The ongoing and future roles of the supermarkets in the retail sector

In timely fashion, this White Paper was prepared soon after the Competition Commission’s latest announcement on the progress of its investigation into the UK’s supermarket business. The amount of media coverage generated by what was just an interim announcement highlights how the subject of the supermarkets’ growing influence over the retail sector remains highly contentious.

In debating this issue, the Retail Think Tank (RTT) came to the following conclusions:

- The RTT concurs with the Competition Commission that businesses cannot be criticised simply because they are successful in what they do. This is especially true in a particularly challenging and competitive sector like retail.
- Love them or loathe them, the supermarkets have played a key role in the development of the UK retail sector in the past decade, introducing innovation and new business practices which have benefited the sector as a whole. UK retail is more competitive and more efficient now than it has ever been.
- Without a doubt, risks do exist over the amount of choice being offered to consumers, particularly as the supermarket’s march into the non-food sectors continues apace, but opportunities for the specialist or niche players remain.
- There are challenges ahead for the supermarkets as they consider how they improve that shopping experience and it is in this area – along with the servicing of particular product niches – that the well-run, smaller, independent player will always have the scope to compete.

According to statistics from RTT member, Richard Hyman’s company, Verdict, the UK food and grocery market (i.e. the value of all sales, including non-food items, through all formats and channels from large superstores to corner shop tobacconists and the internet) had an estimated value of £120bn in 2006. This represents approximately 44% of the UK retail market. Verdict also estimates that it grew by 4.5% in 2006, almost double the growth of the retail market as a whole. Non-food now accounts for almost 13% of what these food and grocery players sell (up from 8% 5 years ago).
The Big Four Supermarkets (Tesco, Sainsbury's, ASDA and Morrisons) control 61% of the food and grocery market up from 54% 5 years ago. Nearly £1 in every £8 spent in the wider retail market is spent in Tesco.

The RTT has no doubt that this is a competitive market and is expected to become more so. It could be argued that over recent years Tesco has had a relatively easy time of it as a result of weakness among its main competitors. While Sainsbury’s recovery is well on track, and it has laid out plans to restart its store development pipeline after becoming largely inactive on the superstore opening front in recent years, it has to be mentioned that its recovery plans may be delayed, sidetracked or even derailed by the potential private equity takeover bid.

Having completed its acquisition of Safeway and appointing a new CEO, Morrisons has most of its troubles behind it and is now well placed to capitalise on its larger estate and expanded marketing budget. Meanwhile at ASDA, space development is expected to push up a notch as the retailer works harder to open new superstores and roll out its ASDA Living concept further.

Outside the Big Four (the next rank is Somerfield followed by M&S, Waitrose and Co-operative Group), competition is also intense.

Driven by competitive pressures, the supermarkets, each to varying degrees of success, have pursued their customers relentlessly, making huge strides to understand them better (e.g. via Tesco Clubcard), to promote innovation within their ranges (e.g. organics, healthy eating, international cuisine and own-label premium ranges) and to increase the number of sites and formats from which they operate.

The supermarkets have demonstrated their ability to provide choice, value and convenience. They operate a variety of formats aimed at enticing the top-up shopper through to the weekly one-stopper, who welcomes the sunk-time opportunity to explore the expanding non-food aisles.

Interestingly, when asked about the continued rise of the supermarkets, the average British shopper may bemoan the impact they have had on rural communities and local high streets, but very few complain about the convenience of having these stores nearby. According to the Competition Commission's interim findings, 80% of us have a choice of three supermarkets within a 15 minute drive. Far from voting with their feet, people are now shopping at the supermarkets in increasingly large numbers.
As RTT member, Mark Teale of CB Richard Ellis pointed out, "Actually, the only real surprise when considering the rise of the supermarkets – and their branching out into non-food sectors – is that it has taken the UK so long to follow the European hypermarket route."

**The UK high street**

One accusation commonly laid at the doorstep of the major supermarkets is that they have decimated high streets up and down the country, forcing old, traditional retailers out of business and giving rise to the theory of "clone town" Britain. Indeed, the number of specialist food retailers has fallen by 7% in the last 5 years while the number of stores operated by the supermarkets has doubled – largely driven by their push into convenience.

While there can be no argument that a number of smaller, specialist retailers have gone out of business, the RTT felt that the apparent demonisation of the large grocery retailers for their role in this has at times been over-played.

In any retail sector, the businesses which suffer are those that struggle to understand or properly engage with their target customer or those that don't quite have the right product offering. This is all about getting the retail fundamentals right. If they are not right, then the looming presence of a powerful competitor, such as a supermarket, will only exacerbate the problem and accelerate the demise of the underperformer.

