RETAIL AT INFLECTION POINT: A NEW AGE OF DIGITAL TRANSFORMATION

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EXECUTIVE SUMMARY

Digital technology has impacted every stage of the retail value chain, and adoption has become more prevalent across businesses of all sizes and channels as technology has become more accessible.

Now, the industry is entering a new phase of more aggressive technological advancement while fighting multiple macroeconomic headwinds, all of which will continue to shape their digital journeys going forward.

To understand how digital transformation can be a differentiator of success for retailers, in good and bad times, Alvarez & Marsal conducted research to measure the impact of their digital sophistication on various financial indicators, including sales growth, profitability and valuation.

The exclusive analysis, based on a range of qualitative and quantitative data points for over 100 listed companies, confirms that businesses that have continually driven digital transformation have reaped the fruits of their investments, achieving substantial financial rewards and competitive advantage over time. Some of our key findings include:

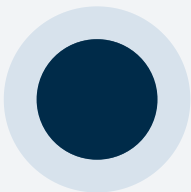
Average sales growth over last 8 years

Digital Leaders	Digital Followers	Digital Latecomers
+4.9%	+2.6%	-0.4%

Increased market share (Digital Leaders)

2014–15
61.4%

2021–22
66.5%



Sales growth (Pure online retailers)

Previous five-year average	2022
29%	4.2%

Collective share price since start of 2021

Pure online retailers	Omnichannel players
↓ 70%	↑ 12%

- Digital Leaders seeing average sales growth of 4.9% over the last eight years, higher than Digital Followers (+2.6%) and Digital Latecomers (-0.4%).
- Digital Leaders have increased their market share from 61.4% (2014–15) to 66.5% (2021–22), and not always at the expense of profit margins.
- As technology and digital adoption has become more widespread, and barriers to e-commerce entry have lowered, the valuation gap between Digital Leaders and Digital Latecomers has narrowed considerably in recent years.
- Pure online retailers are facing greater competition. They saw sales growth of just 4.2% in 2022, considerably lower than the previous five-year average of 29%. Indeed, omnichannel leaders experienced growth of 12.1% in 2022, albeit this is compared with softer figures from the previous year.
- Pure online retailers' collective share price has fallen approximately 70% since the start of 2021, partly due to harsher headwinds faced by these players but also reflecting general negative market sentiment towards the tech growth sector overall. In contrast, omnichannel players have seen their share price rise on average 12% during the same period. Another factor playing out here is the valuation crash of certain groups of players – for example quick-commerce companies – due to intrinsic business model issues and their inability to find a way to profitability.

INTRODUCTION

The shape of retail continues to evolve with digital technology a critical enabler for retail brands. The sector has been deeply impacted by the pandemic, overcoming disruption brought by the rise of e-commerce, shifting consumer behaviour, and supply chains issues among other challenges. More recently, persistent inflation and the worst cost-of-living crisis in a generation have placed additional pressure on sales and profitability.

Our research reveals that businesses that have continually driven digital transformation have largely outperformed their peers, including during the tough business environment of the last few years. They have achieved greater efficiencies and stronger sales growth, resulting in increased market share, profitability and strengthened business models.

This advantage has been particularly strong for those players that invested in an omnichannel digital strategy, rather than a pure player one, especially given the rebalancing of online and physical sales that has been unfolding since the pandemic.

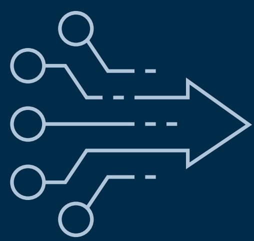
METHODOLOGY

In order to identify successful transformation programmes, our research measured a range of data points covering four digital transformation pillars for over 100 listed European retailers. Specifically, we look at online performance presence and metrics, social media activity and engagement, proportion of digital job roles, usage of software tools across various business functions and digital partnerships, among other metrics.

