
Abstract

This chapter will introduce alternative routes to company growth for retailers. Ansoff's matrix is introduced as a strategy tool. Outlet multiplication, cooperation and mergers and acquisitions are described as the basic alternatives for expanding retail store networks.

7.1 Growth Options

Store-based retailing almost always starts with independent, single outlet operations. Compared with other business sectors, such as manufacturing, entering into retailing by opening a retail store is relatively easy and does not require high capital resources. The desire to grow business and increase value is often a fundamental objective from the beginning. For retailers, among other benefits, sales growth provides economies of scale in operations (e. g., IT, logistics and administration) and from purchasing from suppliers in large quantities (Ogden and Ogden 2005, p. 92).

For decades, strategic management has analysed alternative routes to company growth. The Ansoff Matrix (also called the product-market matrix) is a well-known categorisation of growth strategies (see Fig. 7.1). It consists of four separate strategies, depending on **what** products and services are offered and **to whom** they are offered (Ansoff 1988):

- With existing products in existing markets, growth can be achieved by **market penetration**. Higher sales from existing markets can be obtained by attracting current non-customers, who either do not buy products in the offered categories or who

		Products	
		present	new
Markets	present	Market Penetration	Product Development
	new	Market Development	Diversification

Fig. 7.1 Alternative routes to company growth – Ansoff Matrix. (Ansoff 1988, p. 109)

buy them from competitors. Alternatively, the loyalty of existing customers can be improved and the value of their shopping baskets increased.

- **Product development** involves offering new products to existing markets. This can be done by providing the existing customer base with new product categories in existing stores (see Chap. 12). One example would be apparel retailers expanding into selling shoes. Another would be *Amazon* expanding its product assortment from media products to electronics, fashion and many other categories.
- Considering that a retailer’s “products” are its stores (see Chap. 9), product development in retailing often means introducing **new retail formats** in existing markets (see Chap. 2, 3 and 4). Superstore retailers like *Tesco* that open convenience stores or electronics stores that establish an online shop are examples of such “product development”.
- An existing product can be targeted at a new customer segment, often in a new geographic area (**market development**). Examples include regional retailers expanding their traditional store formats into other regions or national retailers expanding into new countries. International expansion will be discussed in more detail in Chap. 8. However, it is also possible to simply target a new customer segment in an existing geographic market. A recent example of a market development strategy is the so-called **R2B** (“**retail-to-business**”) strategy (Zentes et al. 2015; Channel EMEA 2013). While retailers by definition mainly sell their products to the final consumer, some retail companies also target business customers. The main focus is usually micro and small businesses who use retail channels for their purchases. A survey by Zentes et al. (2015) showed that the main retail segments in which R2B is relevant are office supplies, electronics (including ICT), food, furniture and home improvement. Companies like *Staples* and *Office Depot* have long followed this approach, but electronics and IT retailers (e. g., *Best Buy for Business*, *Conrad Business*), furniture retailers (*Ikea Office*) and food online shops (e. g., *Asda business*) are newer examples. In 2012, *Amazon* launched *AmazonSupply*, before integrating it into the newly established

AmazonBusiness in spring 2015 to tap the business customer segment with a specific assortment, pricing and even business-specific procurement processes (including multi-user accounts, order approval workflows, etc.).

- **Diversification** involves offering new products to new markets and includes several sub-strategies: horizontal diversification, vertical diversification and conglomerate diversification.
- **Horizontal diversification** involves diversifying into a related business field at the same value chain level. In the case of a retailer, this would involve opening (or acquiring) stores dedicated to new product categories. A typical example is the German food retailer *REWE*, which now operates home improvement stores (*toom*). Here the distinction between diversification and product development is somewhat blurred, since offering new products (or new retail formats) often attracts new customer segments as well.
- **Vertical diversification** involves moving into business at the level of customers (forward diversification) or suppliers (backward diversification). Since retailers are usually the last commercial stage in the value chain, forward diversification is rare. However, backward diversification is common. As shown in Chap. 1, retailers now often operate manufacturing facilities in which they produce their own products.
- Finally, **conglomerate diversification** involves offering new products or services to new markets unrelated to the company's core business. For example, a number of retail companies (e. g., *Tesco*, *Migros*, *Auchan*) are active in banking. This is not entirely unrelated, because customer credit cards, financing, etc. for the retail process can be handled via these banks as well. Some retailers have entered into the travel and tourism market, (e. g., the *REWE Group* or *Casino*). The archetype for conglomerate diversification is the *Virgin Group*. Originally started as a record store which owned *Virgin Megastores*, the company now operates *Virgin Airlines*, *Virgin Finance* and many other unrelated businesses.

Diversification often takes retailers outside of traditional retail markets, and the management literature warns of the dangers that arise when a company's core competence lies in other fields. Diversification into unrelated domains can often lead to low performance and even failure.

Growth strategies for retailers can basically take two different forms:

- Increasing sales in existing retail outlets. This is mainly achieved via improved application of the retail marketing instruments presented in Part III of this book.
- Increasing sales by enlarging the outlet network. This is the focus of this chapter.

Establishing new stores is the most important growth route for retailers. For example, *IKEA* entered Poland in 1991 and now operates seven large stores in the country; in 2005 alone, *Macy's* (then still called *Federated Department Stores*) added 400 department stores to its store network in the USA; while *Fressnapf*, a German-based pet supply retailer, was

founded in 1989 and now controls a store network of more than 1300 stores in twelve European countries, of which around 850 are in Germany. *Inditex* entered Germany in 1998 and now operates 122 outlets there, 79 of which are under the *Zara* banner. *Tesco* entered Eastern Europe in 1994 and as of 2014 operated about 1025 stores in four countries. These examples also highlight the most important options for outlet growth:

- **Organic growth:** *IKEA*'s stores in Poland – and in fact most other countries – were established through organic growth.
- **Joint ventures:** *Inditex*'s market entry into Germany was achieved in a joint venture with the German retail group *Otto*, before later being transferred into full ownership.
- **Franchising:** Most of *Fressnapf*'s growth in Germany comes from attracting new franchise partners who open outlets under the *Fressnapf* brand.
- **Acquisition:** *Macy*'s growth in 2005 was the result of acquiring the *May* company and converting these stores into *Macy*'s department stores.
- **Mixed strategies:** *Tesco* entered most Eastern European markets with small initial acquisitions, buying a few stores from regional retailers or, as in the case of the Czech Republic and Slovakia, from US retailer *Kmart*. Many new stores were then opened via organic growth. However, if the opportunity to purchase additional stores emerged, the company took it. For example, in Poland, *Tesco* acquired stores from a German retailer that was exiting the country. And in the Czech Republic, *Tesco* acquired two convenience store chains, *Koruna* and *Zabka*, in 2011. While the *Koruna* stores were transformed into *Tesco Express*, *Zabka* stores are still operated by independent franchise partners. Thus, *Tesco* uses a wide range of different growth options in parallel in Eastern Europe.

