In light of consolidation and diversification, what does the future hold for the UK grocery sector?

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Introduction

The UK retail market is currently in the midst of seismic change, a once in a generation shift that is impacting on the way that retailers operate and sell. Driven by a consumer that is undergoing a demographic and lifestyle evolution, retailers in every sector are having to adapt in order to both survive and thrive. The grocery sector is no exception to this rule, and here the KPMG / Ipsos Retail Think Tank (RTT) set out to discuss, in light of consolidation and diversification, ‘what does the future hold for the UK grocery sector?’

Members were in unison that fundamental changes are taking place, with a wide spread of factors discussed and taken into consideration. Members agreed that the following five ‘influences’ were having the biggest impact on the UK grocery sector, and as such hold the key to shaping its future: the rise of the discounters, shifting consumer shopping habits, technology, consolidation & diversification, and Brexit.

Whilst change can be disruptive, the RTT was keen to express that they felt optimistic about the future of the grocery sector, with Nick Bubb, retailing analyst, noting “that the Food Retail sector has been one of the best performing sectors in the UK stock market so far this year, implying that the City is optimistic about the outlook for the main players”.

The rise of the discounters

The discounters’ rise in popularity has forced the hand of the ‘big four’ into adapting their offering and changing how they operate as retailers. The RTT wanted to stress just how seismic the impact of Aldi and Lidl had been, and also how there is room for further expansion. Mike Watkins, head of retailer and business insight at Nielsen UK, said: “In 2011 Aldi and Lidl had 6% market share, and by the end of 2018 this will have more than doubled to 14%. A market share of 20% no longer seems impossible, which incidentally is still below the European average of 22%. Put another way, £15 billion sales per annum are being lost by supermarkets each year, which is equivalent to a retailer the size of Morrisons.”

RTT members also pointed out that the pinch being felt by the ‘status quo’ of supermarkets was not just in food sales from the likes of Aldi and Lidl, but homewares and general merchandising were also being impacted on. Maureen Hinton, group research director at GlobalData, stated that: “Not only have Aldi and Lidl taken market share, and will take even more as they open more stores, the general merchandisers such as B&M and Poundland are diluting spend at the big players. So, from having 58% of all consumer spending in food & grocery in 2008, the big four grocers will have just under 52% in 2018.”

Driven by uncertainly in politics and the economy, the popularity amongst consumers to shop for better value products is a trend that the RTT didn’t expect to fade away anytime soon. The supermarkets, whether through lethargy or ignorance, underestimated the discounters and failed to react quickly enough to their rise. The discounters tapped into what the customer of
today valued in their grocer, and now we are seeing the big four consolidate and diversify in an effort to catch-up with themselves.

**Shifting consumer shopping habits**

The way that people in the UK shop is changing, whether that is for cars, clothes, technology, property or food, as we see, the next generation of consumers spend money in a very different way to their parents.

Up until five years ago, it could be said that the majority of ‘food shops’ were undertaken in the same way that they had been for decades before. Yet the RTT members agreed that in the future it was “inconceivable that this generation would be spending nearly two hours every Sunday walking around a supermarket for a weekly food shop”.

With people shopping more often, more frequently and increasingly online, the RTT members stated that, “brand loyalty to specific supermarkets is now a thing of the past, it doesn’t exist in the mind of the next generation of consumer”. The grocers are going to have to re-invent their loyalty schemes and offerings, at a time when people are happy to buy their meat from one store, fresh vegetables daily and then have larger bulky items delivered weekly, grocers have a challenge ahead of them and could look to the likes of Amazon Prime and the non-food sector for inspiration.

Experiential shopping has been a strategy adopted by swathes of non-food retailers in an effort to combat the rise in online shopping, persuading consumers to put down their laptops and smartphones, leave the sofa and enjoy shopping on the high street in physical stores again. Dr Tim Denison, director of retail intelligence at Ipsos Retail Performance said, “supermarkets need to provide immersive experiences and a compelling reason for people to choose to spend time in them.”

