and Amazon.

Sephora is a good example of such openness and has partnered with tech giants like Google and Apple[6] and continues to develop further strategic alliances, for example with Pantone and other suppliers,[7] with whom it provides personalized product recommendations based on the exact tone of your skin or lip colour. Sephora has also partnered for upstream innovation, for example with RangeMe,[8] an online platform that facilitates "new product discovery" between product suppliers and retailers. RangeMe gives Sephora's buyers an efficient way to discover new products and manage the inbound product submission process.

This openness has been a critical part of Sephora's innovation strategy, which has helped to position it as a leader in its sector: between 2010-2017 Sephora's US revenue is estimated to have grown at c.10% per year, far outpacing industry average.[9]

Organizationally, we have to be incredibly external facing and incredibly open to adaptive learning, always actively listening and surveying the external landscape.

Casey Carl, Outgoing Chief Strategy and Innovation Officer at Target Corp

[Our] Innovation Lab team is always scouring the market for new technologies as well as technologies that have been around and may finally be ready for prime time or could be leveraged in a unique way.

Bridget Dolan, VP of Sephora Innovation Lab

FOR STRATEGIC TRANSFORMATION LOOK ALSO TO M&A

The ultimate form of "openness" is M&A, and in this (as shown above) Amazon leads the field. We believe this to be the most under-exploited method of strategic innovation available to retailers. Those retailers who pursue acquisition targets to enable "seismic shifts" in their strategy are more likely to succeed than those who confine themselves to organic development alone.

Dixons' merger with Carphone Warehouse is a case in point, in which the UK's market-leading retailer of large domestic appliances acquired the country's leading mobile phone retailer, to exploit the growing "networked home" opportunity and build a service- and-subscriptions business to complement (and in some cases replace) the increasingly competitive hardware retail business.

UK supermarket retailer Sainsbury's recent acquisition of Argos, and UK home furnishings retailer Dunelm's acquisition of UK dotcom Worldstores, are other recent examples.

Since Walmart's acquisition of Jet.com for more than $3 billion,[10] CEO of Walmart eCommerce US Mark Lore and his team have bought four more digital businesses including Moosejaw[11] (online active outdoor retailer with a large web presence and 10 physical stores) for c.$51m (February 2017) and, most recently, ModCloth[12] (a US online retailer of indie and vintage-inspired women's clothing) for an undisclosed sum estimated at $50-$75m[13] (March 2017). These moves have added online commerce companies to Walmart's stable, each with a unique set of management talent (importantly), customers, market presence and (largely digital) capabilities.

Such mergers are enabling these companies to enter new markets or channels and acquire new skills and a strategic direction they would otherwise have struggled to build organically. These moves are high risk – especially when pursued at the scale of Walmart's acquisition of Jet.com – and therefore must be undertaken only by those with a stable financial platform and with keen judgment as to how the combination will add up to more than the sum of its parts. But this is the spirit and boldness that is now required to address the crisis in retail. For strategic innovation and "big shifts", we believe that judiciously-applied M&A is best placed to deliver the scale of transformation that is now required by many retailers.

Our merger with Carphone allowed us to rewrite the book on large areas of our business. I think it's hard for a successful business to change itself because people have something to lose. It's only when you make big seismic shifts when you acquire or enter new markets, it's only then that you can say well let's rewrite it because we can.

Sebastian James, CEO of Dixons Carphone

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ABOUT JAVELIN GROUP

Javelin Group, part of Accenture Strategy, provides strategy consulting and digital transformation services to the world's leading retailers and consumer brands. Javelin Group helps clients improve their competitiveness by anticipating and responding to the rapid changes in customer shopping habits and retail technologies. In 2015, Javelin Group was acquired by Accenture to spearhead digital retail within Accenture Strategy.

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