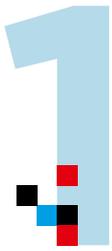




**WHY ARE
LOW-END RETAILERS (LERS)
SUCCESSFUL AND HOW
COULD CONSUMER
PACKAGED GOODS (CPG)
BRANDS AND RETAILERS
FIGHT BACK?**





WHY LOW-END RETAILERS (LERS) ARE BECOMING MORE AND MORE IMPORTANT

Low-End Retail is a huge success in Europe and BeLux. In Belgium it represents a 1% market share of all FMCG, increasing to 2.1% when looking only at home & personal care based on the GfK definition of Low-End Retail ⁽¹⁾.

OTHER INTERESTING FINDINGS IN THE STUDY ARE (GfK MAT Q2 2016) AS FOLLOWS:

<p>LER has a penetration of 40.6%, with almost 2 million households buying from LERs at least once a year</p>	<p>70% of LER shoppers bought a home and personal care product from a LER</p>	<p>7.1 trips on average across all FMCG (+7% versus MAT Q2 2015) as a benchmark, the shopping frequency at drugstores is on average 5 trips per year</p>
<p>The average basket value is €18.5 (FMCG products only, +8% versus MAT Q2 2015) - for home and personal care only the average basket size is €7.5</p>		<p>The growing market share of LER is driven by more shoppers, buying more often and with bigger baskets</p>
<p>LER is taking value from all actors in the (food) retail market</p>	<p>The top 20% greatest LER shoppers :</p> <ul style="list-style-type: none"> -Go 18.1 times per year- -Spend on average €24.3 per visit- -Are mainly low-income households with children, 2-person low-income households and singles between 40 and 65 years of age- 	

This 1% MS (market share) for LER in FMCG is equal to the market share of FMCG in e-commerce in Belgium (source: GfK).

So why do we pay so much attention to online developments, whilst placing less importance on Low-End Retailers, despite the fact that they have a huge economic impact? Online shopping is hip and trendy but another worthwhile explanation is that Low-End Retailers prefer to stay under the radar. With this strategy, Low-End Retailers are following the strategy adopted by Aldi and Lidl.

The scope of this paper will focus on 5 retailers (Action, Big Bazar, Extra, Flying Tiger and Traffic) who are re-inventing the existing retail business in Europe. This is not an exhaustive list of retailers but represents a strong idea and insights into how this market could evolve. Other retailers like Wibra, Zeeman, Hema, Blokker and even Ikea could be added to make the list complete, but experts believe this would not change fundamentally the view on this new way of doing business.

IN THIS PAPER, WE WILL:

- 1 Clarify the key drivers enabling these players to grow so fast in the saturated Belgian market and what their possible future could be.
- 2 We describe the evolution of 5 Low-End Retailers and what the future might bring. We organised a price comparison in Belgium of 6 products monitored at Action, Traffic, Colruyt, Delhaize supermarket and Carrefour Market.
- 3 Last but not least, we elaborate on how CPG companies and retailers can react to this evolution. We will analyse the potential steps that could be taken in the fields of pricing, category management, assortment and strategy. In September 2016, we launched an online questionnaire for top managers of retailers and brands in BeLux. We got 99 responses, providing a good representation of the opinions of the retailers and the brands. We use the findings of this online questionnaire, as well as some in depth interviews with key stakeholders.

In this white paper we used 3 kind of sources: a consumer panel (B2C), a panel of c-level in retail & FMCG (B2B panel) and market data (all sources are The Retail Academy unless specifically mentioned)

⁽¹⁾GfK definition is the FMCG part of Action, Zeeman, Blokker, Traffic, Ikea, Big Bazar, Wibra and Hema - GfK data, MAT Q2 2016.

2

WHO ARE THE MAJOR LOW-END RETAILERS?

It is hard to define Low-End Retail as there is no general agreement on which players should be included. However, Action, Traffic, Extra, Flying Tiger and Big Bazar all have the following characteristics.