7.2 Organic Growth through Outlet Multiplication

Retailers primarily expand their businesses by establishing their own new outlets. This is also called organic or internal growth. The resulting chain stores operate multiple retail stores under shared ownership and usually engage in some level of centralised decision-making. Large retail chain stores can comprise up to several thousand stores.

Advantages of Outlet Multiplication

Opening new branches has the advantage that the retailer's concept can be applied to the new store from the start. Location decisions, store layout and all the attributes of the new store can be tailored to fit an existing strategy. Store managers are company employees, which allows activities to be monitored closely and decisions to be made centrally. Risk is limited as expansion is gradual. By opening new outlets, necessary changes can be identified early, allowing the process for subsequent outlets to be modified. In addition, financing is sequential (i. e., the existing outlets can contribute to financing new outlets).

Constraints of Outlet Multiplication

At the same time, outlet multiplication can tie up considerable financial resources in the store network. Opening branches requires substantial capital investment, which is a major constraint on growth. In many markets, organic growth is slow because of zoning restrictions, planning permission, the search for sites, including the acquisition and development of premises, and so on. This runs the risk of not reaching critical mass fast enough, letting other retailers with similar concepts – but not constraints – expand faster. This problem particularly affects retailers that require large sites for their outlets (e. g., category killers and hypermarkets) (see Chap. 8), because approval for these sites is restricted in many countries.

Another drawback is the loss of flexibility over time. Many chain stores are slower to respond to changes in consumer demand and other situational factors because of the bureaucracy and decreased employee motivation typical of larger businesses. Tailoring the assortment to specific local needs is often easier for independent retailers than large chain stores (Ogden and Ogden 2005, p. 93). However, modern retail information systems increasingly allow centralised decision-making to be combined with locally adapted marketing, including a locally adapted merchandise mix or prices.

7.3 Cooperative Arrangements

7.3.1 Joint Ventures

Joint ventures are one of the most popular of the wide range of possible cooperative arrangements. Since joint ventures are not retail-specific, they will only be outlined briefly here. A joint venture is formed when two or more parties decide to undertake economic activity together and create a new enterprise as a legal entity in order to pursue a set of agreed goals. The parties agree to contribute equity and share the revenue, expenses and control of the enterprise (Morschett et al. 2015, p. 397; Sternquist 2007, pp. 148–150). For example, when the Spanish *Inditex* group entered Germany in 1998, it did so in a 50:50 joint venture with the German *Otto* group. This joint venture operated *Zara* stores in Germany.

Combining Resources

A major advantage of forming a joint venture is combining two companies' resources. Both companies bring financial and management resources, expertise, store outlets or other assets to the deal. When a retailer enters a new retail or service sector or a culturally distant foreign market, the market knowledge of a joint venture partner is particularly valuable and can facilitate expansion. In the example of *Inditex* and *Otto*, *Inditex* owned the retail brand and had the operating model for fast fashion, while *Otto* had the knowledge of the local market and better insights into location selection in Germany.

Risk Reduction

Another benefit of joint ventures is reduced risk, with risk split between the participating companies. The larger the retail company, the more likely it is to expand on its own, because larger companies can more easily manage the associate expenses and risk, while smaller companies may appreciate the support of a partner.

Coordination Costs and Conflicts of Interest

The major drawbacks of joint ventures are the high coordination costs involved when two independent partners with potentially conflicting objectives have to work together. Opportunism can emerge if one of the companies can profit at the expense of the other. Thus, managing a joint venture is more complex than managing a wholly owned company. Full control over the strategy of the joint venture is impossible, because all decisions must consider the interests of all participating companies. As a consequence, the stability of joint ventures is often rather low.

7.3.2 Franchising

The best-known examples of franchises are fast food chains like *McDonald's* or *Subway*, but franchising is also a common retail growth strategy. *7-Eleven* is probably the best-known example, but *The Body Shop* across Europe, *Fressnapf* in Germany, *ACE Hardware* in the USA, a significant number of *Carrefour's* convenience stores in France and the garden centre chain *Gamm vert* in France are other well-known retail brands operated as franchises.

Franchising is defined as a contractual agreement between two legally and financially separate companies, the franchisor and the franchisee. The franchisor, who has established a market-tested business concept, enters into a relationship with a number of franchisees, typically small business owners, who are allowed to use the franchisor's brand and must operate their business according to the franchisor's specified format and processes. The franchisor provides ongoing commercial and technical assistance. In return, the franchisees typically pay an initial fee as well as ongoing fees (royalties), which average about 5 % of gross sales, plus some advertising fees (Inma 2005, p. 29; Sternquist 2007, pp. 138–148).

According to different national franchise associations, the franchising sectors in different country markets have reached considerable size. As of 2014, there are about 1800 franchise systems in France, about 1075 in Germany and around 930 in the United Kingdom (although the latest available figures for the UK are from 2012). On average, each franchise system has between 40 and 50 franchise outlets, but the largest often exceed 1000. All statistics show that franchising is growing steadily (see, for example, Fig. 7.2).

Division of Tasks

A fundamental characteristic of franchising is that it always involves two separate and independent companies that assume distinct roles and a strict division of tasks in order to

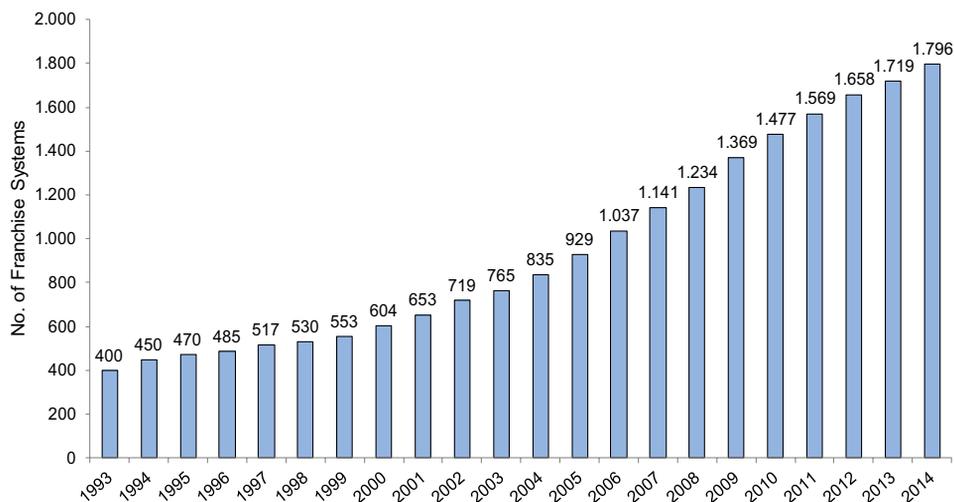


Fig. 7.2 Franchising in France. (Fédération Française de Franchise 2015)

achieve a joint objective. Since the franchisee owns their business, they are entitled to all profits that are generated. Franchising thus combines the benefits of a large, efficient retail system, including economies of scale in procurement, logistics, national advertising, IT systems and administrative activities, with the strength of an independent entrepreneur managing the outlet, including customer contact and supervising store employees (Zentes et al. 2003). The shared brand lets all participants in the franchising system benefit from the advertising and goodwill generated by each outlet. From the consumer's perspective, it is often impossible to detect the difference between franchises and company-run branches.

