Goodbye DIY?

What change processes will the DIY sales channel undergo in future and what opportunities will this provide for manufacturers?

Munich, Germany, November 2012

Preliminary note: The forthcoming changes provide opportunities

- The following dossier summarises important trends and developments in German DIY sales channels and illustrates the impact on DIY suppliers.
- This report is based on around 15 years consulting and project experience as well as various up-to-date sources (see bibliography in the Appendix).
- The majority of the developments that have been identified are megatrends that are slowly but surely advancing.
- The question is therefore not whether, but how manufacturers can react to the challenges to actively expand their market share.
- **Within this context, we want to**
  - Increase awareness of the radical change processes that are currently taking place
  - Prompt individuals to evaluate their chances and risks
  - Initiate a proactive approach to the situation

A snapshot of the press

Change is the only safe option – five theories up front:

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1. **DIY goes online:** The percentage of online sales in the German DIY channel will increase from the current rate of 5% to 20% in 2020.

2. **Every fifth DIY store is facing closure?** A large scale of DIY space is becoming obsolete. Following decades of increasing the floor space, we are now having to face the closure of unprofitable stores for the first time.

3. **Own-brands are booming:** The retail chains can only effectively compete with Internet price comparisons with own-brands. The margin is also significantly higher than that of branded products. The retailers are therefore consistently replacing class B and C brands.

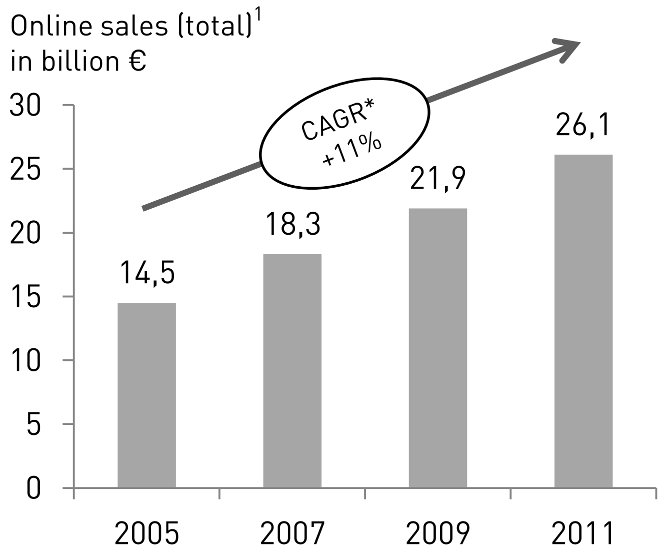
4. **The customer makes the brand:** The brand name is no longer the main compass as it is being replaced by online evaluations and tests. If manufacturers do not change the focus of their marketing campaigns, they will be throwing money away.

5. **Alternative sales channels come out on top:** Manufacturers require a means to combat declining sales in fixed DIY retail units. Whether online or offline, in the retail or direct sales sector, the optimum solution must be determined based on individual company requirements.

➡ The situation for the retailers and manufacturers is expected to change in coming years!

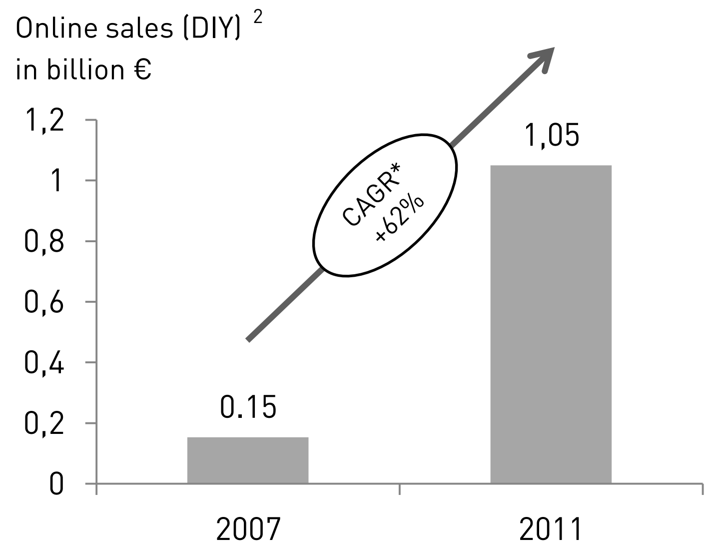
DIY goes online (1/4): DIY stores are jumping on the bandwagon

E-commerce continues to grow



- Sales practically doubled in six years
- A further increase can be expected as young digital natives are of an age (25 to 45 years) when the most purchases are made