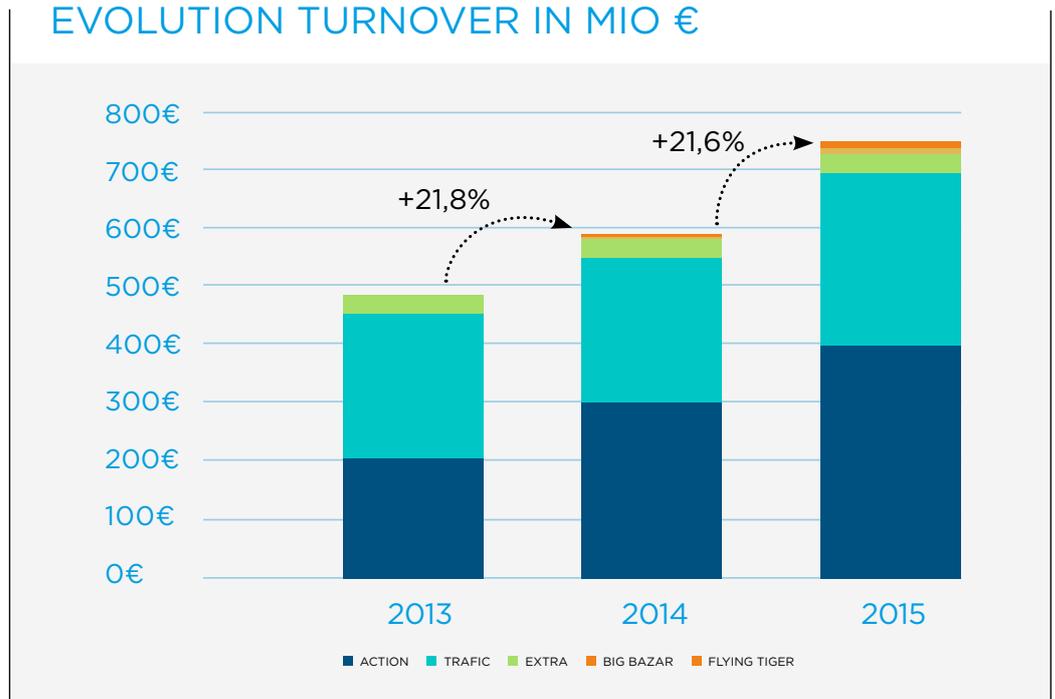
⁽²⁾ Whether the products offered by Low-End Retailers offer good quality remains a huge topic of discussion. The product is not always the same. Jef Colruyt has a clear opinion and believes products at Action, for instance, do not have the same high quality (De Tijd, January 30th 2016).

On the left: Fanta at Colruyt
On the right: Fanta at Action

DEFINITION OF LOW-END RETAIL

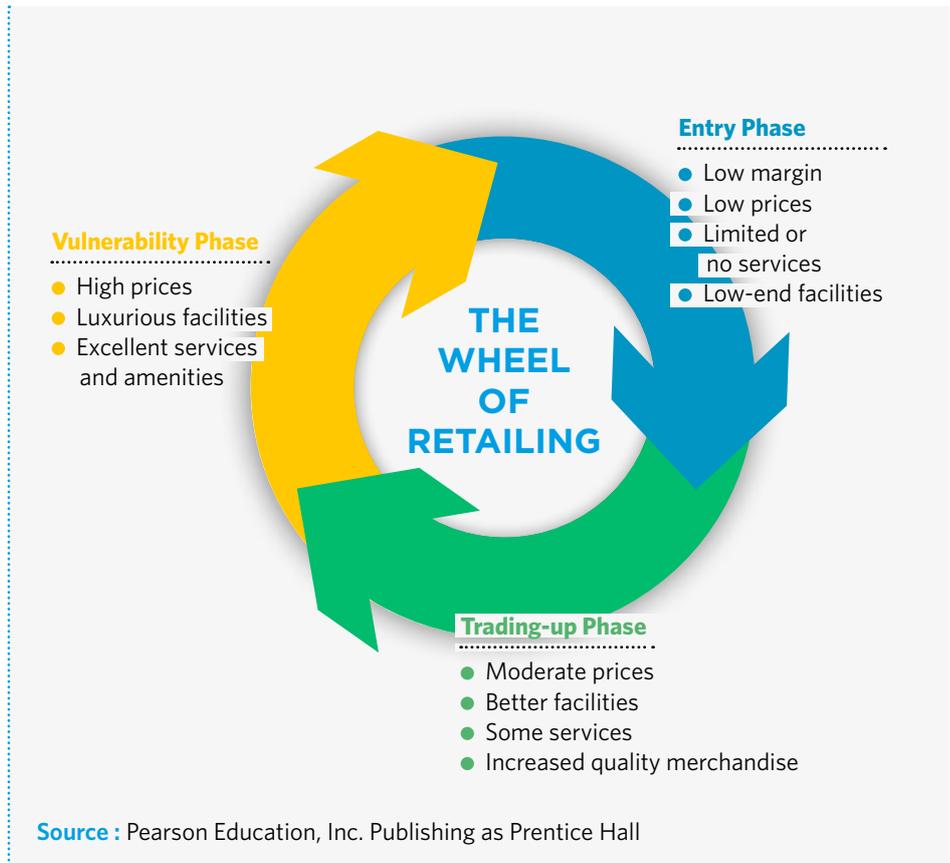
PRICE	PRODUCT	PLACE	PROMOTION	STRATEGY
<ul style="list-style-type: none"> Focus on very low price/dumping prices (margin is purchase driven) 	<ul style="list-style-type: none"> Huge amount of obsoletes from brands in personal/home care and food (at least 3 food categories selling branded products) Fast changing assortment No local products Limited number of categories or limited offer in each category Quality is a huge topic of discussion ⁽²⁾ 	<ul style="list-style-type: none"> Mainly positioned at b-locations No franchise 	<ul style="list-style-type: none"> None or limited Mainly use folders 	<ul style="list-style-type: none"> Main focus on growth (number of stores), followed by value (high basket size) Turnover mainly realised by mono-channel retail (brick & mortar shops) Some call themselves 'value retail' as they have a high 'price/value' perception