Forms of Franchising

There are two main forms of franchising (Sternquist 2007, p. 138):

- **Direct unit franchising** is the basic form. In a unit franchise, the franchisor grants the franchisee the right to engage in a single franchised business operated at a specified location.
- In a **master franchising** agreement, the franchisor grants the master franchisee a territory, and within this territory the master franchisee is allowed to establish unit franchises.

Sources of prospective franchisees can vary:

- Often, start-up entrepreneurs are targeted. Their inexperience makes the franchisor's business package relatively more attractive.
- In **multi-unit** franchising, successful franchisees are allowed to open new branches. This strategy is a type of organic growth within a franchise system. The number of

outlets per franchisee, however, is often strictly limited, because multiple franchise outlets diminish some of the advantages of franchising.

- **Conversion franchising** occurs when a franchisor adds new franchisees to the system by recruiting existing independent retail businesses (Hoffman and Preble 2003). Store owners may affiliate with the franchise system to take advantage of the brand and other components of the operating system.

Advantages for the Franchisee

There are a number of benefits to being a franchisee compared with running a non-franchised independent business. Upon opening the franchise store, the franchisee enjoys instant goodwill in the market because they can use an established brand name, exploit a tried-and-tested business concept and carry out standard operating procedures. The franchise headquarters will also take on certain tasks, e. g., organising a central logistics system, developing IT systems, negotiating with suppliers, developing national advertising, etc.

The franchisee also receives comprehensive information on the business concept before starting, including information on necessary investment and likely profits. They obtain training and support, and belonging to the franchise system usually provides the franchisee with easier access to financing, because from a bank's perspective it is less risky to extend credit to a franchisee, since it can provide a business plan based on the example of existing franchisees.

Advantages for the Franchisor

Franchising also conveys considerable benefits to the franchisor (Berman and Evans 2013, pp. 128–131; Cliquet and Pénard 2012; Zentes et al. 2003):

- Franchising facilitates rapid growth, particularly when the success of a concept depends upon rapid market coverage. Franchising is a way of multiplying a concept without the usual financial constraints, as franchisees finance the investment for establishing stores.
- Franchisees are highly motivated, because they manage their own stores.
- Franchisees have knowledge of local markets and customer and employee contact is direct and personal. Franchisees usually develop close relationships with their customers and local communities.
- Written franchise agreements require franchisees to adhere to stringent operating rules set by the franchisor.

Disadvantages for the Franchisor

One major disadvantage for the franchisor is that it has no direct hierarchical control over its franchisees. Franchisees are independent contract partners, not employees. Franchisees can harm the overall reputation of the franchise if they do not maintain company standards. From a transaction cost perspective, this means that a franchisor must conduct tight monitoring to avoid such freeriding. Representatives of the franchisor will often have to

regularly visit the franchisees, both to advise and monitor them. Changes in the franchisor's strategy may be slow to implement because franchise contracts usually run for three to five years and substantial changes are only possible by changing the contracts. Competition between different outlets leads to stronger conflicts than in chain store outlets, because profits are shifted from one franchisee to another. Also, franchisees can ally to restrict the influence of the franchisor and attempt to change the rules. Another drawback is that, under European law, the franchisor is not allowed to fix final consumer prices for products. Accordingly, the marketing and management of a franchise system is more complex than for a truly uniform and hierarchically managed system of company-owned stores.

Often, the balance between the benefits and drawbacks of franchising leads to an evolving growth strategy during the retailers' lifecycle. The resource scarcity that motivates retailers to embrace franchising as a growth strategy in the expansion stages lessens as the system becomes more established and growth rates decline. The costs associated with managing a complex franchise system gradually outweigh the benefits associated with the resources provided by franchisees. Consequently, over time franchisors tend to buy back franchises and increase the number of company-owned stores (Oxenfeldt and Kelly 1969). However, over the past few years the opposite has been seen, since many chain stores have found operating small, company-owned stores with low turnover in certain market areas is not profitable, and the higher motivation associated with manager-owned stores has often been enough to make such stores profitable. Thus, some large chains have started to spin-off certain retail outlets and transform them into franchised stores. Smaller supermarkets and convenience stores are typical objects of such transformations (Zentes et al. 2003, p. 227).

Plural-form Networks

Franchising is rarely used exclusively; franchisors usually own a substantial number of retail outlets themselves. The complexity of managing such plural-form networks is higher than that of managing monolithic systems of company-owned stores or franchises. While synergies can be leveraged by applying two different growth strategies simultaneously, such as higher franchisor flexibility when deciding on new store openings, the risk of conflict throughout the network is substantially higher, and the management culture required to manage a franchise system of independent store owners is often different from the culture needed to manage a chain store (Cliquet 2000; Cliquet and Pénard 2012).

7.4 Mergers and Acquisitions

Companies also have the option of external growth, namely expanding by acquiring resources from other companies. Expansion through mergers and acquisitions (M&A) involves consolidating or purchasing existing retail companies or retail outlets. Like diversification, it can also involve purchasing companies in other sectors than retailing. In a **merger**, two companies are combined and at least one of them loses its legal independence. In an **acquisition**, one company acquires a majority interest in another or takes over certain

assets (stores) from another company. The term “acquisition” is often restricted to a full takeover. The legal independence of the acquired company can remain intact (Zentes et al. 2013, pp. 264–265).

M&A are a well-established growth mechanism which have played a major role in structural changes in the retailing sector over recent decades (Burt and Limmack 2001), both in international (see Chap. 8) and domestic contexts. Some domestic examples will now be provided.