A scorecard was then created to measure digital sophistication across each of the pillars before normalising the data to create an index used to segment companies into three cohorts:

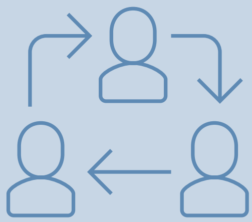
Digital Leaders

Score highly with a strong online presence and slick e-commerce operations that generate significant traffic with solid online performance metrics. In most cases, this is supported by a strong social media following with high levels of activity and engagement. The business will employ a relatively high proportion of digital job roles, sometimes reflected at board level. Digital leaders are often experimenting with new technology and use many third-party software tools across areas such as marketing, data analytics, operations and their website.



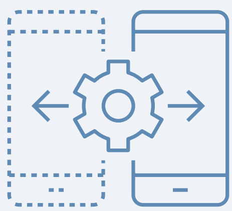
Digital Followers

Typically score well within a couple of digital transformation pillars, but lack a comprehensive digital strategy across all four areas. For example, while website performance may be adequate, digital job roles may be under-represented across the company or board level, or they lack a comprehensive digital investment plan, and do not communicate this effectively with the investor community.



Digital Latecomers

Usually score poorly on website metrics such as SEO and web traffic and have high bounce rates, while lacking the same level of digital partnerships with software solution providers compared with the other two cohorts. There is also often poor representation of digital roles within the company with little evidence of transformational plans of digital investment to external stakeholders.



A range of financial metrics was then collated for each company, focusing on sales, profits, EBITDA and return on investment (ROI) to assess whether a positive correlation exists between higher levels of digital transformation and better financial returns over time.

The following table summarises three critical areas of focus for retailers leveraging the benefits of digital technologies.

1 CUSTOMER EXPERIENCE

E-commerce platform
Shopify, Magento

Mobile commerce
Mobile apps, responsive websites

Customer engagement
Live chat, customer feedback and review systems

Personalisation
Customer data analysis, predictive modelling

In-store technology
Digital signage, interactive displays, video analytics

Augmented reality
AR apps, AR advertising

Chatbot
AI-powered chatbots, customer service chatbots

Video marketing
YouTube, Vimeo, TikTok

Influencer marketing
Influencer marketing platforms

Subscription model
Subscription management software

Customer reviews and ratings
Customer feedback and review systems, etc.

RETAILER EXAMPLES

Zalando has implemented technology such as augmented reality to allow customers to see how products look on their bodies before purchasing. They have also integrated chatbots and voice assistants to provide real-time customer support.

ASOS offers a personalised shopping experience, mobile app, and 24/7 customer support.

H&M uses a virtual showroom which allows guests to experience new campaigns at any time without physically traveling.

Zara offers mobile app and in-store product maps to locate garments quickly.

2 PROCESS EFFICIENCY

Inventory management
Inventory management software, RFID

Contactless payment
Apple Pay, Google Pay

Logistics and delivery
Shipping management software, delivery tracking software

Predictive analytics
Predictive modelling, predictive algorithms

Real-time data
Real-time monitoring and reporting systems

Affiliate marketing
Affiliate marketing platforms

Automated marketing
Marketing automation software

RETAILER EXAMPLES

Amazon uses automation technology, such as robots and machine learning algorithms, in its fulfilment centres to streamline order processing and reduce labour costs. This has allowed the company to scale its operations and increase efficiency.

Zara has implemented an integrated supply chain system that allows it to quickly respond to changes in consumer demand and adjust its production processes. This results in increased efficiency and reduced waste. Physical retail operators can also lead the way when it comes to process optimisation.

Aldi invested in technology such as digital signage and self-checkout systems to reduce labour costs and improve the customer experience.

Primark has a supply chain that moves pre-mixed cartons from factory to shop floor with no additional handling, breakdown, decanting or picking. Cartons are sealed in factory and only opened in the shopfloor for merchandising.

3 DATA AND ANALYTICS

Data analytics
Business intelligence tools, big data platforms

Logistics and delivery
Shipping management software, delivery tracking software

Predictive analytics
Predictive modelling, predictive algorithms

Real-time data
Real-time monitoring and reporting systems

Customer engagement
Live chat, customer feedback and review systems

Cloud computing
Cloud storage, cloud hosting

RETAILER EXAMPLES

John Lewis is using data and analytics to improve its supply chain and inventory management. The company has implemented a sophisticated data analytics platform that tracks sales data, customer behaviour, and weather patterns, among other things, to optimise its product assortment and inventory levels in real-time.