EVOLUTION TURNOVER IN MIO €



3

THE SUCCESS OF LOW-END RETAIL EXPLAINED ON THE THEORETICAL FOUNDATIONS OF 'THE WHEEL OF RETAILING'



LOW-END RETAIL IS AT THE ENTRY PHASE

Although often cited in many marketing journals worldwide, it is important to remain cautious in explaining all of the success of these Low-End Retail chains using this theoretical model alone.

THESE 7 PARAMETERS DEFINE THE SUCCESS OF LOW-END RETAILERS

1 LOW PRICES

Prices at Low-End Retailers are very low and thanks to the price/promotion focus of customers probably the biggest success factor where Low-End Retailers are concerned. Action, for example, manages to offer A-brands at the lowest price on the market. This chain can afford this thanks to low-gross margins and limited or no services.

Most of the Low-End Retailers have huge distribution centres where they can stock products for a long period. Their negotiation power is based on the large quantities they purchase. Part of their inventory also comes from parallel trade and acquiring cheap stock lots, leaving the local CPG companies in the cold. Local CPG companies have limited or no impact on this.

2 LOW MARGIN

The margin will depend on how well they negotiate the purchase price and on efficient low-cost operation more than on the added value they can create. The operating profit of Action, for instance, is around 11% of sales. It is not uncommon for Low-End Retailers to operate at a profit margin (EBITDA) of above 10%.

Low-End Retail is 'offer-based' and not customer centric. The growth per store quickly reaches a peak, and that is why the main way to create growth is by opening a new store.

The average turnover per store is €1 million to 3.5 million. This is in line with homing and DIY stores where the average turnover per store varies between €900k and €4.4 million.

The purchase is driven essentially by impulse-based shopper attitude, although there is a destination element to it as well. As mentioned before, GfK data illustrates that 70% of LER shoppers buy home and/or personal care products. The changing assortment is also an important driver in attracting their shoppers every week and making them come back every week.

There are initial indications to show that LER is also working on category management. The shopping route becomes more logical. In some categories there is a vast basic & logical assortment, the more 'expensive' products are in the most visible spots and promotions are displayed at a gondola head.

3 LIMITED OR NO SERVICES

Low-End Retailers offer no online shop and no home delivery (except for Traffic). There are no other services available.

4 LOW-END RETAILERS LOCATION

Low-End Retailers can often be found on B/C locations. The stores are simple but very efficiently organised. They try to optimise shelf spacing and layout (shelves often look very nice, sometimes even better than at other retailers).

5 SINGLE DECISION UNIT AND LEAN MODEL

Logistics is the single unit decision. Whether a product will be listed or not depends on the warehouse's decision and the possibility of logistics to supply the product rather than on customer centricity or a need/demand on the part of the shopper and consumer.

6 VALUE

Value comes from growth instead of added-value creation.

It is no wonder that Low-End Retail always communicates on short-term growth (where they achieve even double-figure growth) rather than on long-term growth.