In fact, as RTT member Sian Davies of the Henley Centre Headlight Vision pointed out, "It could be said that the supermarkets didn't simply take custom away from the specialists, rather that the specialists no longer earned or deserved that custom."

However, the food sector itself is a good example of where specialist retailers continue to exist – organic foods, specialist produce, farmers' markets etc – alongside the supermarkets. The traditional village greengrocer may have largely gone, but those businesses are being replaced by modern, sharp, niche players who are able to hold their own in the modern retailing world.

There can be no argument that the UK retail market is a tough market in which to establish a new business– but every specialist business which manages to do so and prosper, brings something new and fresh to the sector.

Taking this line of thinking even further, you could even say that the supermarkets will, in time, be credited with reinvigorating the UK high street as the poor performers will have been weeded out and replaced by newer, fresher offerings; many of them exploiting the new
product niches which the supermarkets themselves were instrumental in opening up to the UK public.

RTT member, Nick Bubb of Pali International certainly concurred with this view, saying, "The rise of the supermarkets and their march into other non-food sectors is a good thing because it has made the specialists sharpen up their game."

The RTT was keen though not to down-play or belittle the very real threat which the supermarkets do pose to any retail business – food or non-food. The very fact that two established businesses such as Waterstones and Ottakars felt compelled to consider merging speaks volumes about the very real threat which faces them.

The underlying assertion holds true though – that well-run businesses will have less to fear from the supermarkets than businesses which haven't got their basic offering right.

RTT member, Vicky Redwood of Capital Economics suggested that the tendency to blame the supermarkets for everything is driven by "the same old anti-large-organisation sentiment and says more about the tendency of the British public and media to become distrustful of any organisation which grows too big, but which few of us can avoid interacting with" – an issue which major utility firms, for example, have had to contend with for some time now.

The RTT summarised that the supermarkets’ role in UK retail must also be considered in the context of a market whose structure is changing on many fronts. The creation of retail parks and centres as destinations, as well as the internet, have also played significant roles in changing the way we shop.

**Do we, the consumer, now have more choice or less?**

Consumers will always want choice and it is up to the market to ensure that it can meet this need. This is why there is understandable fear that consumers of the future will have far less to choose from in terms of product range if the limited ranges available in supermarkets are increasingly all they have access to.

RTT member, Paul Clarke of Barclays Retail & Wholesale Sectors suggested that there could be a risk of the supermarkets actually reducing the size of the whole retail market if their limited ranges are all that is available, meaning that many other potential purchases are lost. "Or, at the very least," he said, "the high street is further pruned as more and more shoppers are pushed towards online retailers who may be able to provide the only realistic
challenge to the supermarkets, unencumbered as they are by the property and staff costs of the high street retailer."

RTT member, Helen Dickinson of KPMG was strongly of the view that "There will always be a future for specialists and niche players with a physical as well as internet presence, but only if they get the fundamentals right. Understanding the customer remains paramount".

RTT member, Tim Denison speculated that "Perhaps specialists will converge into particular locations: (organic) food; rare books etc, could become geographically located/clustered, representing havens of choice and hot-beds of competition, attracting shoppers from far and wide."

This fear of the supermarkets becoming too powerful and ultimately determining people's reading or music choices for example, does assume a rather compliant lack of resistance on the shoppers' part. The way in which farmers markets have sprung up in direct response to public concern over the supermarket offerings available to them suggests that UK shoppers are not about to submit meekly to accepting only what is currently on offer on the supermarket shelves.

The question may be asked "are they selling us what they want us to want, or are they just the best at the 'retailing game' by anticipating what we are going to want?" Tim Denison of SPSL considered that "supermarkets don't dictate what we consume – they work hard at chasing our needs – supermarkets are good retailers and well-managed businesses"

It's difficult not to be impressed by just how many product categories the supermarkets are now able to get involved in – even if the actual choice within those ranges may be limited, compared to a specialist retailer. Their ability to expand has clearly come about through being able to build larger formats and offer more floorspace (most recently through mezzanines), rather than by sacrificing food aisles – the growth of which also continues unabated.

However, it did raise the question for the RTT as to whether they have had an easy run up until now, being able to target fragmented sectors such as music, books, clothing and homewares and making easy inroads with their bulk purchasing power and convenient one-stop-shop offering.

Nick Bubb did point out though that, in some ways, this could be their own undoing as, "This rapid strengthening into the non-food sectors is one of the points which could leave
them vulnerable to further accusations of their power and influence growing too great, raising fears of consumers being ripped off, simply because no real viable competition has been able to last the pace." He went to question how far they can realistically stretch their brand.

Interestingly, the supermarkets have never professed to be experts in all of these categories which they have gone into. Sian Davies referred to it as a "lack of arrogance" on the supermarkets' part; an approach to new categories which tells consumers from the outset that they are not specialists in the field, but can still provide a decent, if limited, range.