The DIY sector has been woken from its slumber

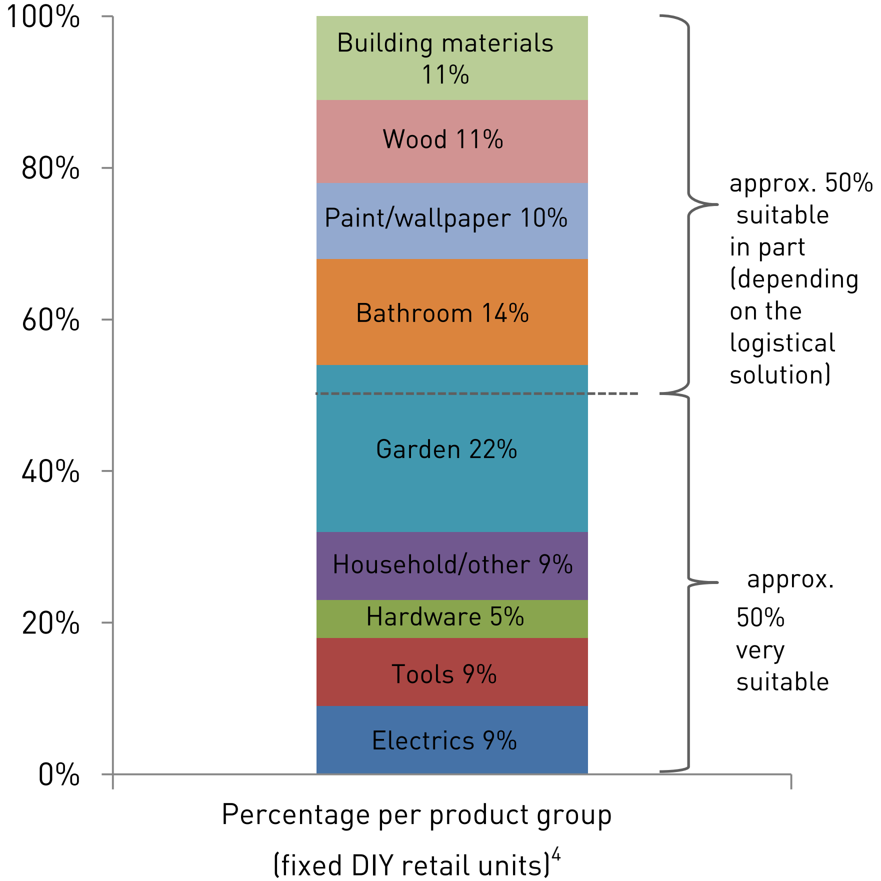


- It was not until 2011 that the leading DIY retailers launched online shops
- Specialised online merchants had already seized the opportunity: Amazon, Westfalia, baumarkt-direkt (the latter already generating sales of € 180 million in 2010/2011) [3]

Footnote index, see page 22

*Compound Annual Growth Rate

Well suited for e-commerce applications:



Explanation

- Large sections of DIY products are suitable for e-commerce applications. The risk of disappointment when buying a drill, for example, is low.
- Companies that only have an online presence (e.g. Amazon) are forcing fixed retail units to expand their online shops. These are currently growing at a rate of ~28%, while online shops for fixed retail stores are only growing by 8%[5].
- Experts are highlighting the additional online potential.

  Peter Wüst, the CEO of BHB, emphasises that there is still a lot of room for improvement, as companies are facing logistical challenges due to the wide range of products.[6]

- When these logistical challenges have been solved, we can expect to see an increase in the percentage of heavy and bulky items that will be available online. It is clear that this convenience will provide consumers with an advantage.

DIY goes online (3/4): The weak shopping experience means that retail stores are vulnerable