Tesco uses data and analytics to optimise their supply chain and improve their in-store inventory management. By analysing sales data and customer behaviour, they can make informed decisions about which products to stock, reducing waste and improving customer satisfaction.

IKEA uses data and analytics to optimise supply chain operations, reduce waste, and improve customer experience.

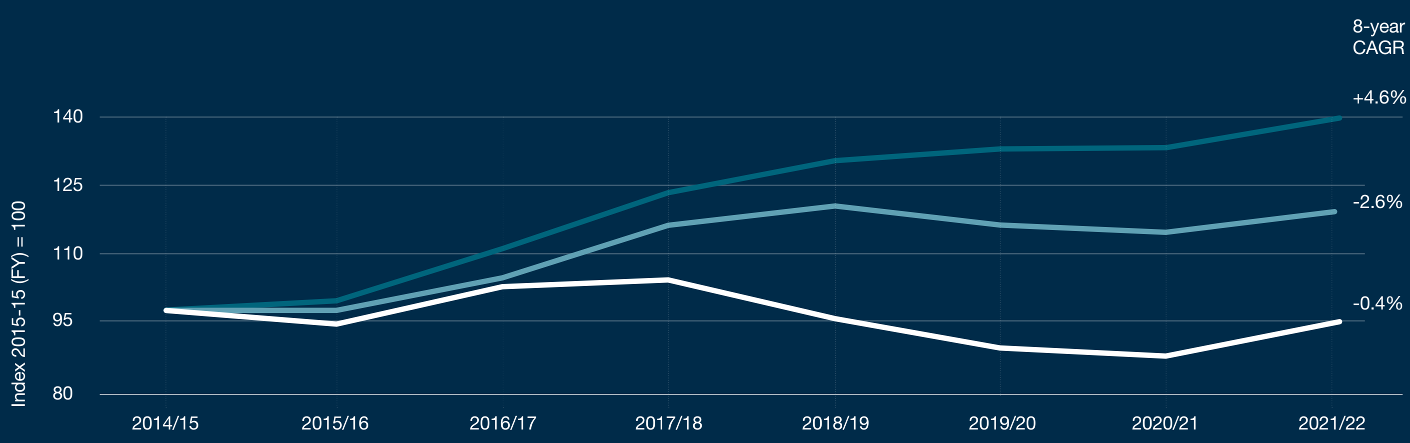
Adidas is leveraging the availability and applicability of Big Data, which is leading the digital age and critical to the competitiveness of many businesses. Emerging technologies such as machine learning, artificial intelligence and robotics are being used extensively in e-commerce to improve the customer experience and drive sales growth.

KEY FINDINGS

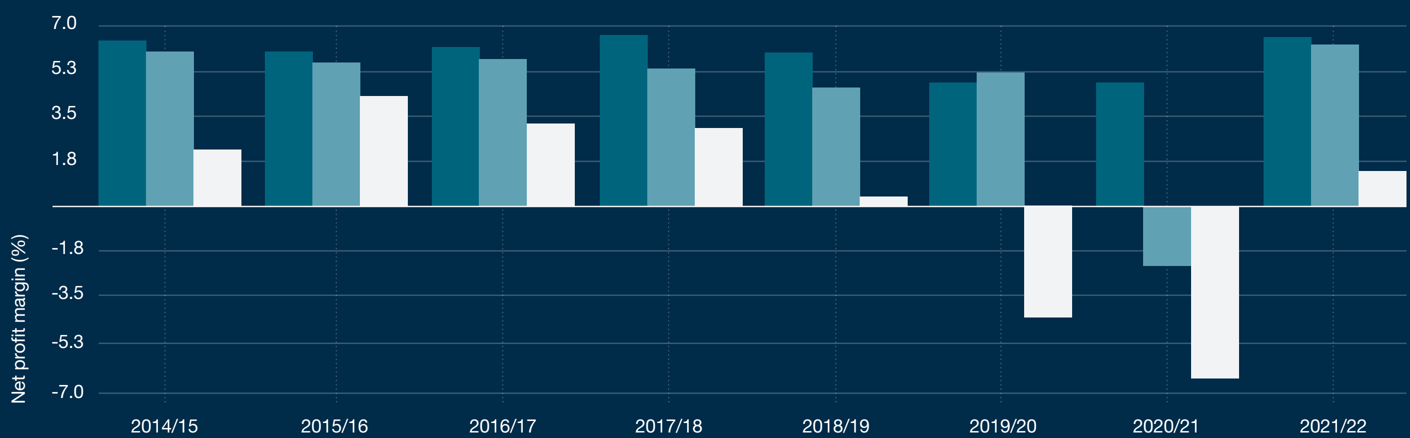
1 Investing in digital transformation has clearly paid off for retailers