For the time being, consumers seem to trust them in their forays into these new categories. It is worth asking though how far these forays can be extended – either before the brand becomes over-stretched or until retailers find themselves out of their depth in product categories which perhaps represented a step too far.

"Interestingly," said Paul Clarke, "as the supermarkets find their feet in new categories, there may be an opportunity here for more specialist retailers to step in and undertake their category management for them, thereby protecting themselves somewhat against the entry of the supermarkets into their sector."

"It's easy to run a business when times are good though," added Tim Denison of SPSL, "and times have been good for the supermarkets for ten years now. Therefore, it will be interesting to see how the supermarkets react once the competition gets its act together rather better and really starts to challenge their dominance."

**The future for retail?**

As the supermarkets expand into yet more non-food areas, they will be asking themselves how they can continue to offer the sort of shopping experience which the customer demands.

Away from the grocery sector, much is talked about nowadays of "retail theatre" or the need to provide an individual shopping experience. Despite improvements around the fringes, the supermarket shopping experience often remains functional. Therefore, if we assume the continued migration of custom from the non-food specialists to the supermarkets, won't those customers bring with them their pre-set notions of how they expect their shopping experience to be?
If so, the supermarkets will need to up their game – and fast. In the meantime, this remains a key area in which the specialist retailer can differentiate themselves from the supermarket businesses. However, on this point, Helen Dickinson of KPMG sounded a note of caution, saying, "The supermarkets have been responsible for much of the innovation across the sector in recent years so it would be a brave person who bets against them making similar strides forward in this area too."

Some of the changes already being trialled in supermarkets hint at the first innovative steps towards evolving the supermarket shopping experience into something less functional and much more than it already is. Initiatives which some may currently dismiss simply as Corporate Social Responsibility (CSR) gimmicks may in fact give clues as to the way in which supermarkets could evolve into social hubs at the heart of a local community.

Liasing with local farmers to give a more home-grown flavour to the produce offering, becoming involved with the provision of local low-cost housing, or even taking a wider role in the regeneration of a whole neighbourhood; all of these are worthy social initiatives which generate PR column inches, but they also paint a picture of retailers intent on seeing communities evolving around them, as opposed to resenting their arrival.

It will be interesting to see how far such initiatives can be taken. For sure, the grocery retailers are savvy enough to know that their CSR programmes have never been more important, potentially preventing a brand backlash that some powerful US players, such as WalMart and McDonald's have suffered in the past. With the Competition Commission's investigation still hanging over them, they need the general public on-side more than ever before.

The need to rebuild or maintain public sympathy is a key factor in the supermarkets' decision to up their game in the CSR space as they need to protect their brand and be seen as the community's friend, not their enemy.

Expect therefore plenty more CSR related initiatives being announced in the near future, alongside further attempts to deal with issues such as cheap alcohol, food wastage, food miles and food labelling. As ever, the supermarkets will not be caught dozing on these issues but far from being undertaken purely for PR purposes, it can be guaranteed that each and every one of these responses will have been well thought through and will – somehow – have a positive impact on profitability.

**Conclusion**
Much has been written recently to say that the supermarkets have nothing to fear from the Competition Commission's findings. However, one point which the RTT raised – and which was subsequently endorsed by the Commission – was the need to consider regional availability of good quality food offerings, ensuring that certain towns or regions were not becoming slaves to a single major supermarket retailer.

A mixed retail economy can only be a good thing for consumers. Unfortunately, while ensuring that every British consumer should have access to a range of high quality food offerings is a laudable goal, it is unclear just how far the Commission could go in pursuit of this goal before crossing the line into interventionist territory; something which very few would find palatable for the future health of the sector.

Another issue which is unlikely to go away is the concern about supermarkets amassing large land-banks for future developments. Mark Teale noted "it's the retailers, i.e. the industry itself, who are complaining about Tesco's land bank". While this may well make it even harder for new entrants to the sector, it is indicative of successful businesses protecting their current position. As the Commission pointed out, it is hard to be critical of businesses simply because they are performing strongly, innovating or protecting their market position better than anyone else.

In their 'emerging thinking' findings, the Competition Commission admitted that they found no significant evidence of the supermarkets using the planning system to gain competitive advantage. Nevertheless, the tightening of planning regulations will inevitably prevent supermarkets from building endlessly larger stores, so providing the ultimate constraint on the expansion of the one-stop store and the end of this chapter in the supermarkets' history.

However, it is unlikely that either of these issues will cause the supermarkets too much angst. The one barb which will continue to hurt comes from the continued suggestion that they stand accused of limiting the amount of choice available on the UK high street, both in the food and non-food sectors.

Judged purely on the number of businesses which have disappeared in the face of their onslaught, then they would have to be found guilty.