Higher degree of satisfaction when buying online than from fixed retail units

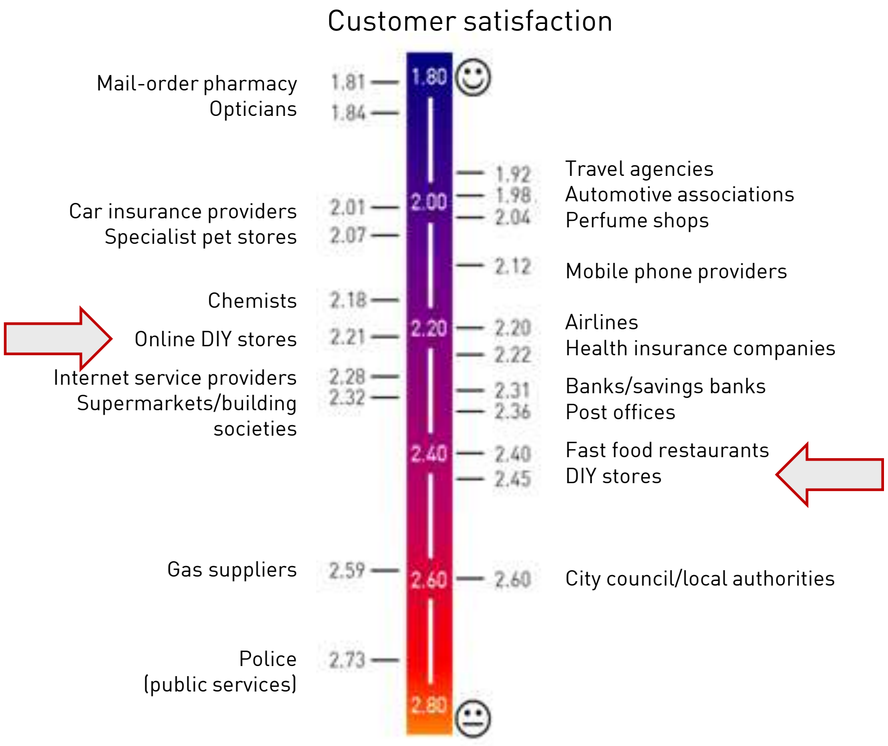


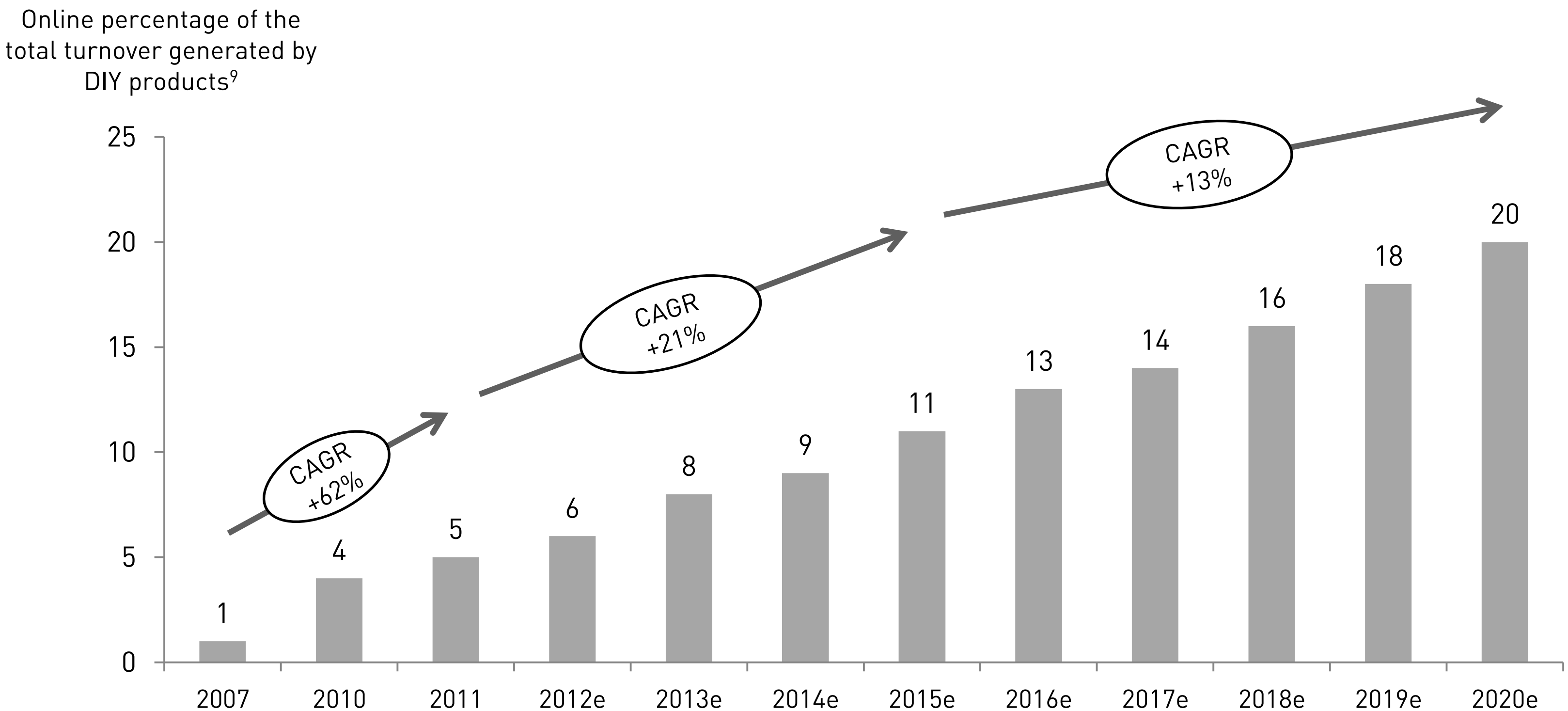
Figure provided by: Servicebarometer AG (2011)

What makes the difference?