Our research shows that Digital Leaders have seen higher levels of growth across sales, profitability and market share since 2015. In fact, they saw average sales growth of 4.9% over the last eight years; this is considerably higher than Digital Followers (+2.6%) and Digital Latecomers (-0.4%), in part driven by a superior omnichannel proposition using technology to create a consistent, relevant and blended customer journey across all channels.

Revenue growth index (2014–15 to 2021–22)
Sales growth for 'Digital leaders' has significantly outpaced 'Digital followers' and 'Digital latecomers' over the last eight years. They also benefited from the online shift during the pandemic.



Net profit margin (%)
While 'Digital leaders' are disproportionately comprised of large retailers, they continued to grow their market share from 61% to 67% during this period.



Market share by cohort (%)
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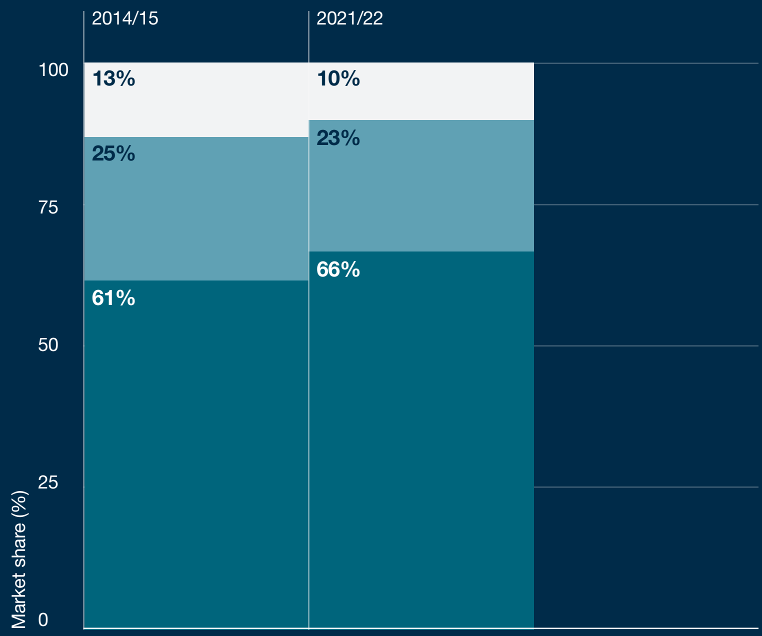
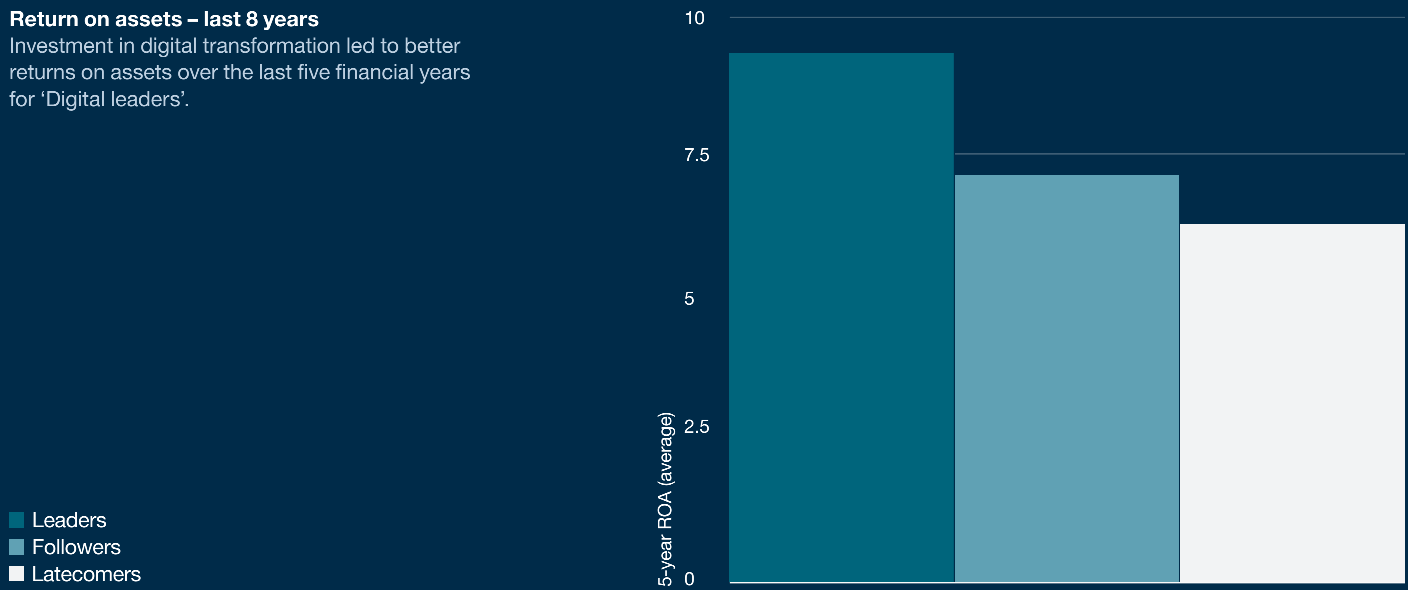