In 2005, the merger of *Sears* and *Kmart* into *Sears Holding* created the US’ fourth largest retailer. In 2014, *Dollar Tree* announced its intention to acquire *Family Dollars*, still subject to approval by the competition authorities. In 2007, the Swiss retailer *Migros* bought a 70 % stake in the Swiss discount chain *Denner*, adding 470 outlets to its store network. In the same year, the *Coop Group*, which already owned *Interdiscount*, the no. 1 consumer electronics retailer in Switzerland, acquired *Fust*, the no. 3 consumer electronics retailer in Switzerland. In 2013, the *Casino Group* acquired the remaining 50 % stake in the retail company *Monoprix*, which it had previously co-owned with the retail company *Galeries Lafayette*. At the beginning of 2015, the US supermarket chains *Albertsons* and *Safeway* completed their merger to form a 9 billion USD company. And in mid-2015, the merger of *Ahold* and *Delhaize* was announced. When this comes into force in 2016, *Ahold Delhaize* will be one of the biggest grocery retailers in the USA and Europe. An exhaustive list of such examples would be very long.

Advantages of M&A

M&A allow rapid expansion by overcoming the bottleneck created by the difficulty of establishing and developing adequate retail locations, which can take years from site selection to finally opening a store (Burt and Limmack 2001, p. 4). Within a short period of time, an acquisition makes an entire bundle of resources available to a company. This can be a critical success factor, especially when first-mover advantages are pursued in a new market (Meyer 2001, p. 359). Since the customer base of the acquired company can be preserved, market share is gained quickly in a new market. Thus M&A provides a company with substantial turnover in a new market from the outset, which can help pay for the investment.

After an acquisition, the original retail brand of the acquired retail outlets can be changed or retained. The brand is often kept when the acquisition is used to expand into other retail sectors or formats. A food retailer entering the DIY market, or a supermarket company acquiring a discount chain, for example, could be well advised to keep the acquired chain’s established retail brand, because the acquired company’s existing resources – management expertise, personnel, sites and so forth – will be focused on its established field of business. Thus, one objective of an acquisition is to exploit the expertise and dedicated assets of the acquired company.

Disadvantages of M&A

However, integration costs following an acquisition can be high. Incompatibility of company strategies, capabilities, resources and cultures often results in insufficient exploita-

tion of existing potential for synergies. The takeover and associated cultural change in the acquired company may also lead to brain drain and the loss of significant management skills. Also, in many markets it is difficult to find suitable takeover candidates. Successful retailers are usually not available for acquisition and the retail locations, stores and premises of less successful retailers are often insufficiently attractive for acquisition. However, properly evaluating the value of a retail company is difficult, and the real value and quality of the acquired company can often only be correctly assessed after the acquisition (Burt and Limmack 2001, p. 4). For example, in Germany *Walmart* found the store network it had acquired for market entry was unfavourable and no other targets for takeover became available later. The option of further expansion through acquisition may also be limited by antitrust laws, as the example of *Safeway* in the United Kingdom illustrates. In highly concentrated markets, authorities often prevent the largest players from acquiring other outlet networks.

In summary, acquisition is a strong fast growth strategy when adequate takeover objects are available, but the associated risk is substantially higher than with organic growth.

7.5 Minority Investment in Retail Companies

Owing to the difficulties associated with full-scale acquisitions, acquiring a minority stake in another retail company is another frequently pursued strategy. For example, *Kingfisher* bought a 21 % stake in the German DIY retailer *Hornbach* and supported *Hornbach's* national and international expansion, for example by providing funds. However, this stake was sold back in 2014 when *Kingfisher* entered the German market with its own retail chain. In 2004, Hong Kong-based *A.S. Watson* purchased a 40 % stake in the German drugstore chain *Rossmann* (see the case study for this chapter). In 2015, Australian retail market leader *Woolworths* acquired a 25 % stake in the purely online cosmetics company *Adore Beauty*.

Acquiring partial ownership of another retail company involves similar advantages and disadvantages to an acquisition strategy, but it also shares similarities with **equity joint ventures**. However, successful retail companies generally prefer for another company to buy an equity stake in their company rather than be fully acquired. Equity participation by a larger company can add resources to support further expansion. The strategy can also be useful in situations where full-scale acquisitions are difficult because of the particular market conditions or government control. At the same time, the remaining equity stake in the initial company reduces the risk of a brain drain (Zentes and Morschett 2002, p. 174), since the established management team of the acquired company often retains control, frequently only supplemented by additional management capacity from the acquiring company. This is evident when large store-based retailers acquire smaller online players, where the human capital of the online retailer is one of the most important assets to be acquired. The risk of overestimating the value of the partially acquired company is reduced compared to a full acquisition, because the acquiring company achieves full transparency over business processes and results, facilitating a potential full acquisition after a certain period.

7.6 Divestment – Reduction of Store Networks

While most companies focus on growth, some authors point out that strategic planning and analysis should also include the strategic withdrawal options from certain product or geographical markets. Sometimes closing down or divesting (selling-off) the unprofitable parts of a business or those that do not match the current strategy can help the retail company as a whole. Again, divestment can occur internationally (see Chap. 8) or domestically. Some domestic examples will be provided here.

In 2002 *Fressnapf*, the European market leader in pet food and pet supplies, closed down its online shop (which it reopened in 2010). In 2008, German retail group *Tengelmann* sold an 85 % stake in its discount chain *Plus* to German competitor *Edeka*. In 2011, *Carrefour* divested its global discount operation *Dia*. However, in 2014, *Carrefour* bought back *Dia*'s 800 discount outlets in France. In 2014, German retail group *Douglas* sold the jewellery chain *Christ* to focus on its perfumery business. In early 2015, *Tesco* announced the closure of 43 unprofitable stores in the UK to optimise its store network. Also in 2015, US retail company *Dollar Tree* announced it would sell 300 of its stores to secure approval for its takeover of competitor *Family Dollar*.

These examples demonstrate that retail growth strategies are closely connected to withdrawal or reduction strategies. Withdrawal or reduction are not always the result of failure (although they often are). Other reasons can include a change in corporate strategy, a change in external conditions, the need to generate cash to strengthen operations in another retail sector or low future expectations for the specific retail format.

Generally, divestment means a retailer expects a better opportunity for investment and growth elsewhere. Retailer portfolios are often reassessed in terms of their stores, store formats and country markets, and strategic withdrawal from one retail format, region or national market often provides the starting point for expanding into other markets or for opening additional stores in the remaining markets.

7.7 Conclusion and Outlook

Growth is highly relevant for the success of a retail company, but it has become harder to achieve, for several reasons. Large retailers hold a lot of power, crowding out independent retailers and small chains, and there is already a high and increasing level of concentration in many retail markets, combined with market saturation in many product categories.

Flexible growth strategies are more important than ever. Retail companies do not normally use these strategies in isolation, as the example of *Tesco*'s internationalisation or the description of plural form networks illustrates. If a retail company wants to enter a completely new country or establish a new store format (e. g., a food company entering into electronics retailing), an initial acquisition can help quickly achieve critical mass. From there, the company can grow by establishing new sites and opening stores. In addition, as

was shown in the context of increasing concentration in retailing, companies often gain a major boost by acquiring smaller chains who are leaving the market.