- The following is deemed to be particularly unsatisfactory:
  - Availability of service staff
  - Quality of the advice provided
  - Friendliness
  - Price/service ratio
  - Product presentation
- In contrast, good reasons for completing purchases online include[7]:
  - Unlimited availability
  - Simple and easy ordering process
  - Price advantages
  - Home delivery
  - Larger assortment
- Additionally, the online merchants in total provide much more information and a considerably larger range of products.

➡ Please note: 95% of online-shoppers buying DIY products online are satisfied or very satisfied.[8]

DIY goes online (4/4): In 2020, every fifth Euro will be generated from the online business



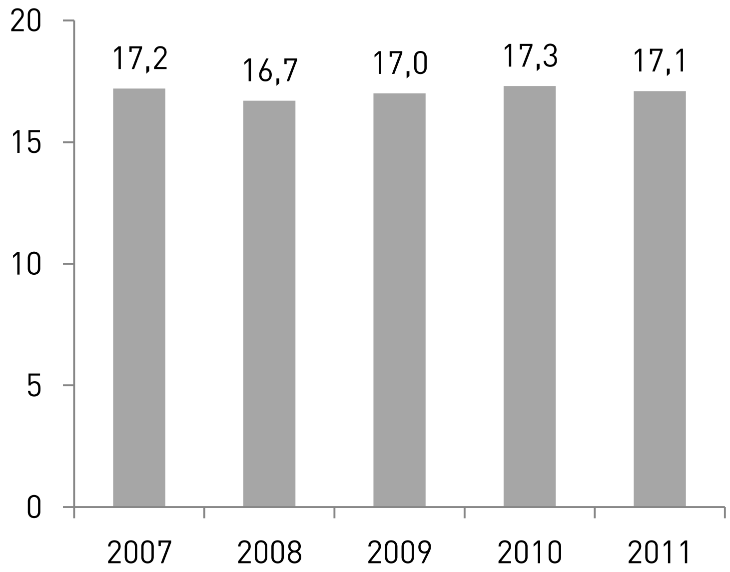
Source: Actuals: GfK Panel Market; Projection by: Suberg Strategy Consultants

➡ Specialist shops for electronics, sport, fashion, and books have already undergone this development stage.

Every fifth DIY store is facing closure? (1/3) DIY sales have stagnated for years

DIY sales trend (inflation-adjusted)

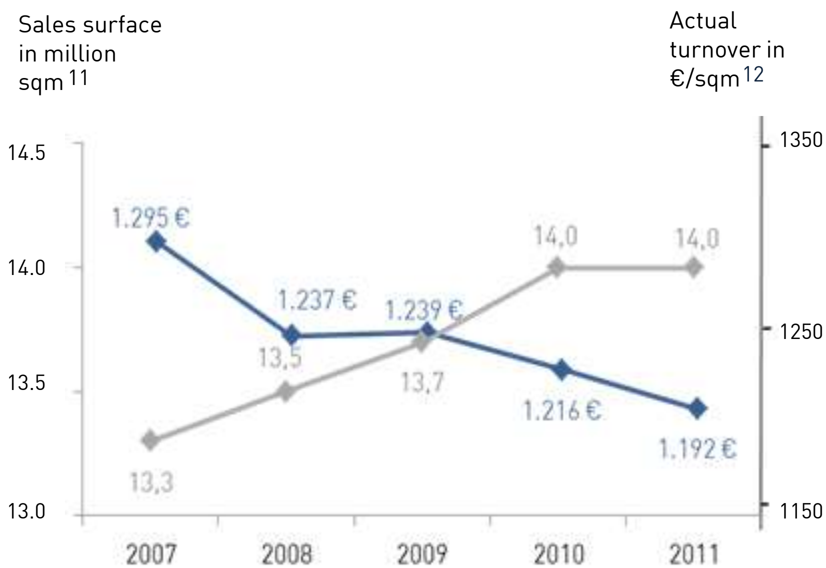
Sales generated by DIY stores[10]
in billion € (inflation-adjusted)



Explanation

- In the past, an important driving force for growth was during the period when traditional specialist shops for hardware, gardening and power tools, etc. were replaced.
- However, these shops are hardly ever replaced nowadays as the remaining specialists have either become more professional or have given up.
- "Good years" only really occur if the weather conditions are favourable as these increase sales in the most important product sector – gardening.
- Are fixed retail units now facing the same fate as specialist traders?