Return on assets – last 8 years
Investment in digital transformation led to better returns on assets over the last five financial years for 'Digital leaders'.



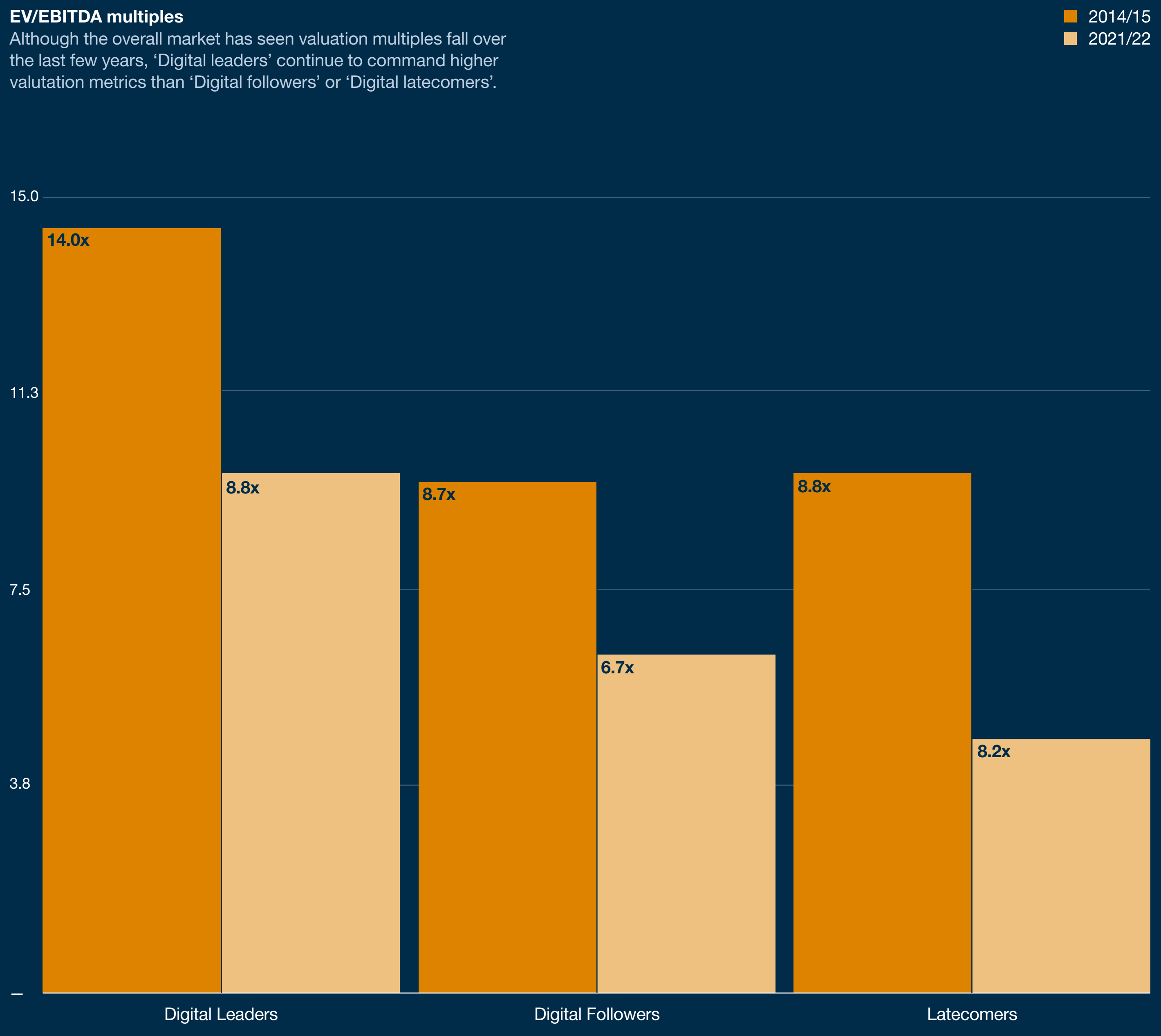
Their investment in a strong digital proposition was shown to be crucial throughout the pandemic, particularly during lockdown. The ability to pivot sales through e-commerce platforms (particularly within non-food) ensured continued growth throughout the disruption as retailers were able to quickly scale online operations. Both Digital Followers and Latecomers experienced weaker sales, constrained by capacity, or were simply unable to switch to an online channel that was fit for purpose. Digital Leaders also managed to increase their market share over the period, increasing from 61.4% of combined sales in 2014–15 to 66.5% in 2021–22. This market share increase did not come at the expense of profit margins. Our analysis shows that Digital Leaders experienced consistently higher margins and higher average return on assets (ROA), implying that Leaders leveraged assets to boost profitability more effectively than Followers or Latecomers.