Larger, divisionalised retail store groups with different retail formats often implement different growth strategies for different formats and/or markets. For example, *Carrefour* operates its hypermarkets in most parts of the world as its own outlets, but it franchises its system in the Middle East (United Arab Emirates, Egypt, Saudi Arabia) to the *Majid Al Futtaim Group*, which operates a number of large hypermarkets. This is probably due to difficult market conditions in this region, which are offset by its franchise partner's local knowledge. Most of *Carrefour's* convenience stores throughout the world are franchised, and the expansion of supermarkets stems at least partly from franchised outlets, although they also have a substantial number of their own outlets. In the Balkans, *Carrefour* established a joint venture in 2010 with the Greek company *Marinopoulos* to open stores in Bosnia, Slovenia, Serbia and Croatia, among others. This is typical for retail companies who use different growth strategies over time and who tailor these strategies to the retail format and specific situation.

Further Reading

- Hoffman and Preble (2003): Convert to compete: Competitive advantage through conversion franchising. *Journal of Small Business Management*, 41(2), 187–204.

7.8 Case Study: A.S. Watson

7.8.1 Profile, History and Status Quo

The forerunner of *A.S. Watson*¹, a small dispensary named *The Canton Dispensary*, opened in 1829 in Guangzhou, China. In 1871, the company changed its name to *A.S. Watson & Company, Limited*. Today, *A.S. Watson* is the largest international health and beauty retailer in Asia and Europe. It operates 13 retail brands with more than 11,600 retail stores in 24 countries worldwide and employs 110,000 people. Since 1963, *A.S. Watson* has been part of the Hong Kong-based conglomerate *Hutchison Whampoa Ltd.*, which comprises different core businesses: telecommunications, energy, infrastructure, investments, retail, property and hotels, ports and related services. *A.S. Watson* is *Hutchinson Whampoa's* retail division; almost all of *Hutchison Whampoa's* retail formats are run by *A.S. Watson*. In 2014, Singaporean *Temasek Holdings* bought a 25 % stake in *A.S. Watson*, partly because *A.S. Watson* is well-suited to serving the growing middle class in emerging countries.

¹ As well as the explicitly cited sources, sources used for this case study include the website <http://www.aswatson.com> and several editions of the newsletter *WatsOn*.

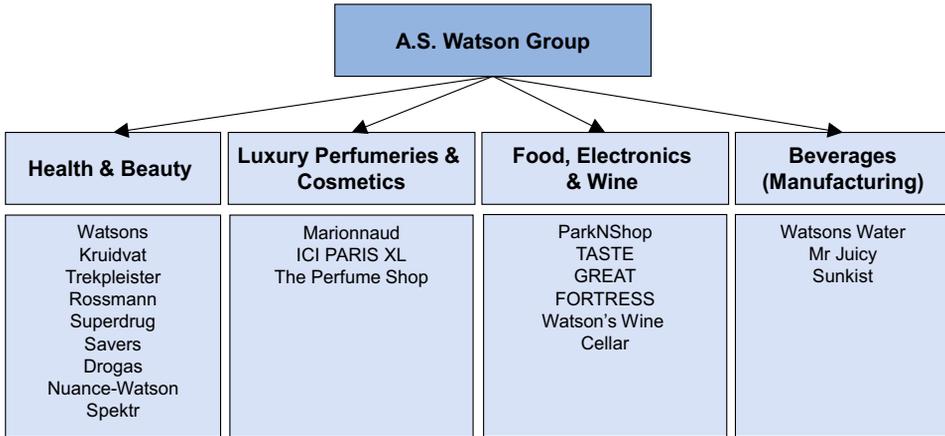


Fig. 7.3 Divisions and retail brands of *A.S. Watson*

A.S. Watson operates retail stores selling health and beauty products, perfumes and cosmetics, food and electronics and airport retail stores in Asia and Europe. The company also produces and distributes a range of own-label beverages including distilled water, fruit juices, soft drinks and tea products for retail, office and domestic supply. In the course of expanding the group's operation in Europe, business units were realigned into divisions. As shown in Fig. 7.3, there is a health and beauty division, a luxury perfume and cosmetics division, a food, electronics and wine division and a beverages manufacturing division.

A.S. Watson consists of several business units and offers a diverse brand portfolio. The health and beauty category, for example, is represented by *Watsons Your Personal Store* in Asia (Hong Kong, mainland China, Taiwan, Macau, Singapore, Malaysia, Thailand, Philippines, Indonesia, Korea and Turkey), *Kruidvat* (the Netherlands, Belgium), *Superdrug* (UK), *Rossmann* (Germany, Poland, Hungary, Czech Republic, Turkey and Albania), *Savers* (UK), *Trekpleister* (the Netherlands), *Drogas* (Latvia, Lithuania), *Spektr* (Russia) and *Watsons Your Personal Store* (Estonia, Slovenia, Ukraine) in Europe. *A.S. Watson* also sells luxury perfumes and cosmetics. It operates the retail chains *Marionnaud* (France, Austria, Switzerland), *ICI Paris XL* (Netherlands, Belgium, Luxembourg) and *The Perfume Shop* (UK, Ireland). In Asia, *A.S. Watson* operates groceries retail chains such as the *PARKnSHOP* supermarket chain (Hong Kong, Macau, mainland China). The company also owns *Watson's Wine Cellar* (Hong Kong, mainland China).

In 2014, *A.S. Watson* reported a 6 % growth in total revenue to 157.4 billion HKD (18 billion EUR) while EBIT increased 11 % to 13.0 billion HKD compared with 2013. The company reported like-for-like sales growth (i. e., sales growth in previously existing stores) of 2.3 %, with 1.4 % in Asia and 3.0 % in Europe in 2014. Thus more than half of overall growth resulted from opening new outlets. Fig. 7.4 shows the changes to the number of stores worldwide since 1999.