Permanent decrease in productivity in relation to the floor space



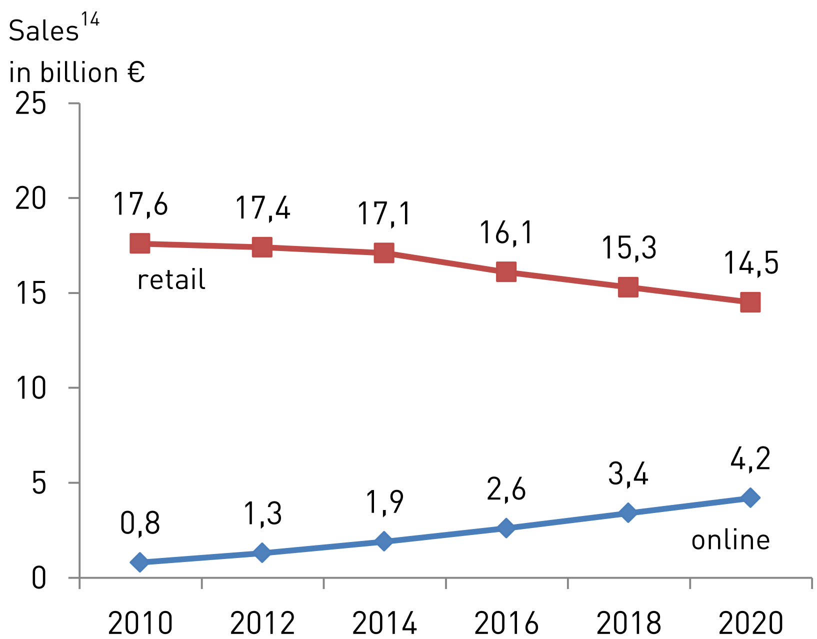
Explanation

- To date, competition was based on floor space and the motto was: Whoever is closer to the customer or has the largest store is the winner.
- Increasing the floor space of the store no longer increases sales – the limits of the growth potential have been reached.
- More floor space means higher costs (material, per-sonnel and operating costs) thus reducing profitability.
- The price war must also be taken into consideration, e.g.: low price guarantees provided by Bauhaus; tagline "Hier spricht der Preis" (The price is key) used by Praktiker, etc.
- In future, the profit generated by DIY stores can be expected to decline further.
- Praktiker (40 candidates for closure[13]) has already been affected by this development

➡ This situation is exacerbated by a significant share of sales migrating to the Internet!

Every fifth DIY store is facing closure? (3/3) Development continues

Projection: DIY sales trend



Explanation

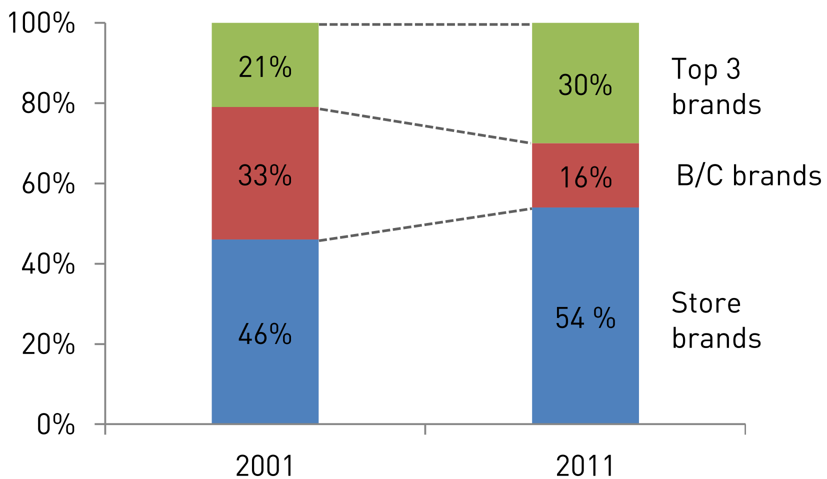
- In the USA, this development has already taken off in all areas of the DIY channel:
  - Sears (retailer with a range of DIY products amongst other things) rents out part of its branch network[15]
  - Fashion chain GAP is giving up 20% of its space[16]
  - Best Buy, the electrical retailer, is closing 50 of its large stores, specifically because sales have migrated towards Internet retailers[17]
- Regardless of this trend, individual DIY chains will open new segments, such as:
  - Professional customer group developing service expertise and thus eliminating specialist traders of power tools
  - Plumbing, heating and air conditioning product group working more closely with the trade, thus replacing specialist traders/wholesalers in the plumbing, heating and air conditioning sector

➡ For manufacturers this means that market shares in their segments will be reallocated.

