

## Focus on Germany >>

CONSUMER FOCUS – ISSUE 6



# For German companies, recovery in the Euro zone means rethinking European market strategy

The future appears brighter for German firms and Europe in general but a tangible recovery in the Euro zone will require German companies to rebuild broken trade ties in the region. >>



Election year in Germany has brought a lot of tensions to the fore concerning the country's role in Europe. In this article

we give an overview of the German consumer industry, pre and post election, and discuss what could be done to help reaffirm the role of German industry in European markets.

In the month leading up to the German election on 22nd September it was confirmed that in Q2, the German economy grew at its strongest rate in more than a year and this faster than expected growth also helped ease the Euro zone out of an 18 month recession. Moving into election month, spurred on by this positive news and the imminent prospect of, perhaps not a new government, but certainly a symbolic new start for Merkel and the CDU, many anticipated German consumer confidence to continue growing, as it had so far this year. But no. The GfK Consumer Confidence indicator for Germany unexpectedly declined from the previous month's six year high and the general economic outlook expressed by those who participated in the survey was less optimistic.

This was a sobering reminder that although the German economy appears more robust than its European peers, even signs of a tangible Euro-

wide recovery, or indeed a general election, wasn't enough to persuade consumers that the future, certainly in the short term, may appear brighter. The reality is that the average price for grocery and household products has risen by around 4% this year in Germany and the anticipation of further price increases, particularly within the discount market,

**"Although German consumers recognised that the economy was improving, they remained slightly pessimistic about their overall purchasing power..."**

seemed to have put an end to the upward trend of consumer sentiment in Germany, for the time being. Although German consumers recognised that the economy was improving, they remained slightly pessimistic about their overall purchasing power amidst price hikes and the prevailing uncertain conditions, regarding household income.

However, following the news in September that Angela Merkel and the CDU had won an historic third term in government, taking 41.5%

of the vote, consumer confidence, measured in the monthly GfK consumer index, rose to its highest level in six years. It would seem that Germany's 'underwhelmed' pre-election spenders were perhaps reacting to the puffery of election promises and analyst forecasts suspiciously, securitising how meaningful this new era of growth really was and perhaps giving the impression that definitive change, as far as they were concerned, was still going to take some time. But, once some clarity had been brought to the proceedings (at the time of writing a CDU/ SPD coalition was still undecided), consumers appear to have

taken a sigh of relief and confirmed that yes, things might be looking better after all.

Germany's businesses, on the other hand, have, for months, given the impression that their satisfaction with the current business climate

was growing. In the month before the election, the Ifo Business Climate Index, which measures business satisfaction in Germany, reached a 16 month high and in September, a day after the election was called, it rose again, for the fifth month in a row. Certainly, if we look at the performance of some of Germany's leading consumer companies, we can see that their fortunes have turned a corner since the beginning of the year.

Henkel, for example, Germany's biggest consumer products manufacturer, expressed

concerns in March that its European business, where a high proportion of its sales exist, as well as its Latin American operations, were underperforming. And again, in June, it conceded that overall 'top-line growth', was disappointing. Henkel had its 'most successful year' in 2012, but 2013 was proving to be tougher than expected. However, resurgence in demand for washing powder and other cleaning products gave a much needed boost to domestic and European profits and by July the business confirmed it was seeking to capitalise on this growth through market acquisitions. At home, Henkel has responded to increasingly price-sensitive German consumers by introducing, for example, simpler product packages such as a basic bottle of detergent, designed to meet the needs of Germany's rising population of single person households. In Q2 Henkel's profits surged and in August the business confirmed that 'all regions' had now returned to growth.

For German sports brand Adidas, things have been a little tougher but the business remains set to end the year in fairly good shape. After reporting a loss in the last quarter of 2012, due in large part to the disappointing performance of its Reebok brand, its share price rallied in January as the business outlined its post-Olympic global brand strategy, 'Boost'. By May although Q1 sales were down, profits had actually increased across the Group, as consumers demonstrated a willingness to buy higher priced Adidas goods. Adidas contend that without the Olympic Games or Euro 2012, the market is certainly sluggish; but its renewed focus on innovation, particularly in the yoga, dance and fitness training categories, led analysts in Q2 to agree the business will likely deliver strong annual revenues.

Similarly, some German retailers have followed the incremental growth trend experienced by companies in the consumer products industry. This time last year, in the fifth edition of Consumer Focus Magazine, we reported how ecommerce growth gave a relatively positive spin to an otherwise contracting German retail sector, with online shopping experiencing a 13% increase in volume sales during the first half of 2012. Turnover in the sector again rose in Q1 2013 by 37% and annual growth



from now until 2017 is expected to be around 21% with around half of Germans saying they intend to increase online spending in the future. Complementing this enduring positive news for Germany's ecommerce industry is the fact that traditional German bricks and mortar operators are beginning to show signs of returning to healthier times.

Despite a shaky start to the year for Germany's largest retailer, Metro, which fell out of the Dax Index of leading German companies in March, things gradually started to pick up by Q2. In January, the retailer announced plans to withdraw its electronics stores from China and focus instead on developing its profitable cash and carry business. A new CEO was installed to help rejuvenate the cash and carry operation and the knock-on effect of this restructure was apparent almost straight away, as Metro's domestic stores unexpectedly improved in May. Subsequently, its share price also grew again in August, as the business continued with plans to streamline operations. Analysts are now confident that incremental sales growth from Metro as well its peers in the German retail sector will help bring further stability to the German economy. The Ifo data

for September, for example, highlighted how German retailers' satisfaction with the current business situation had reached its highest level in almost two years.

It's important to note, however, that the assumption 'if German companies are performing well, then so is the rest of Europe' no longer rings true in today's global economy. Certainly, during its previous two terms, Angela Merkel's CDU government has backed German companies to seek markets outside of the Euro zone to sell their wares, as part of a conscientious effort to promote German global prowess. As a result, traditional European trade ties have been weakened and there has been a growing lag between the performance of German industry and the prospects of neighbouring countries in the region. The fact is though that the Euro zone's economic future and particularly, the consumer goods sector in Europe, is still dependant on German involvement. Many hope that, with consumer confidence returning with a vengeance after its pre-election slump, healthy domestic spending could certainly persuade some of Germany's adventurous companies to look back to Europe for further growth opportunities.