The way that ‘millenials’ and ‘generation X’ consume and use services away from food shopping will no doubt influence the offering of the grocers, and Martin Newman, CEO of Practicology, believes this has already started: “Tesco now talks of frictionless shopping, and one of its most interesting developments is same-day delivery in one hour. Thinking about where future competition for service and solutions-focused offerings come from – Amazon, but also Deliveroo and Uber Eats-style services – this is particularly relevant."

**Technology**

The digital revolution, unlike the industrial revolution is not a long-drawn out cycle of engineering and construction. The digital revolution re-invents itself almost continually as technology improves, and as such retailers have to adapt their offering to ensure that the consumer’s demands in terms of convenience, ease of use and experience, are met.

The RTT looked to Amazon as having the potential to lead this shift-change in utilising technology, or depending on how they enter the market, force the supermarkets themselves to start adopting solutions that make the shopping experience more appealing to younger generations.
James Sawley, head of retail and leisure at HSBC, commented: “Online grocery is still a minority channel for supermarkets in terms of sales, which I have no doubt will grow, but in terms of penetration, I can’t foresee it reaching the heights of non-food retailers. The till-less supermarket, however, is a space I see excitement, with Amazon leading the way in the US and Tesco currently testing smartphone scan/pay as you go technology in the UK - this way of shopping will possibly be a game changer in taking the customers experience to a new level.”

The RTT acknowledged that Amazon would have a huge challenge ahead of itself to gain market share in the UK grocery space, but its breadth of product, existing customer base and Prime ‘loyalty’ offering will all work in its favour. The RTT believed the big four supermarkets would be best advised to not directly compete with Amazon, as it will offer something very different to what makes them so successful, although that’s not to say there isn’t anything to learn from the internet giant. If the dust settles on the Sainsburys / Asda merger, with their partnership with Argos, they would have a product range that appeals to the general consumer to compete with Amazon.

Martin Newman added: “Online developments are not always the answer for the incumbent main players, but with Amazon taking an increasing interest in becoming a platform to supply grocery products, then they should certainly be keeping a close eye on further signs of digital disruption.”

It isn’t just initiatives from supermarkets and the likes of Amazon that are changing and disrupting the online grocery space, with Nick Bubb pointing out “that Ocado’s recent success in licensing its online grocery delivery software and systems to overseas food retailers has propelled its market capitalisation to £7.5bn (which makes it bigger than Sainsbury’s) and elevated into the ranks of the prestigious FTSE 100 index”. This blurring of lines between retailer and tech company is a trend that the RTT expects to continue, as businesses seek opportunities to take full advantage of improvements in technology that are changing consumer habits.

Consolidation and diversification

Headlines have been made in recent years as grocers look to consolidate their positions with mergers and acquisitions, with deals such as Sainsbury’s/Asda, Tesco/Booker and Co-Op/Nisa to name but a few. Paul Martin, head of UK retail at KPMG, commented on recent activity: “This is happening due to increased competition within the sector, alongside rising costs resulting in decreased margins. Therefore the perception is prevailing that scale and buying volume is one of the few means to survive and to demonstrate growth.”

The RTT called the proposed Asda and Sainbury’s merger a ‘defensive move’ to shield themselves against rising competition in the grocery sector. Whilst it has been proposed that the increased buying power will result in price cuts of up to 10% for the consumer, the RTT delivered a warning regarding staff redundancies and store closures.

Jonathan De Melo, head of retail consultancy, Harper Dennis Hobbs, said: “In the case of Asda and Sainsbury’s, consolidation is inevitable – whether Asda and Sainsbury’s want it or not. The overlap that exists and the fact that both chains offer product from relatively similarly
sized stores, will mean the CMA will have to step in – with all the ramifications to store closures and job losses that will bring.”

In terms of how this series of deals could impact on the grocery sector, the RTT suggests a series of interesting implications, unintended consequences, opportunities for smaller brands and even a direct market response from supplier brands. The RTT also discussed what the catalyst was for such a sudden burst of activity that resulted in a strategy of consolidation and diversification.

Martin Hayward, founder of Hayward Strategy and Futures, said: “The underlying driver of consolidation across the major grocers lies in their ‘success’ at making price such an overwhelmingly important driver of trade.”