Own-brands are booming (1/2): B and C brands are experiencing pressure from two sides

Example 1: Paint/varnishes

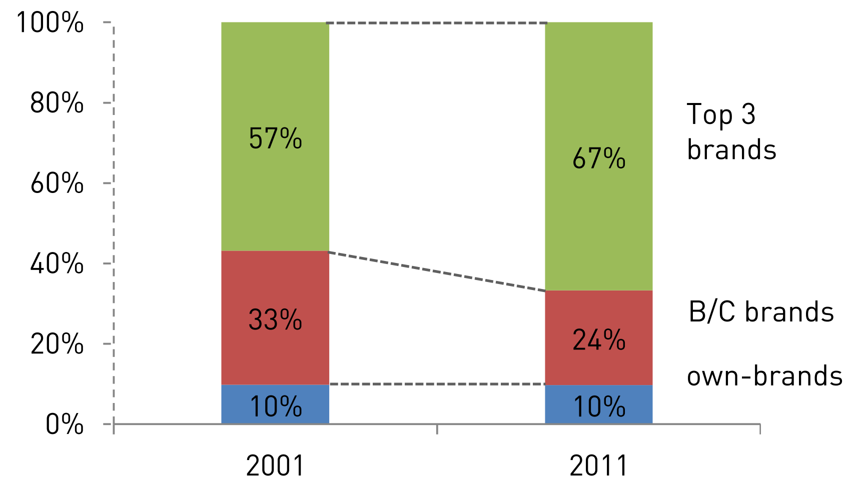
Percentage[18]



- Own-brands already had a very high percentage of the market share and have increased it by about 10%
- The top brands have also increased their market share
- The percentage of B and C brands has been squeezed to half its volume by the top and own-brands

Example 2: Electric tools

Percentage[19]



- Top brands are eliminating B and C brands
- To date, own-brands have been stagnating at a comparably low level
- It is very likely that an initiative for premium own-brands will be developed in coming years

Own-brands are booming (2/2): Retailers do not have another choice

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Why they have to make changes

- In view of continuing price wars, reduced productivity in relation to floor space, and a huge loss of sales due to the Internet, everything seems to suggest that fixed retail units must increase profitability.
- Own-brands are a reasonable solution. In comparison to manufacturer's brands, the margins are significantly higher.
- They make particularly good **differentiation tools**. Thanks to the exclusivity of the products, consumers cannot search for the cheapest price provided by Internet pure players.
- In brief, investing in the establishment of strong own-brands is worthwhile.

What is their plan

- Current objectives of PRAKTIKER, a company that is in need of restructuring: Increase own-brands from 30 to 40(!) per cent[20]
- Similar situation at OBI:

  "The development of the proportion of own-brands and/or increase in the number of private labels included in the OBI/LUX brand must be continued."[21]
- Or HORNBACH:

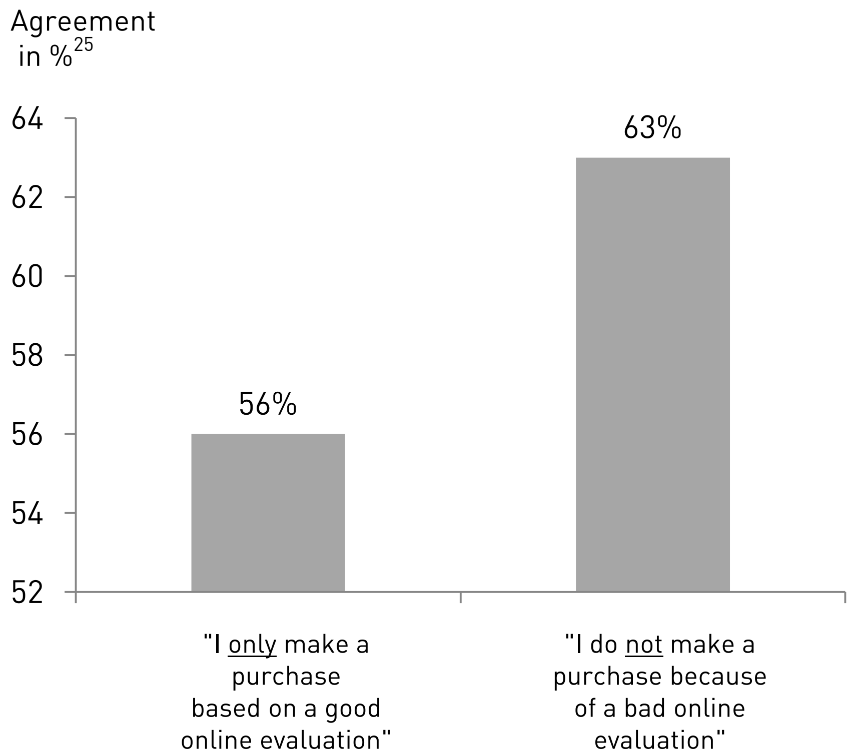
  "We are generating additional earning potential by increasing cooperative development of own-brands [...]"[22]
- Or KINGFISHER:

