FURNITURE INDUSTRY SECTOR UPDATE:

Transforming furniture trade as an opportunity for manufacturers

RISING CHALLENGES BECAUSE OF IMPORTS AND CHANGED DISTRIBUTION STRUCTURES

Andersch

PRESSURE FROM ALL ANGLES

According to the Association of the German Household Furniture Industry (VdDW), the sector contracted by -3.13% in the first three quarters of 2018 compared to the prior-year period. Sector experts also expect negative market growth in the full year, especially for German manufacturers. In addition to growing pressure due to imports from Poland, China and the Czech Republic, other factors also put increasing pressure on the German furniture industry, rendering it impossible for the German furniture industry to maintain last year's record export level. The main reason is Brexit – the UK had previously been one of the key export targets. Our key growth driver of recent years – trends in the construction industry and the general economic development – have already reached peak levels with no more room for growth.
In addition, the long summer heat wave caused a real summer slump in (stationary) furniture retail, while price increases for the raw materials wood, metal and energy on the cost side led to shrinking margins. Industry associations expect that the sector environment will continue to be challenging in 2019.

STATIONARY TRADE CANNIBALIZED BY ONLINE RETAILING

The dramatic growth of online retailing poses additional challenges. According to the household furniture survey 2018 conducted by the Otto Group, online furniture retailing gained 15% since 2014. Ikea alone saw a 37.5% increase in its online revenue between 2011 and 2016.
In addition, stationary shops are also under pressure due to the high transparency of prices making products easily comparable: An increasing number of customers consult the Internet before visiting a furniture store, thus needing much less advice than in the past (so-called ROPO effect: research online, purchase offline). The unique selling proposition of being able to provide consultation on site is therefore no longer as important.
The long delivery times of traditional furniture stores are also a serious competitive disadvantage compared to the more common immediate delivery provided by online trading. This is perceived by end customers as a lack of service and supports the already widespread perception that furniture stores are "outdated"(1). In addition, the trend is shifting towards more individualized interior designs: People tend to buy individual pieces today instead of complete wall units or bedroom units – also playing into the hands of online retailing.

THERE IS URGENT NEED FOR ACTION

While Eastern European competition is quite open to online trading, German manufacturers still find it difficult. However, even traditional furniture retailers are starting to establish their own online shops. If companies want to prevail as manufacturers, they will have to serve this channel in the future.

„Those who are not ready for change will disappear from the market."

(anonymous, manufacturer of household furniture)

This requires, on the one hand, the development of interfaces for ERP systems and the provision of content (images, texts, product data) for the web shops of online retailers. On the other hand, it also includes logistical adjustments – to the point of enabling drop shipping and direct delivery to end customers. Manufacturing processes need to be modularized, for example using a toolkit system, in order to meet the high requirements of individual furnishings.
Building a brand becomes a key factor for online distribution. While manufacturers often disappeared behind their own brands of stationary retailers in the past, online shops usually sell various brands under their own name. Manufacturers are called upon to considerably expand their media presence in order to set themselves apart from their competitors. Focusing on a core brand is important for a strong and consistent brand positioning. This creates another online retail opportunity for manufacturers: Using platforms such as amazon, manufacturers can sell directly to end customers without first having to invest in setting up and establishing their own shop. In addition to a strong brand, this also requires highly efficient logistics. If this can be achieved, however, amazon provides manufacturers with the outlook of specifically targeting customers with an interest in furniture from a pool of around 44 million potentials.

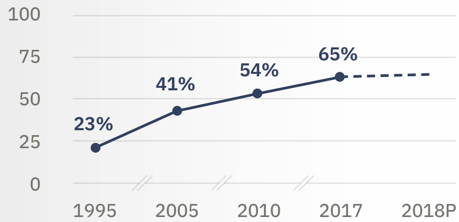
(1) Around 40% of all intensive smartphone users already share this perception
(2) Extrapolated forecasts by BVDM based on the first ten months 2018
Sources: Andersch analysis; VdDW; OTTO Furniture Survey 2018; IKEA; IFH Cologne 2018; German Federal Statistical Office; Eurostat; IMF; Statista; VDM; BVDM; Eurostat

REVENUE FORECAST
FURNITURE/HOUSEHOLD ITEMS
2017-2022F (CAGR)

1,5% Total sector growth

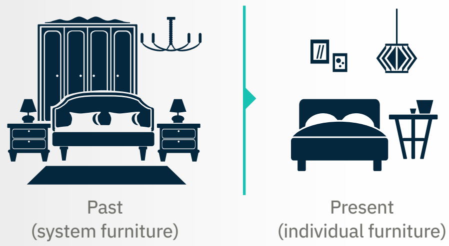
10,5% e-commerce

INCREASE IN FURNITURE IMPORTS
REVENUE SHARE IMPORTS (%)