The counter-argument is that they have stripped much of the high street of the deadwood which was strangling it. Old businesses trapped in inappropriate locations have gone, providing the opportunities for newer businesses (using the sharper practices which the
supermarkets themselves introduced) to take their place, serving the niches which even the most powerful supermarket cannot hope to cover off.

It is hardly the supermarkets' fault if not all of those high street gaps have yet been plugged, especially as shoppers continue to come through the supermarkets' doors in ever increasing numbers, proving that they are the ones who are giving shoppers what they want.

Supermarkets have played a key role in making the UK retail sector set for the 21st century. As Sian Davies reiterated, "The supermarkets, especially Tesco, have dragged UK retailers into the future." In doing so, the grocery sector has grown into a power-house; one which is far too easy for self-interest groups to attack but which – at its core – is built upon a small number of well-run businesses which have mastered their retailing fundamentals.

To criticise them solely for the commercial success which their rapid expansion has brought them is to ignore the massive revolutionary effect they have on UK retail as a whole.

Date Published: 2/2/2007 5:40 PM

Note to Editors:
The RTT panellists rely on their depth of personal experience, sector knowledge and review an exhaustive bank of industry and government datasets including the following:

Members of the RTT are:

- Nick Bubb – Independent Retail Analyst
- Dr. Tim Denison – Ipsos Retail Performance
- Jonathan De Mello – Harper Dennis Hobbs
- Martin Hayward – Hayward Strategy and Futures
- Maureen Hinton – Conlumino
- James Knightley – ING
- Richard Lowe – Barclays Retail & Wholesale Sectors
- David McCorquodale – KPMG
- Martin Newman – Practicology
- Mike Watkins – Nielsen

The intellectual property within the RTT is jointly owned by KPMG (www.kpmg.co.uk) and Ipsos Retail Performance (www.ipsos-retailperformance.com).

First mentions of the Retail Think Tank should be as follows: the KPMG/Ipsos Retail Think Tank. The abbreviations Retail Think Tank and RTT are acceptable thereafter.

The RTT was founded in February 2006. It now meets quarterly to provide authoritative ‘thought leadership’ on matters affecting the retail industry. All outputs are consensual and
arrived at by simple majority vote and moderated discussion. Quotes are individually credited. The Retail Think Tank has been created because it is widely accepted that there are so many mixed messages from different data sources that it is difficult to establish with any certainty the true health and status of the sector. The aim of the RTT is to provide the authoritative, credible and most trusted window on what is really happening in retail and to develop thought leadership on the key areas influencing the future of retailing in the UK. Its executive members have been rigorously selected from non-aligned disciplines to highlight issues, propose solutions, learn from the past, signpost the road ahead and put retail into its rightful context within the British social/economic matrix.

Definitions: The RTT assesses the state of health of the UK retail sector by considering the factors which influence its three key drivers.

1. **Demand** – Demand for retail goods and services. From a retro-perspective, retail sales, volumes and prices are the primary indicators. When considering future prospects, economic factors such as interest rates, employment levels and house prices as well as others such as consumer confidence, footfall and preferences are used

2. **Margin** (Gross) – Sales less cost of sales; the buying margin less markdowns and shrinkage. Cost of sales include product purchase costs, associated costs of indirect taxes and duty and discounts

3. **Costs** – All other costs associated with the retail operations, including freight and logistics, marketing, property and people

The Retail Health Index – how is it assessed?
Every quarter each member of the RTT makes quantitative assessments of the impact on retail health of demand, margins and costs for the quarter just completed and a forecast of the quarter ahead. These scores are submitted individually, collated and aggregated in time for the RTT’s quarterly meeting. The individual judgements on what to score are ultimately a combination of objective and subjective ones, drawing upon a wide range of hard datasets and softer qualitative material available to each member. The framework follows the example of The Bank of England Agents’ scoring system on economic intelligence provided to the Monetary Policy Committee.

The aggregate scores are combined to form the Retail Health Index (‘RHI’) which is reviewed at that meeting and occasionally revised after debate if members feel it appropriate. The RHI tracks quarter on quarter changes in the health of the UK retail sector and as such
provides a useful and unique measured indicator of retail health. The index ‘base’ of 100 was set on 1 April 2006. Each quarter, it assesses whether the state of health has improved or deteriorated since the previous quarter. An improvement will lead to a higher RHI score than that recorded in the previous quarter, and with a deterioration leading to a lower score. The larger the index movement, the more marked the shift in the state of health. The RHI has two main benefits. Firstly, it aims to quantify the knowledge of the RTT members in a systematic way. Secondly, it assesses the overall state of health of the UK retail sector for which there is no official data.

For media enquiries please contact:
Max Bevis, Tank PR

Tel: +44 (0)1159 589 840

Email: max@tankpr.co.uk