KEY FINDINGS

Digital transformation within these businesses was also recognised by investors in terms of valuation, with Digital Leaders reporting multiples (EV/EBITDA) consistently higher than the other two groups. However, average valuation multiples have declined for all groups since 2015, with the largest drop seen across Digital Leaders. This has led to the valuation gap between the Leaders and Latecomers narrowing from 5.2x to just 0.6x.

Indeed, some of the most digitally advanced retailers experiencing rapid growth over the last decade have operated a pure online model. Being 'first-movers' in some parts of the market, competition was low, capital was cheap, hence they experienced rapid growth in the online space as consumer adoption accelerated.

EV/EBITDA multiples
Although the overall market has seen valuation multiples fall over the last few years, 'Digital leaders' continue to command higher valutation metrics than 'Digital followers' or 'Digital latecomers'.



Sales growth (Pure online retailers)

2021

34%

2022

4.2%

Share prices since start of 2021

Omnichannel players and others

↑ 12%

Pure online retailers

↓ 70%

In addition, the pandemic instigated huge levels of investment from retailers, logistics companies, and software and hardware providers, making the entire digital ecosystem significantly more competitive. Put simply, many retailers who were previously behind the curve were forced to invest heavily in their digital proposition, accelerating their transformation plans by 3–5 years, in a matter of months. Meanwhile, it provided an opportunity for global brands such as Nike, Adidas, Gymshark, Samsung, Dyson and many other to focus on direct-to-consumer (DTC) strategies, sparking further disruption.

Crucially, technology has become cheaper and more accessible across the marketplace, allowing for example established and challenger brands to use a wide range of low-cost, cloud-based e-commerce platforms, alongside digital and social marketing solutions, to establish their digital presence.

These factors combined resulted in sales growth of pure online retailers moderating to just 4.2% in 2022, compared with 34% in the previous year. Their share prices of pure online have also been significantly hit, falling approximately 70% since the start of 2021 – wiping off as much as £57.5 billion from combined market cap, although some of this decline reflects general negative market sentiment towards the tech growth sector overall. Omnichannel players and other have seen their shares rise on average 12% during the period.