7 GROWTH STRATEGY: WHAT WILL THE FUTURE BRING?

Low-End Retail will continue to grow over the coming years. This growth will mainly be driven by shop openings. Low-End Retailers will follow more or less the same track as hard discounters did when they entered the Belgian market. The pace of growth will slow down year after year. This segment will, however, continue to grow at a faster pace than the food retail

market. From a LER perspective, it makes sense to quickly 'capture' a country by covering it with stores (supplied from a single DC). The next wave of growth will probably be found in the next country, rather than further optimising the stores in the first country. This implies that there will be a 'ceiling' to the market share of LER (similar to discounter supermarkets). The big remaining question, obviously, is "where is the ceiling?"

Low-End Retailers also have their competition. Retailers and manufacturers in all countries are looking for ways to get the 'lost' business back.

The biggest threat to Low-End Retailers are low-cost online only players like Alibaba and Amazon.

More specifically in the case of Action, the latter is a private equity holding. They might keep Action for another 5 or 6 years and then put Action on the market for sale.

THERE ARE 2 POSSIBLE WAYS IN WHICH LER MIGHT EVOLVE

1 GROWTH IN FREQUENCY:

they develop their categories (more products) in order to offer a coherent basket and to boost re-purchase and increase frequency. That way they move towards the value retail model. This will increase the basket size.

2 STRUCTURAL GROWTH:

Once they reach their critical size (the marginal cost of opening a new store becomes higher than the benefits that this single store can offer), Low-End Retail moves to structural growth through merger and acquisition.

Reasons for the success of LER were also solicited in the questionnaire. According to the market, the main success factor where LER is concerned, is that they cater for the limited budget available for consumer goods (60.7%) and this reflects the economic crisis (52.5%).

Most respondents (90.2%) agreed that price is the main driver where LER is concerned and 39.4% of the respondents agreed that LER products are of a much lower quality than similar non-LER products.

4

HOW CAN CPG COMPANIES AND RETAILERS REACT IN THIS TURBULENT AND FAST-CHANGING MARKET?

HOW CAN BRANDS PREVENT THE DEVALUATION OF BRAND EQUITY AS THEIR PRODUCTS ARE SOLD AT LOW-END RETAILERS?

The results of the questionnaire show that all respondents agree that LER has an impact on the volume sold/basket size. Brands also indicated a degree of concern with regards to decreased value perception. If the value of the brand is respected, this will not be a big issue, but in most cases this value is not respected.

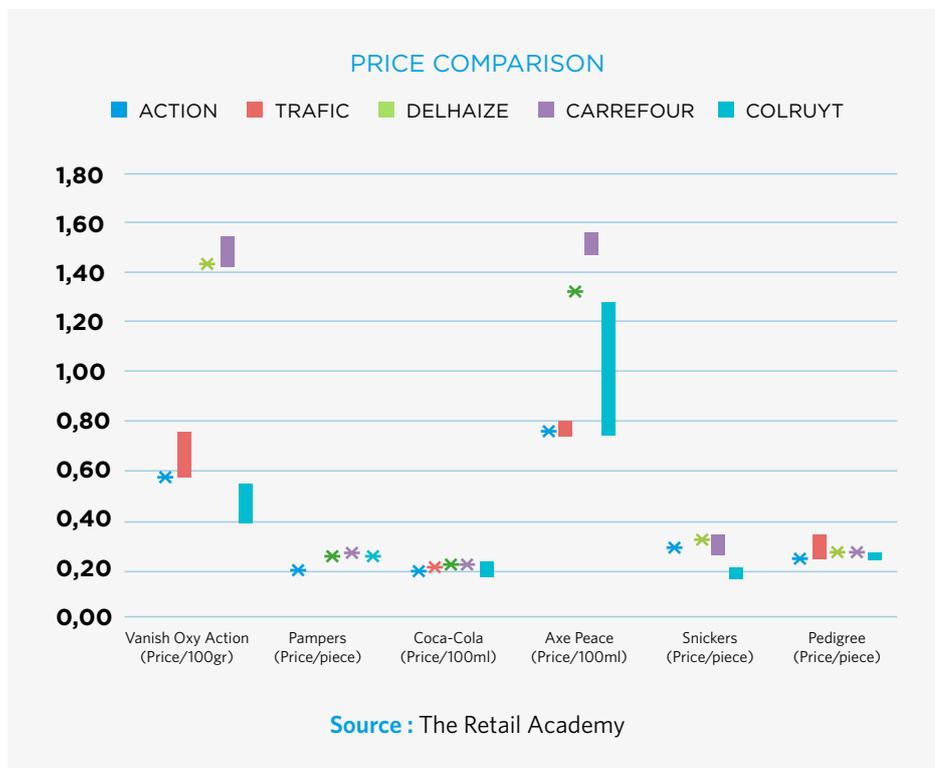
Nivea Sunmilk, for instance, is sold at €3.50 at Action and for €13.50 at Colruyt. There is also a substantial risk with regards to product safety. Sun creams are taken