  *"Own-brands [...] should also be about quality, innovation and exclusivity. [...] To support this, we are investing in a new Kingfisher Innovation Centre [...] to develop a pipeline of products that will be exclusive to us."*23
- Peter Wüst, the CEO of BHB: *"Companies must invest even more in own-brands."*[24]

➡ The struggle for existence between B and C brands has started!

The customer makes the brand (1/1): Brand management is shifting towards consumers

Importance of online evaluations



Explanation

- An increasing number of consumers inform themselves online before a purchase. In addition to evaluations on specialised portals and online shops, consumers particularly trust[26]:
  - Consumer organisations (83%)
  - Product testing organisations (72%)
  - Consumer/business magazines (64%)
- The ease of access to information and evaluations is increasingly replacing the traditional focus provided by the brand. This process applies to B and C brands, although A brands will not be exempt.
- In reality this means that:
  - Traditional marketing is disappearing
  - The presentation of the POS is not as important
  - Purchase-related information that is available online can only be "influenced" in part – this is precisely what is becoming more important!

➡ This shift in the information and buying behaviour must lead to the reorientation of the marketing strategy.

Alternative sales channels come out on top (1/1): Some have already been established, while a lot of others are considering it

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A possible starting point: direct marketing

Example segments	Direct sales (retail stores and online)
Sport/fashion	BOSS, ESPRIT
Electronics	B&O
Domestic appliances	WMF, Miele, PHILIPS
Food/FMCG	NIVEA, Lindt
Toys	märklin, LEGO

Drivers of development

- DIY suppliers can expect the following developments:
  - Less sales through key DIY accounts
  - Growth of the medium-priced own-brands
  - Request for higher discounts
- This specifically means:
  - Decreasing sales
  - Declining margins
  - Tougher competition
- Within this context, it is in the interest of manufacturers to reduce their dependency on the DIY sector
- Regardless of whether this relates to internal, external, online or offline sales, the aim is to have a broad and profitable access to the market and customers. In this case, the appropriate solution can only be determined on an individual basis for each company.

➡ Reduce the dependency on fixed retail units and increase knowledge about the consumer.

Summary: The challenges that manufacturers face can be clearly defined

1. **The capacity of sales representatives must be adjusted:** In the wake of decreasing in-store sales, the effectiveness of this tool is reducing. This is further affected by the increasing central disposition of the market.

2. **The key account management must develop specialist online knowledge:** The core competence of KAMs must be to position their products in commercial online shops otherwise the consumer will increasingly find competitive or own-brands.

3. **The condition systems must be expanded to include online presentation:** In future, the performance-oriented condition systems must take the optimum online positioning of the brand into consideration.

4. **A clearly defined strategy for processing own-brands will be required:** If own-brands experience strong growth, manufacturers will have to keep up or counteract it in a targeted manner.

5. **The marketing tasks must be re-aligned:** The aim is to develop an understanding of customers' changed information behaviour and adjust the marketing output accordingly.

6. **The manufacturer must establish alternative sales channels:** To date this has been avoided to prevent conflicts with DIY retailers, however, market access must now be expanded considerably. Direct sales (online or offline) are providing a lot of manufacturers with great opportunities.

The following key questions are now of particular interest:

1. What are the risks for us?

- How fast will the Internet's market share grow for our product groups?
- What is the risk of top brands being substituted by own-brands in future?
- How dependent are we on the DIY channel?
- What specific scenarios are derived for the sales and EBIT?

2. What options do we have?

- How can we successfully establish alternative sales channels?
- What measures can we implement to increase the efficiency of existing sales?
- What is the best way to adjust our marketing in line with the altered consumer behaviour?
- What potential do we have in future by changing our own brand strategy?

3. How do we implement them successfully?

- What will the approach to solving the problems determined during the second step look like in detail?
- What specific steps are necessary to ensure successful completion?
- What is the best way to include our employees in these changes?