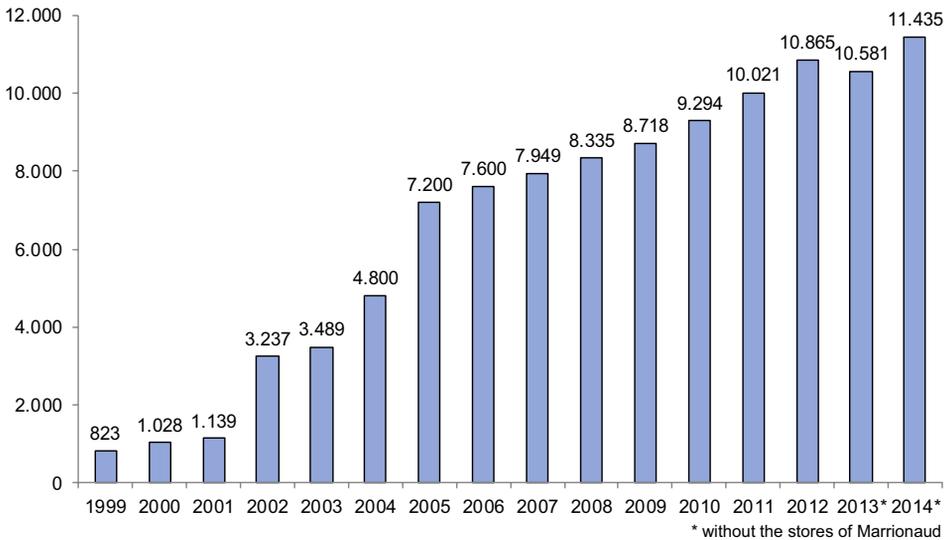


Fig. 7.4 Changes to the number of *A.S. Watson* stores worldwide. (Hutchinson Whampoa 2014, p. 27; Hutchinson Whampoa 2011, p. 9)

7.8.2 Organic Development in Selected Fields in Recent Years

A.S. Watson intends to continue to expand into high growth markets. Its strategy can be explained as a mix of market penetration (e. g., further extending the chain store network in existing markets) and market development (mainly through internationalisation into new country markets). *A.S. Watson's* international operations outside China (incl. Hong Kong) contribute about 70 % of the company's total revenue, showing the significance of internationalisation to the group's success. The internationalisation of *A.S. Watson* began as early as 1883 with market entry into the Philippines. Since 1987, *A.S. Watson* has gradually expanded into other Asian countries before entering Europe in 2000 (Zentes et al. 2011, p. 171).

As discussed in this chapter, a primary method for a retailer to expand its business is organic growth – usually through outlet multiplication. *A.S. Watson's* strategy includes a diversified product offering and an expanding customer base owing to new store growth. In 2011, Ian F. Wade, former Group Managing Director of *A.S. Watson*, stated: “Organic growth plays a major part in our expansion” (Zentes et al. 2011, p. 173).

The retail brand *Watsons* has seen particularly strong growth rates in recent years. Growing rapidly across Asia and Eastern Europe, *Watsons* has been organically expanding its store portfolio to bring quality health and beauty products and professional services to its customers. In 2013, its store expansion accelerated. The highest growth was achieved in mainland China, where it increased its total number of stores by 255 in 2013 and by 395 in 2014. The company currently operates 2000 stores in 353 cities in mainland China (Hutchison Wham-

poa 2014). “Our global expansion plan for *A.S. Watson* is to exceed 13,000 stores in 2015. *Watsons* is one of the Group’s flagship retail brands. This year alone we plan to open 1200 new stores, amongst which 700 will be under the *Watsons* brand. This represents an average of over 3 new stores a day throughout the year”, says Dominic Lai, Group Managing Director of *A.S. Watson*. For its 2015 expansion in China, the company announced plans to further penetrate existing regions (mostly China’s first and second tier cities) with additional outlets while simultaneously beginning to expand its outlet network into lower tier cities.

However, as Fig. 7.4 illustrates, retail companies do not only grow; **divestment** from specific markets and **downsizing** of store networks may also be necessary and useful. Since 2013, the *Marionnaud* store network is no longer included in the group’s store figures, because this retail brand is being restructured and was separated from the rest of the *A.S. Watson* group by *Hutchinson*. *Marionnaud* is also not part of the deal with *Temasek Holdings*. In fact, the luxury perfume chain has shown weak performance in Europe, particularly in the aftermath of the financial crisis. Therefore, the retail chain divested from Poland and drastically reduced its store network in Spain and Portugal.

7.8.3 Cooperative Growth and Buying Stakes in Retail Companies

Cooperation is another growth strategy. The most popular forms of alliances for growth are joint ventures, which combine the resources of at least two companies to reduce the business risk for both parties. *A.S. Watson* also uses this strategy to grow.

In 1998, the company formed a partnership with the *Nuance Group* to form the *Nuance-Watson* retail airport concessions joint venture. The business operated 46 stores in Hong Kong, Macau, mainland China, Singapore and Malaysia, offering travel retail services and duty-free stores, primarily in airports. However, in 2014, *A.S. Watson* reached an agreement to sell its share in the travel retail business back to the *Nuance Group* (CK Hutchison Holdings 2014): “The *Nuance-Watson* joint venture has been strong and fruitful, and the co-operation with the *Nuance Group* has been a win-win partnership for many years. We see this deal as an opportunity for us to focus on our core retail operations, as we continue to expand rapidly in Asia and Europe.”

In 2002, *A.S. Watson* launched a joint venture with the *SM Group* in the Philippines. This partnership brought *Watson’s* health and beauty and pharmacy stores to the Philippines. It has acquired the existing 61 health and beauty and drug stores under the *SM Group* to launch the popular *Watsons* concept nationwide (Hutchison Whampoa 2002). Today, *Watsons* operates 402 stores in the Philippines and plans to increase its share in the local retail sector with an aggressive expansion programme, adding 50 new stores each year (The Philippine Star 2014).

In 2005, *A.S. Watson* established a 50:50 joint venture with the leading Korean retail company *GS Retail* (formerly *LG Mart*), which signified the expansion of its flagship *Watsons* health and beauty retail chain into the Korean market. The joint venture company was given the name *GS-Watsons* and the retail chain was launched under the *Watsons* banner (Hutchison Whampoa 2004). “The success of any joint venture depends much on

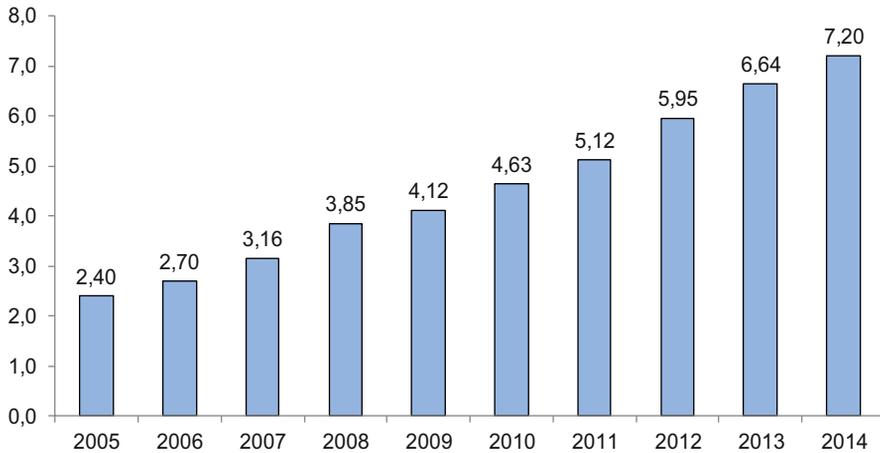


Fig. 7.5 Growth of *Rossmann's* revenues (in billion EUR). (Rossmann 2015b, p. 9)

the complementary strategic values each party can bring to the business. *LG Mart* is an established retailer in Korea with all the market know-how and network, while *Watsons* health & beauty chain is a proven successful concept that travels. Combining *Watson's* advanced operating skills and global sourcing capabilities with *LG's* distribution, logistics infrastructure, information system, and site development expertise, the growth potential of *Watsons* chain becomes very promising in Korea,” said Ian F. Wade.