These dynamics suggest that some level of digital capabilities is, by now, somewhat a hygiene factor in the retail environment. In other words, digital engagement with consumers is potentially no longer the differentiator factor that it once was, especially when the cost of deploying basic digital retail capability has come down so much. Retailers will therefore need to work harder and be much smarter at building their competitive differentiation through digital; many are already doing that.

KEY FINDINGS

2 The rebalancing of online and physical post-pandemic has benefitted omnichannel retailers

Our analysis shows that across UK, Germany, Italy, Spain and France, there has been a significant shift back towards stores between 2021 and 2022. Indeed, across these markets, online sales fell by €18.2 billion (-5.8% YoY) in 2022 compared with the previous year, while in-store sales rose by €198 billion over the same period. This shift across channels was even more pronounced in the UK where online sales fell by 9.8% while in-store sales rose by 11.0%.

The recalibration amid rising input and operating costs and softer demand caught some retailers off guard, particularly those operating in the pure online space where many expected the online shift to be much 'stickier'. In grocery, a rebalance between online and stores following the pandemic was always anticipated, but the cost-of-living crisis has accelerated the speed and depth of the retrenchment.

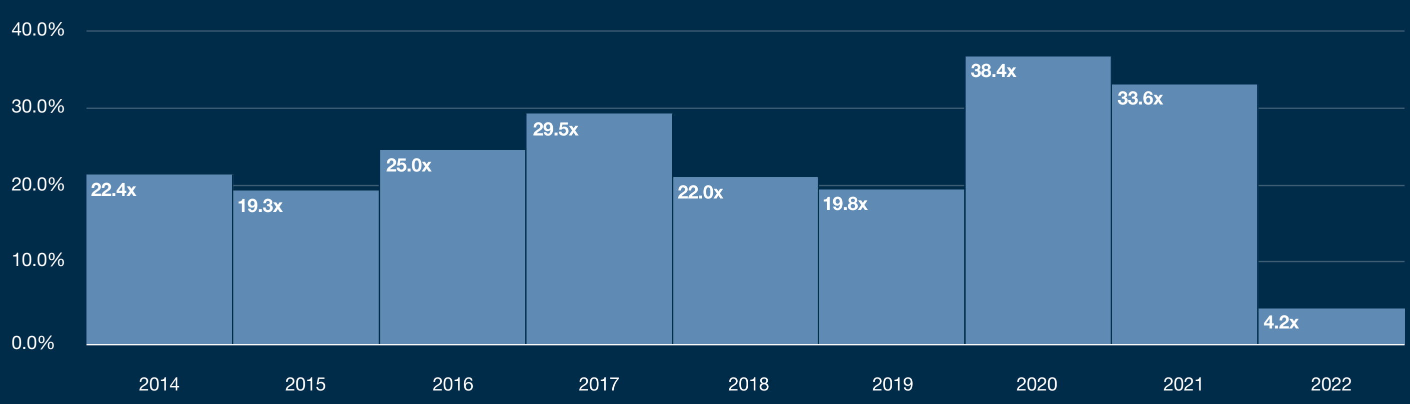
One example is how cash-strapped consumers have recently migrated to discount grocers, who typically do not offer any digital platforms. We also see cost-conscious buyers looking to shun extra costs of delivery and returns charges, with some even willing to visit several stores to make the most of the promotions. In addition, having to potentially wait for online refunds, an increase in the use of cash and desire for physical experiences following the pandemic have all favoured physical retail more recently.

It remains to be seen whether the ongoing rebalancing between online and physical will reverse the long-term secular trend of e-commerce growth. So far, there is little reason to believe that is the case. Consumers continue to flit between digital and physical channels, demanding a seamless, consistent and hyper-personalised journey across all touchpoints – physical stores, online platforms, social media and mobile devices. This can only be achieved by putting a truly omnichannel model at the epicentre of digital transformation.

Finally, while many pure online disruptors may be struggling amid a more competitive landscape, there are opportunities for pure digital commerce players to stand out in the current economic environment. For example, as consumers look for fast, convenient credit services amid the cost-of-living crisis, they have the chance to capitalise on the availability of solutions such as Buy Now Pay Later (BNPL) and the relative ease it can be provided in a digital environment compared to in-store credit products.