off the shelf after 2 or 3 years, but when stock is sold to brokers the manufacturer has no control over the product anymore. If a problem occurs, the brand will be held responsible in the eyes of the consumer. This will also damage the reputation of the retailer.

Seasonal products represent a double risk, not only is the selling period very short but during this period they also face, in some categories, heavy competition from Low-End

Retailers. They will put the same products on the shelves.

To get an idea of the price differences, a price check was performed on 6 products⁽³⁾. The prices of these products were compared across 5 supermarket chains, namely Action, Traffic, Colruyt, Carrefour Market and Delhaize Supermarket. Prices were checked all over Belgium. In the grid below you will find the minimum and maximum prices observed for each product at the specific retailers.



Generally speaking, Colruyt was the cheapest (has to keep its own promise), followed by Action and Traffic. However, Pedigree Dental sticks were the most expensive at Traffic, when looking at price per piece.

⁽³⁾ During august and september 6 SKU's (stock keeping units) were analysed in 88 stores from 5 supermarket chains.

4

MAJOR ACTION POINTS THAT COULD BE FOLLOWED

BRANDS

1. ASSORTMENT

- A.** Keep innovation out of LER.
Old stocks and relaunches can be sold via LER. High-end products prefer to burn their remaining stock rather than sell the stock at dump prices. This way they keep their brand equity.
- B.** Keep 'treasure' brands out of LER.
- C.** Create an assortment specific to each retailer based on their location and shopper profile.
- D.** Repack more expensive products and sell them through 'traditional' retail channels.

2. PRODUCT MANAGEMENT

- A.** Only smaller pack sizes for LER.
- B.** Other packaging for LER (but same product inside).

3. PRICING STRATEGY

- A.** Negotiate with LER.
- B.** Stop conditioning based on promotion, create value - revise promo strategy. Doing promotions is still OK, but not that many. Analyse the best performing promotions and focus on these. Try to limit the number of promo's and the discount given.
- C.** In the case of international dumping, you can still dump your national product - calculation based on variable cost without calculating the fix costs of the goods sold. This will make you very competitive on 'one-shot actions'.

4. STRATEGY

- A.** Use the European/global scale of your company - don't let each country compete against each other but define a European/global strategy focusing on value creation.
- B.** Develop e-commerce.
- C.** Start treating Low-End Retail as a mature channel/ customer with account management, category management and direct supply.
- D.** Go for a win/win. Can manufacturers do something that caters to the LER business model and shopper profile? E.g. shelf-ready packaging, pre-loaded merchandising displays, etc.

RETAILERS

1. ASSORTMENT

- A.** Support innovations, especially if they appeal to your audience.
- B.** Differentiate the assortment, based on store location and shopper profile.

2. PRODUCT MANAGEMENT

- A.** Sporadic offer of low-budget products or one-shot actions with obsolete products.
- B.** Just in time - have the products on the shelf and in sufficient quantities when the consumer expects it.

3. PRICING STRATEGY

- A.** Stop conditioning based on promotion, create value - revise promo strategy.
Doing promotions is still OK, but not that many. Analyse the best performing promotions and focus on these.
Try to limit the number of promo's and the discount given.

4. STRATEGY

- A.** Create value.
- B.** Improve the shopping experience.
- C.** Higher service and personalisation in-store.
- D.** Make clear agreements with manufacturers.

SOURCES:

- All data sources are from The Retail Academy
- GfK, presentation given on 22nd of September 2016 by Karina De Cock
- De Tijd: http://www.tijd.be/ondernemen/retail/Colruyt_Pas_op_voor_agressieve_prijsbrekers.9726727-3073.art?highlight=jef%20colruyt%20action

APPENDIX: A CLOSER LOOK ON THE 5 MAJOR LOW-END RETAILERS IN BELGIUM.