In 2004, *A.S. Watson* acquired a 40 % stake in the German retail chain *Rossmann*, adding 786 new stores to the group's portfolio. *Rossmann* was founded in 1972 by Dirk Rossmann, who has developed the company into a network of over 3200 stores in six European countries. In Germany, where it has 1930 stores, *Rossmann* is one of the leading players in the health and beauty retail market and a very established name in the community. Today, *Rossmann* operates 1353 stores outside Germany: more than 1000 in Poland, nearly 200 in Hungary, about 120 in the Czech Republic, 32 in Turkey and six in Albania (Rossmann 2015a). As Fig. 7.5 indicates, participating in *Rossmann* contributes to the *Watson* group's steady growth in Europe; *Rossmann's* revenues have seen constant growth. This rapid expansion will continue with the opening of 340 new stores within and outside Germany in 2015 (Rossmann 2015c). This joint venture also shows the benefits of such a growth strategy: *Rossmann* knows the German retail market and the Eastern European retail markets very well, and the financial strength of *A.S. Watson* lets the company fully leverage this market expertise into growth.

7.8.4 Acquisitions by A.S. Watson

Expanding by acquiring other companies is another way for companies to grow. *A.S. Watson* recently used this strategy.

In 2000, *A.S. Watson* acquired *Savers*, a health and beauty chain that sells fast-moving toiletry products. *Savers* operated 176 stores at the time, and the discount format complemented *A.S. Watson's* fast expansion strategy. Today, *Savers* operates over 230 stores in England, Scotland and Wales. *Savers'* retail strategy is a pared down product range, with customers only able to choose from 3000 products, compared with 10,000 at other key specialists. Its strategy involves opening 50 new stores a year. Since 2002, England's *Superdrug* has been part of *A.S. Watson* as well. *Superdrug* is the second largest health and beauty chain in the UK, with over 900 stores nationwide. *Superdrug* offers thousands of own-label products, specially tailored to the needs of British customers.

In 2001, the Swiss company *Badaracco* was added to *A.S. Watson's* portfolio, and its wine business was expanded into Europe via this international distributor. Exports represented a share of 75 % of total sales, underlining the international orientation of *A.S. Watson's* partners. However, in 2013, this business was sold off again.

In 2002, *A.S. Watson* acquired the *Kruidvat Group*, making *A.S. Watson* the world's third largest beauty retailer. Together with *Kruidvat*, *A.S. Watson* took over *Trekpleister*, *Ici Paris XL* and *Superdrug* and integrated *Rossmann* into the group. *Kruidvat* currently has a store portfolio of 1900 stores and operates in the Netherlands, Belgium and Luxembourg. This merger was an important step in their progressive expansion plan into the European market. Consequently, the group's European portfolio instantly increased to 12 countries. This merger was also an important factor in *A.S. Watson's* expansion strategy, as it brought geographical balance to the group's retail business and increased and diversified the group's earnings in Europe. *Kruidvat* was seen as an important entry point for expansion into the Eastern European market, which has high growth potential in terms of GDP and store expansion. In addition to growth potential, there is also room to increase efficiency thanks to companies' synergies in IT, logistics, accounting, best practices and sales trends.

Drogas was taken over by *A.S. Watson* in 2004. *Drogas* is a well-established health and beauty chain in Latvia and Lithuania. The acquisition was the first step into Eastern Europe, where *A.S. Watson* wants to exploit the great potential for economic growth and customer spending. In 2004, *Drogas* operated 85 stores and had a market share of 30 % in the Latvian market. The acquisition was an important strategic factor in the group's expansion: "Latvia and Lithuania is our springboard to the Baltics, the Confederation of Independent States and Nordic markets," says Ian F. Wade.

The acquisition of *Marionnaud* in 2005 made *A.S. Watson* the largest health and beauty retailer and luxury and cosmetics retailer in the world. *Marionnaud* has presence in France, Austria and Switzerland and adds to *A.S. Watson's* strong family of brands. In the same year, *A.S. Watson* acquired the Russian retail chain *Spektr*; expanding the group's global reach to 34 markets. *Spektr* owns 24 stores in Russia. The first entry into Korea also took place in 2005. Today, the portfolio has expanded to 27 stores.

In 2006, *A.S. Watson* acquired a 65 % stake in *DC*, Ukraine's largest and only nationwide health and beauty retail chain with 113 stores. It is operated using the format of a convenience drugstore, offering a comprehensive mix of personal care and toiletry products.

Since the acquisition in 2006, *A.S. Watson* has successfully expanded the *DC* network in Ukraine increasing the number of stores from 112 to 212. In 2010, *A.S. Watson* bought the remaining shares in *DC* Ukraine and rebranded the retail network from *DC* to *Watsons* (CK Hutchison Holdings 2011).

In 2015, *A.S. Watson* bought all 50 stores of the Dutch drugstore chain *Dirx* and announced they would be transformed into *Kruidvat* or *Trepleister* stores.

As well as direct acquisitions, *A.S. Watson* also participates in the growth its joint venture partners or other venture partners achieve through acquisitions. For example, in 2008, *Rossmann* acquired more than 150 German outlets from its smaller competitor *Kloppenburg*. The resulting sales growth also contributes to *A.S. Watson's* growth thanks to their 40 % stake in *Rossmann*.

As this section has demonstrated, retail chains are rarely rebranded after acquisition because of the low brand awareness for *Watson* in Europe. Instead, local brands provide consumers with a familiar shopping experience and appeal to local customers. Hence, they can operate in heterogeneous markets with diverse formats and concepts while still achieving economies of scale thanks to an efficient procurement system. Even within China, *A.S. Watson* tailors its offers to specific customer demands. Dominic Lai, managing director, puts it this way: “Our offer is different in Shanghai from in the south. This isn’t cookie-cutter expansion” (Danaher 2009).