-2% **2018 revenue** vs. prior yearin the furniture, kitchen and furnishing trade(2)

MANUFACTURERS DISADVANTAGED BY NEW INTERIOR DESIGN HABITS



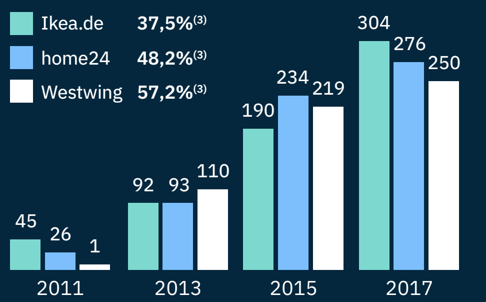
„It remains to be seen, which manufacturers will actually still exist in 3 to 5 years."

(anonymous, manufacturer of household furniture)

GROWTH AREAS OF GERMAN FURNITURE RETAILING

- Hardly any growth of overall market
- High growth rates, however, in the online segment
- Online pure players such as home24, Westwing and wayfair boast particularly strong revenue growth
- Stationary providers expand their online presence, Ikea successfully assumes pioneering role
- Increasing furniture sales via platform providers such as amazon
- Increasing significance of online distribution enables furniture manufacturers to directly sell to end customers via platforms or own online shops

ONLINE REVENUES OF LEADING RETAILERS (€M)



(3) CAGR 2011-17 and Westwing CAGR 2012-16

	STATIONARY TRADE	ONLINE TRADE	PLATFORMS/ DIRECT SALES ONLINE
STATUS	Still strong position as a traditional distribution channel; broad geographical coverage; high degree of concentration and bargaining power vis-à-vis manufacturers	Rapid growth thanks to cannibalization of stationary sales; pure player advantaged due to head start and intensive knowledge of end customers	Online platforms as a digital environment allowing sellers/manufacturers to find buyers/end customers already successful in other sectors such as book retailing
TRENDS	Sharp decline in visitors; intensive expansion of online presence; increasing consolidation due to insolvencies	Advance into stationary trade with pop-up or flagship stores; development of new country markets	The platform principle is gaining importance in furniture retailing; millions of end customers can be reached directly via platforms such as amazon

For furniture manufacturers, the online sales channel is both a challenge and an opportunity: For many manufacturers, having an online presence is turning into a question of existential importance. This also offers the potential, however, of opening a door to direct sales.

„Ikea's success hinges on being available to end customers on all channels. Our deep understanding of the end customer, his purchasing behavior and living habits plays a pivotal role in keeping the shops attractive. However, e-commerce is also becoming increasingly important for us."
(Leading manager at Ikea)

Manufacturers need strong brands and access to end customers

„We hope to cooperate even more directly with furniture manufacturers in the future. German manufacturers in particular are very cautious for fear of offending their traditional customers. Polish manufacturers are much more daring, flexible and faster in their reactions. Their great success in Germany seems to prove them right."
(Buyer & Business Developer at Wayfair)

Source: Andersch analysis; expert interviews

IMPLICATIONS FOR MANUFACTURERS

KNOWLEDGE OF END CUSTOMERS & MARKET POSITIONING

- Breaking the dependency on stationary retail and purchasing associations by increasingly addressing end customers directly
- Detailed target group analysis and detecting points of contact with brands in the furniture purchasing process
- Broadening the customer base: contact new trade partners (e.g. online pure players) and review direct sales options (possible via intermediary platforms)
- Improving the basis for negotiations with retailers/associations through sales support services such as provision of digital content
- Reducing complexity and increasing the brand positioning by concentration of activities on leading core brands

DEVELOPMENT OF DIGITAL MATURITY

- Consistent realignment of processes and structures, for example to enable drop shipping
- Positioning a core brand vis-à-vis the end customer
- Creating an online presence and communicating via all channels (social media, website, shops) and as many points of contact as possible in order to draw the attention of end customers looking to make a purchase to your specific brand and products
- Comprehensive preparation to enable furniture e-commerce and e-fulfilment (highly intensive logistics)
- Modularity (e.g. introduction of a toolkit system) enables efficiency increases, while complexity is at the same time increasing due to a high diversity of products
- Standardized pricing and positioning of core brand in order to indicate transparency

Are you interested in trends in the furniture industry? We look forward to hearing from you and would be happy to arrange an informal first discussion.

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