The supermarkets know that with the pressures that come from the rise of the discounters, ensuring low prices and great value is key to driving demand, something they believe they can achieve through increased buying power. This is supported by recent research, which Maureen Hinton shared: “Research at GlobalData shows that UK consumers in 2018 are looking primarily for value for money (92% cite this reason) in their food and grocery shopping.”

Martin Hayward went on to paint a picture of what this ramped up consolidation could mean for consumers: “The ultimate state of efficiency is commoditisation – everyone gets the same products, from similar, faceless, efficient outlets at a bargain basement price” - a statement that is further supported by the increasing popularity of own-brand products within supermarkets.

In a world where the price of goods has been driven to rock bottom lows, the RTT discussed how opportunities would emerge for smaller retailers. Unable to compete on price, message and marketing will play a key role in selling to consumers these retailer’s ‘own unique way’, whether that be improved customer service, innovation in offering or provenance in product. This was echoed by James Sawley, who expected “a renaissance of farmers markets and both boutique and independent food stores, as the millennial generation matures and is happy to take the time to enjoy the food shopping experience again if it is something unique and different.”

Brexit

Brexit and the negotiations currently being undertaken by the UK Government and the EU will certainly effect how the grocery sector operates. The RTT discussed at length the varying scenarios, negatives and opportunities for the supermarkets, but Brexit is a moveable beast, and it will be years before the dust has settled and its true impact can be assessed. What was unanimously agreed amongst members was the sense of the danger Brexit brought with it - James Knightley, ING chief economist, called Brexit “from a macro point of view, the biggest threat right now to the grocery sector".
The trade deals that are signed, and the details within those agreements have the potential to require grocers to completely overhaul their supply chains. James Knightley continued: “40% of food consumed in the UK is imported with the majority coming from the European Union, Netherlands, Ireland and France being the big three, via roll on roll off ferries.”

The RTT feared that many supermarkets currently did not have enough of their focus on sourcing ‘shadow supply chains’, in an effort to minimise the cost and disruption in the event of a Brexit deal that either priced out the EU or made it logistically impossible to import certain goods. The natural direction to take would be to look closer to home, however the UK food manufacturing sector would require sizeable expansion in both farming and production in order to even come close to fulfilling demand.

RTT members were quick to suggest that Brexit shouldn’t take all of the focus, as it is not just European borders that retailers may find importing and trading through more difficult in the coming years. Macro and geo-political lines are shifting all of the time, US-China and US-EU trade barriers and tariffs could all lead to changes that will mean grocers need to be agile in their supply chains, with the RTT members suggesting both the price and size of produce ranges could change extensively in the future.

**Conclusion**

Undoubtedly, UK grocers are undergoing a step-change in nearly every aspect of their businesses. Their customers are shifting, technology is evolving, new competitors are entering the market and of course, there is Brexit. The future of the sector is one where supermarkets ensure they understand their new generation of customers, following the path of the non-food sector with experiential in store experiences, true multichannel shopping and of course, great value.

Consolidation and diversification has come about for many retailers as a defensive move, whether that be against Amazon, Brexit, the changing desires of consumers or the rising fortunes of the discounters. The RTT stated that those operating in the grocery sector that can quickly tap into the unique benefits that consolidation brings, whether that is with lower prices, wider product range or better margins, will be the ones to succeed and drive consumers to the tills.

Dr Tim Denison concluded: “To my mind, future success in the UK grocery sector is about putting the customer first, getting all the basics right, embracing new technologies to achieve this and creating more innovative and rewarding store experiences – that's the way to ‘be in the money’.”

**Ends**
Note to Editors:

The RTT panellists rely on their depth of personal experience and sector knowledge, and review a comprehensive bank of industry and government datasets. More in-depth comments from the individual RTT members on this white paper can be found at www.retailthinktank.co.uk/whitepapers.

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 – GlobalData Retail
- James Knightley – ING
- Paul Martin – KPMG
- Martin Newman – Practicology
- James Sawley - HSBC
- Mike Watkins – Nielsen

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

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 by KPMG and Ipsos Retail Performance (formerly Synovate) 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.

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