7.8.5 Conclusion and Outlook

Over the past 20 years, *A.S. Watson's* expansion has accelerated tremendously. The group now operates retail chains all over Asia and Europe and still plans to continue its strategy of aggressive growth. *A.S. Watson* wants to benefit from Asia’s growth potential by expanding its presence into markets such as China and Singapore. *A.S. Watson* also plans to further penetrate European markets to tap into the economic growth in newly developing countries in Eastern Europe.

A.S. Watson does not focus on a single growth strategy, instead using different strategies in combination. One such strategy is organic growth. In recent years, the company has been steadily opening new outlets in Europe and Asia. Another growth strategy is cooperation, for example the joint venture with *GS Retail*. Similarly, *A.S. Watson* has bought stakes in companies like the German retail chains *Rossmann* and *DC* to develop new market segments. These ventures continued to grow themselves after establishing the partnerships, often via organic growth but also partially through their own acquisitions.

Because of *A.S. Watson's* international expertise and knowledge of regional conditions in the target countries, it can offer precisely the right products and services to satisfy customer demand. It can achieve growth advantages in procurement despite having a very diverse portfolio of retail brands. Furthermore, the company has a very strong financial basis, which helps achieve organic growth and also helps alliance partners fund their own growth.

Questions

1. Retail companies have different options for growth. What strategies does *A.S. Watson* pursue?
2. What are the advantages and disadvantages of mergers and acquisitions for the growth of *A.S. Watson*?
3. Discuss the main benefits and challenges of forming a joint venture, using the example of *A.S. Watson*.

References

- Ansoff, H. (1988). *New corporate strategy* (4th edn.). New York: Wiley.
- Berman, B., & Evans, J. (2013). *Retail management: A strategic approach* (12th edn.). Upper Saddle River/NJ: Pearson Education.
- Burt, S., & Limmack, R. (2001). Takeovers and shareholder returns in the retail industry. *The International Review of Retail, Distribution and Consumer Research*, 11(1), 1–21.
- Channel EMEA (2013). New Retail-to-Business (#R2B) channel summit confirmed for DISTREE EMEA 2014. <http://www.channelemea.com/spip.php?article11085>. Accessed June 18, 2015.
- CK Hutchinson Holdings (2011). A.S. Watson Group rebrands its retail network in Ukraine to Watsons. http://www.ckh.com.hk/upload/attachments/en/pr/2292_eng.pdf. Accessed June 10, 2015.
- CK Hutchinson Holdings (2014). Press release. http://www.ckh.com.hk/en/pr/topic_pdf/ASWG_TNG_e_20140529/ASWG-TNG/. Accessed June 13, 2015.
- Cliquet, G. (2000). Plural forms in store networks: A model for store network management. *The International Review of Retail, Distribution and Consumer Research*, 10(4), 369–387.
- Cliquet, G., & Pénard, T. (2012). Plural form franchise networks: A test of Bradach's model. *Journal of Retailing and Consumer Services*, 19(1), 159–167.
- Danaher, T. (2009). A.S. Watson: Gunning for the Chinese lion's share. *Retail Week*, December 4, 2009.
- Fédération Française de Franchise (2015). Les chiffres-clés en France. <http://www.franchise-fff.com/franchise/chiffres-cles/les-chiffres-cles-en-france.html>. Accessed June 7, 2015.
- Hoffman, R., & Preble, J. (2003). Convert to compete: Competitive advantage through conversion franchising. *Journal of Small Business Management*, 41(2), 187–204.
- Hutchinson Whampoa (2002). A.S. Watson launches joint venture with SM Group in the Philippines. http://www.hutchison-whampoa.com/en/media/press_each.php?id=888. Accessed June 5, 2015.
- Hutchinson Whampoa (2004). A.S. Watson enters Korea. http://www.hutchison-whampoa.com/en/media/press_each.php?id=1550. Accessed June 13, 2015.
- Hutchinson Whampoa (2011). Annual report 2011. <http://www.hutchison-whampoa.com/en/ir/annual.php>. Accessed June 13, 2015.
- Hutchinson Whampoa (2014). Audited results for the year ended 31 december 2014. http://www.aswatson.com/uploads/news/news312/pdf_e.pdf. Accessed June 13, 2015.

- Inma, C. (2005). Purposeful franchising: Re-thinking of the franchising rationale. *Singapore Management Review*, 27(1), 27–48.
- Meyer, K. (2001). Institutions, transaction costs and entry mode choice in eastern Europe. *Journal of International Business Studies*, 32(2), 357–367.
- Morschett, D., Schramm-Klein, H., & Zentes, J. (2015). *Strategic international management – text and cases* (3rd edn.). Wiesbaden: Springer Gabler.
- Ogden, J. R., & Ogden, D. T. (2005). *Retailing – integrated retail management*. Boston et al.: Dreamtech Press.
- Oxenfeldt, A., & Kelly, A. (1969). Will successful franchise systems ultimately become wholly-owned chains? *Journal of Retailing*, 44(4), 69–87.
- Rossmann (2015a). Rossmann International. http://www.rossmann.de/unternehmen/ueber_uns/rossmann-international.html. Accessed June 13, 2015.
- Rossmann (2015b). *Das Unternehmen 2015*. Burgwedel: Rossmann.
- Rossmann (2015c). Unternehmensprofil. http://www.rossmann.de/unternehmen/ueber_uns/unternehmensprofil.html. Accessed June 13 2015.
- Sternquist, B. (2007). *International retailing* (2nd edn.). New York: Fairchild.
- The Philippine Star (2014). Watson's targets bigger market share. <http://www.philstar.com/business/2014/09/01/1363922/watsons-targets-bigger-market-share>. Accessed June 5, 2015.
- Zentes, J., & Morschett, D. (2002). Retail branding – concept, effects and its influence on the Internationalisation process of retail companies in Europe. In C. Scholz & J. Zentes (Eds.), *Strategic management – A European approach* (pp. 161–184). Wiesbaden: Schäffer-Poeschel.
- Zentes, J., Morschett, D., Neidhart, M., & IBB (2003). Vertikale Vertriebskooperationssysteme – Perspektiven und Strategien. In H.I.MA (Ed.), *Die Zukunft der Kooperationen* (pp. 189–267). Frankfurt: H.I.MA/IBB.
- Zentes, J., Morschett, D., & Schramm-Klein, H. (2011). *Strategic retail management – text and cases* (2nd edn.). Wiesbaden: Gabler.
- Zentes, J., Swoboda, B., & Schramm-Klein, H. (2013). *Internationales Marketing* (3rd edn.). Munich: Vahlen.
- Zentes, J., Ney, B., & Whitaker, D. (2015). *Retail to Business (R2B) – Der Einzelhandel entdeckt den Profikunden*. Saarbrücken: H.I.MA.