Pure online growth

Ongoing supply chain disruption, rising interest rates and a softer outlook for demand have hit pure online retailers the hardest, reflected by a significant deterioration in growth in 2022.



KEY FINDINGS

3 Next wave of disruption heralds opportunities for 'second movers'

The inflection point for digital transformation has arrived as the industry collectively shifts towards a truly omnichannel model and one that embraces unified commerce. This is materialising at a time where consumers seamlessly traverse between physical and digital channels, powered by 'invisible' digital infrastructure which puts their interests, desires and emotions at the heart of a hyper-personalised customer journey.

The pace of change in this new dawn of digital retail may prove too much for many. Transformational technologies such as AI, 5G/6G, IoE, blockchain, quantum computing and the metaverse will collide, remoulding the retail world around us. Different aspects of the industry will also infiltrate other spheres of everyday life. In particular, sustainability will become entrenched in many brand values, with digital tech helping to supercharge content (e.g. carbon emissions data) being served to shoppers throughout the day.

Embracing this change will require retail brands to be agile and leverage the power of emerging technologies, while continually refining business models. It will mean living a culture of innovation where creative energies reimagine the customer journey, perhaps through the metaverse, looking at new sources of growth, new transactional platforms, and predictive customer insights.

The race for technology companies to create a foothold in transformative technologies will lead to rapid scaling. Improved accessibility, reduced costs, lower barriers to entry and supportive software and hardware will inject further disruption into the sector – in fact, the industry has already entered these early stages.

As digital transformation across the industry unfolds, the competitive advantage enjoyed by many early adopters will quickly fade, introducing risk. In other words, the Digital Leaders of today can quickly become the Digital Followers of tomorrow.

On the other hand, this is a moment of reckoning for many retailers who have failed to fully embrace digital opportunities over the last decade. The moment has come to seize a new, more aggressive wave of technological progression in which utilising AI, forming strategic partnerships, and leveraging consumer insights from big data will form key action points for many.

> The Digital Leaders of today can quickly become the Digital Followers of tomorrow

The next wave of disruption heralds an opportunity for 'second movers'. While piggybacking off the investment and learning of others, slower adopters will have a relatively small window of opportunity to quickly get up to speed before being left too far behind. Embracing the 'technological curve' at just the right moment will yield significant ROI for many smaller players.

However, it's inevitable that many will be left behind in this hyper-competitive technological arena. As such, further industry consolidation is likely, as brands are bolted on to retailers open to opportunistic acquisition (e.g. Next, Fraser Group), and who can leverage their scaled operations.

CONCLUSION

Our research confirms that, in the ever-evolving landscape of retail, digital transformation has emerged as a critical enabler for competitiveness and growth.

Retailers who have made strategic investments in digital transformation have reaped substantial financial rewards and realised efficiencies across areas such as customer engagement, supply chain optimisation, and marketing. But even if the competitive advantage of early adopters seems to be diminishing, the race is not over. The current climate presents an opportunity for retailers big and small to leverage reduced technology costs and execute a comprehensive digital transformation strategy, securing – or increasing – their competitive advantage in the marketplace.

Retailers must embrace new technologies, such as predictive analytics, machine learning and conversational AI, to improve data and analytics capabilities, thus enhancing online shopping journeys, streamlining operations, and fostering a more robust and engaged customer base. As new models of customer engagement emerge, they must adapt accordingly to drive customer loyalty and retention, taking advantage of data analytics once again to personalise pricing, promotion and assortment. The inflection point within the retail industry presents both opportunities and challenges. As such, retailers must be constantly alert to the possibilities and risks that digital transformation presents. Businesses must leverage the full spectrum of technological advancements to continuously drive innovation and refine their business models. The adoption of cutting-edge technologies must be integrated with the pillars of customer engagement, operational efficiency, and data-driven decision making to create a comprehensive and holistic approach to digital transformation.

As the retail industry continues its digital journey, new partnerships will be crucial to help retailers navigate the complex digital landscape, avoid pitfalls, and identify winning strategies for growth.

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