Turnover Belgium 2015:

€409 M
(+40% versus 2014)

POS:

116 (+23 versus 2014)

Average turnover per shop 2015:

€3,05M

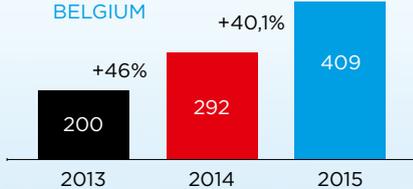
Media investments 2015:

€7,1 M (1,7% of turnover)

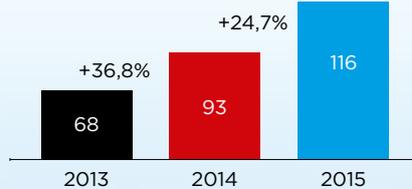
Action, a Dutch company established in 1993, is a fast-growing international non-food discounter. They have more than 700 shops in the Netherlands, Belgium, Germany, France, Luxemburg and Austria. The shops are supplied on a daily basis by three distribution centres in the north and south of the Netherlands and one near Paris (opened in 2016). They opened their first shop in Belgium in 2005. They sell approximately 6000 different items. Their aim is to surprise their clients with a changing assortment offering good value for money. The bulk of their assortment is bought via wholesalers and traders. They rarely buy directly from the manufacturer, except for products coming from multinationals such as

Unilever, P&G and Henkel. With regards to their product assortment they try to follow the trends, recently adding healthy food and fair trade products to their selection. Action is mainly advertising in regional and local papers and actively use social media, although Action claims that they don't invest in marketing. According to Nielsen Data, their media investment is above average in comparison with the big 3 food retailers (their budget is between 0.4% and 0.6% of their total turnover). Action will continue to focus on opening more stores in more countries. In 2017, they will open distribution centres in Germany and the South of France.

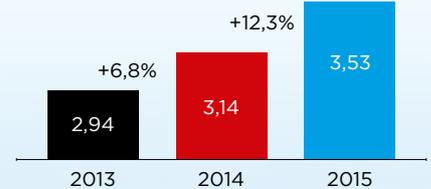
TURNOVER IN M€ ACTION BELGIUM



NUMBER OF SHOPS ACTION BELGIUM



TURNOVER/SHOPS ACTION BELGIUM





Turnover Belgium 2015:

€8 M

POS:

11

Average turnover per shop 2015:

€0,8M

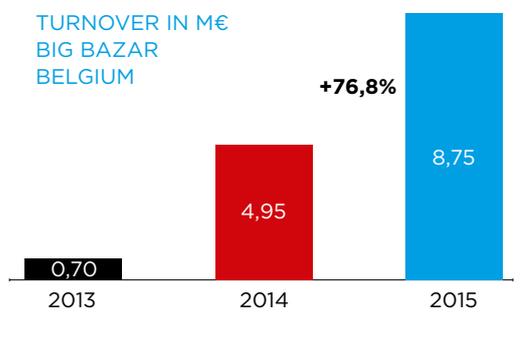
Media investments in Belgium in 2015:

€0,4 M (5% of turnover)

Big Bazar is part of the Blokker Holding (Blokker, Bart Smit, Leen Bakker, Intertoys, Xenos, Marskramer and Cook&Co). This is a relatively new format. The first shop opened in the Netherlands in 2007. The 127 shops are mainly located in the Netherlands, with 11 shops in Belgium. They often look for locations near Blokker shops to optimise the distribution flow, but they do face problems when too many competitors are already located in the neighbourhood. For instance, Big Bazar Oudenaarde had to close after only a couple of months. In this region they had competition from Action, Kruidvat, Albert Heijn and Colruyt. They offer a large assortment of cleaning, household and personal care products but they also sell decorating products, pet products, confectionery, chocolate and soft drinks. The assortment changes quickly and A-brands are offered at a low price. Communication is mainly done via folders and online.

Big Bazar is currently remodelling their shops and primarily changing the layout.