We will be happy to discuss the following points with you:

- To what extent are your company's products and brands going to be affected by the developments described above in coming years?
- What chances and risks arise for your company?
- What basic opportunities are there to increase the efficiency of your company?
- What options are available to your company by establishing or expanding an alternative market access?
- At first glance, what is the online information and buying behaviour like for your products?
- Generally, what customised approach could your company take to make the most of the changes described above?

Conclusion: "Nothing good happens unless you do it!" (Erich Kästner)

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- We must admit that when we selected the title "Goodbye DIY?" we were being a little provocative. This market will still be around in ten years time, although its focus will have changed.

- All of the developments described above are already underway and will progress year by year. As many other sectors have previously illustrated, this development can have huge effects (electronics, fashion, books, toys, etc.).

- In this context, the DIY market will undergo considerable changes on the retail as well as on the manufacturing sides over the coming two to five years.

- A positive outcome is that manufacturers will once again take matters into their own hands. In the context of the forthcoming changes, manufacturers have the opportunity to win market shares by means of a consistent approach.

- With this dossier, we would like to initiate early involvement to take advantage of this opportunity.

Speak to our experts

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Short biography:

- More than 15 years of management and consultancy experience in strategies, marketing and sales
- CEO at Unique of Personalservice GmbH, Munich, Germany (personnel service company with an annual revenue of € 200 million)
- Head of Marketing & Sales (ad interim) at ARRI AG, Munich, Germany (camera/lighting equipment with an annual revenue of € 300 million)
- Head of the Competence Centre Sales & Marketing at Dr. Wieselhuber & Partner Consulting, Munich, Germany

Short biography:

- More than six years management and consultancy experience in marketing, sales and finance
- Commercial Manager (international hotel chain)
- Project Manager of Marketing and Communication (association)
- Interim Managing Director (association)

A selection of references from our customers

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"Finally, consultants who speak the language of their customers!"
Jochen Ziegler, Managing Director of Atrias Personalmanagement GmbH

"People make the difference – this also applies to Mr Suberg and his employees!"

Sabine Forest, Managing Director of Alterim GmbH

"With their interim management for finance, SSC has ensured in a very professional way that we get a clear picture of our financial position in our German operations."
Russell Knight, Group Chief Financial Officer, The Karma Royal Group, Indonesia

➡ Well-known companies trust our experience in the fields of strategies, marketing and sales. When providing advice our main focus is to work jointly with companies to develop and implement growth concepts. We measure our success based on the achievements of the companies we work with.

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Appendix: Footnote index

[1]Quelle: HDE Handelsverband Deutschland (2012)
[2]Quelle: Bvh (2008), Bvh (2012)
[3]Quelle: baumarkt direkt (2011)
[4]Quelle: MediaAnalyzer (2012)

[5]Quelle:Quelle: Axel Springer AG (2011)

[6]Quelle: Lebensmittelzeitung vom 05. März 2012
[7]Quelle: Interone (2011)
[8]Quelle: Servicebarometer AG (2011
[9]Quelle: eigene Berechnungen; GfK Panelmarkt (IST 2007 – IST 2011)
[10]Quelle: Nur Bau- und Heimwerkermärkte & Shops, kein Fachhandel; inkl. Online-Handel, Umsätze inflationsbereinigt (Basis 2007); Quelle: BHB e.V. (2012); Eurostat; eigene Berechnungen
[11]Quelle: Gemaba Baumarktstruktur-Studie (2012) (gewichtete VK-Fläche)
[12]Quelle: BHB, eigene Berechnungen, Umsatz inflationsbereinigt (Basis 2007)
[13]Quelle: Handelsblatt vom 29.03.2012
[14]Quelle: eigene Berechnung; Umsatz ohne Fachhandel; reale Umsätze ohne Inflationseffekte
[15]Quelle: BOOZ & Co. (2011)
[16]Quelle: BOOZ & Co. (2011)
[17]Quelle: Handelsblatt.com vom 30.03.2012
[18]Quelle: GfK, individuelle Auswertung für SSC
[19]Quelle: GfK, individuelle Auswertung für SSC
[20]Quelle: Praktiker AG (2011)

[21]Quelle: Geschäftsbericht Tengelmann Unternehmensgruppe (2010)
[22]Quelle: Geschäftsbericht HORNBACH AG (2010/2011)

[23]Quelle: Kingfisher Plc (2011)

[24]Quelle: Lebensmittelzeitung.net vom 05.03.2012
[25]Quelle: DSAF (2011)
[26]Quelle: GfK/GS1 (2010)

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