TURNOVER IN M€
BIG BAZAR
BELGIUM





Turnover 2015:

€250 M
 (+0.4% versus 2014)

POS:

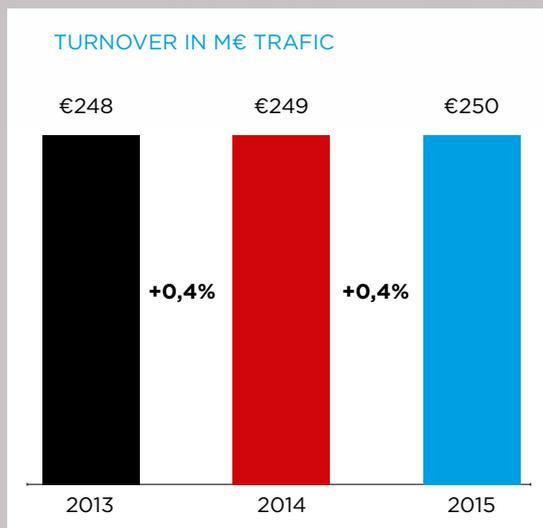
69 in Belgium (+10 abroad)

Average turnover per shop 2015:

€3,2M

Media investments 2015:

€1,2 M (+0,4% of turnover)



Traffic (part of the Sogesma group) describes itself as a neighbourhood discounter. This Belgian company was established in 1983 and opened its first shop in Doornik in 1984. Today Traffic has 69 shops in Belgium and 10 shops abroad (France and Luxembourg). The shops are mainly located in rural areas or near small cities.

They have an assortment of 20,000 articles and claim to provide the best brands at the lowest market prices. They purchase their products directly from the manufacturers. They also have a changing seasonal offering. This is the only Low-End Retailer with an online shop. Before buying via the online shop it is best to read the small print regarding delivery and return options.

Traffic hopes to reinforce its growth plans over the coming year thanks to the partnership with Gifi. They want to grow in Belgium and France.



Turnover Belgium in 2015:

€44M

POS:

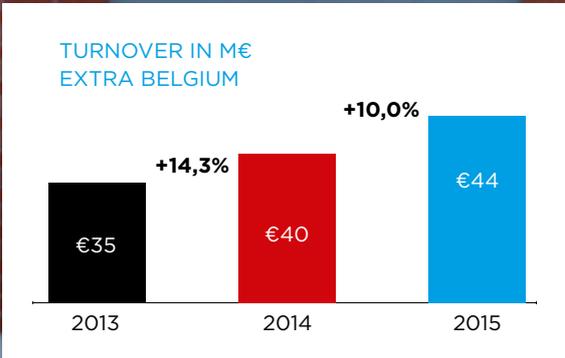
25 (only in Wallonia; +8 versus 2014)

Average turnover per shop 2015:

€1.8M

Media investments Belgium in 2015:

€0,3 M (0.7% of turnover)



In 1993 the first Eurobazar opened in Comines. In 2002 the first Lediscount was opened.

Since October 2015, Lediscount and Eurobazar shops have been combined and are now operated under the common name Extra. The assortment is put together by buying up destocks of brands of house-keeping, decoration, pet and cosmetic products. Alongside their fixed assortment they also offer a lot of seasonal products. The logistics centre is located in Zwevegem. Last year, they doubled the space of this distribution centre.

This year, Extra is going to open 7 more stores in Belgium. By the end of 2017 they want to have 35 shops and by the end of 2020 they aim for 50 stores. In Flanders they are testing the concept under the name 'Flash'. They have one store in Wevelgem and are opening a second test store in Roeselare in October 2016. If the testing goes well (in 2 or 3 years' time) they will rebrand these Flash stores to Extra and roll out the concept in Flanders.



Turnover Belgium in 2015:

€6.4M

POS:

9 (+6 versus 2014)

Average turnover per shop 2015:

€0.7M (+9.7 versus 2014)

The first Tiger shop opened in Copenhagen in 1995. They only sold products at 10 Krone (=€1.50). They currently have around 585 shops in 27 countries.

In November 2013 the first Tiger store was opened in Belgium (Wijnegem Shopping Centre). They currently have 9 shops in Belgium, all located in major destinations (big cities with over 100,000 inhabitants) and company-owned.

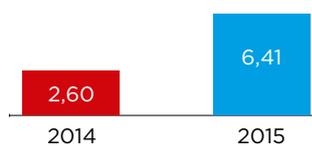
The assortment comprises exclusively own brands: simple and colourful with a Scandinavian touch and a humoristic element. The assortment includes kitchen, office, toy, hobby, party and sports products, along with electronics, gadgets and some food products. The assortment changes on a monthly basis.

Compared to Tiger shops in other countries, the average turnover of Belgian shops is approximately 13% lower. In the UK for instance, sales in these shops grew 61% in 2015. The first shop opened in the UK as early as 2005.

Flying Tiger is also trying to open more stores. They are looking for premium locations.



TURNOVER IN M€
FLYRING TIGER BELGIUM



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