

Offline, Online, and Back: The Evolution of the UK Grocery Market

CASE STUDY

The UK grocery market is predicted to grow by 14.8 percent through 2023, and according to the food and grocery research organization IGD, this market is expected to reach a value of £218.5 billion. The main grocery stores operating in Great Britain are Tesco, which has a market share of 27.4 percent; Sainsbury, 15.4 percent; ASDA, 15.3 percent; and Morrisons, 10.3 percent. Together, they cover almost 70 percent of the grocery market and are considered the “Big Four” in the United Kingdom. Tesco reached its peak in 2007, when it held 31.1 percent of the UK grocery market share. Worldwide, the company operates in 13 countries, with around 7,000 stores across Europe and Asia.

In the United Kingdom, Tesco focused on implementing a strategy that enabled the company to offer the lowest costs and achieve cost leadership. This drew price-sensitive customers away from its competitors and increased its market share. Tesco adopted the following strategies to maintain this cost leadership: (1) high utilization of assets through production of large outputs and spreading the fixed costs over large quantities, (2) minimal direct and indirect costs in the production and distribution stages, and (3) strict control over the supply chain to ensure low costs. This strategy was viable for Tesco; as a big company, it could take advantage of economies of scale in the market.

However, due to the popularity of discount supermarkets such as Aldi and Lidl, Tesco has recently been struggling to maintain its cost leadership. Consumer behavior has changed in the United Kingdom due to economic recession and inflation, leading customers to shift to making their groceries purchases at budget supermarkets. Last year, Tesco's market share fell slightly; by contrast, Aldi and Lidl have continuously been increasing their market share over the last few years. In January 2017, Aldi was the fifth largest grocery chain in the United Kingdom with a market share of 7.6 percent.

Besides the physical supermarkets, Tesco has been operating two online platforms: Tesco.com for grocery home deliveries and Tesco Direct for household goods and clothing. However, in May 2018, Tesco announced Tesco Direct's closure in an unexpected move. Tesco Direct had been launched in 2006, and it had cost the

company between £25 and £30 million. According to Charles Wilson, who recently took over as CEO of Tesco's UK chain, closing one of the websites would help them to focus their investment in one platform to offer better service and more products to customers. Although the closure cost 500 jobs, it was not a huge surprise, considering that Tesco had, by its own admission, faced challenges in making it profitable. Tesco's attempt to compete with huge online retailers such as Amazon and Argos had failed because it had been unable to make profits after covering the costs of marketing and order fulfillment.

Besides this setback, Tesco must also contend with the threat from discount supermarkets. Aldi has opened more than 700 stores since 1990, when its first store in United Kingdom was launched. Similarly, Lidl reached a total of 700 stores in 2018 after it opened five stores in one day. Customers were skeptical at the beginning, but once they saw the low-price products, they switched their buying preferences to these discount supermarkets.

In addition to gaining a larger market share every year, Aldi and Lidl are contributing to the UK economy in different ways. According to some analysis, Aldi has contributed £8.5 billion to the GDP of the United Kingdom through job creation, taxes, and capital investment. Predictions also show that Aldi is expected to provide a £2.2 billion boost for British businesses. Customers who switched from the Big Four supermarkets saved £2.2 billion last year alone by shopping at Aldi. Aldi UK's most successful year was 2017, when it generated £10 billion in annual sales for the first time.

Experts argue that the main reasons these discount supermarkets have been successful is rising inflation and the stagnation in wages. The services offered by Aldi are similar to those that the “Big Four” provide their customers, but Aldi has the advantage of lower prices and is still considered a discounter, which is especially attractive for customers during inflation. Surveys show that Aldi also gets very good ratings in customer satisfaction.

Ever since the two discount supermarkets came to the United Kingdom from Germany, they have forced the big grocery stores to rethink their approach. Thanks to their low-price grocery strategy, Aldi and

Lidl have changed the UK supermarket industry for some time to come. Big supermarkets like Tesco and Sainsbury already offer online grocery shopping, but they had faced difficulties making a profit from their e-commerce operations. With Aldi and Lidl's entry into this market, these challenges will only increase.

In the beginning of 2016, Aldi opened its first online store for the UK market. The discount retailer made its opening move by investing £35 million to launch an online website for selling wine, which was followed by non-food "special buys." According to Kantar Retail analyst Bryan Roberts, this move is a smart way of reaching customers who don't have access to an Aldi.

Lidl founded the Lidl Digital Logistics, and experts expect this supermarket to enter the grocery delivery market too. So far, Lidl has sold wine and some non-food items online in parts of Europe, but not groceries. Lidl's approach to entering the digital market is quite innovative: recently, they launched a chatbot designed to help customers in their choice of wine based on what they are eating.

The public love for the discounters signifies a major threat for big supermarkets looking to keep their market share, both on- and offline. To take the fight to Aldi and Lidl, and having seen Aldi and Lidl's success in gaining market share, Tesco has decided to open a discount chain of 60 stores all over the United Kingdom, thus entering the fast-growing discount market. History has shown that attempts by big supermarkets to launch discount brands have largely failed. However, Bryan Roberts, Insights Director at TCC Global, has stated that Tesco's buying power and expertise could result in success this time.

With Aldi and Lidl trying to enter the e-commerce industry and Tesco trying to defeat them by entering the discount market, the war between the big and budget supermarkets has taken some interesting turns, especially since food shopping has undergone changes too: more people prefer to buy food on a daily basis and more locally, and a high number of them prefer to buy their food online. A number of European retailers have responded to this by opening smaller stores in nearby locations, launching online stores, and testing other new models for shopping.

Tesco has been in the business of selling on the Internet for a long time now; in 1996, it became the first supermarket to launch online shopping. There are several ways Tesco is using information technology to its advantage. For instance, in 2011, while

Tesco's domestic United Kingdom sales were dropping, it was a huge success in South Korea, its largest market outside the United Kingdom, as a result of its ability to adapt to local customer needs. As South Koreans are among the people with the longest working hours worldwide, Tesco introduced "virtual stores" with its Homeplus brand in the country. It displayed these virtual stores in subways and bus stations, where people could scan products' barcodes using their smartphones and purchase them online. These products were then delivered to them right after they returned home, thus saving time and effort for the consumers.

History has shown that the grocery industry needs to adapt to consumer demands and lifestyles continuously. The United Kingdom and South Korea are a study in contrasts. While people in the United Kingdom switched from domestic big supermarkets to budget supermarkets, the opposite happened in South Korea thanks to Homeplus, which turned Tesco into the country's second largest grocery retailer. Customers in the United Kingdom are price-sensitive due to economic recession and inflation, whereas customers in South Korea have embraced the technology made available to them to suit their time-sensitive lifestyle.

E-commerce is a huge opportunity for discounters, but what will happen to the grocery sector if these chains [Aldi and Lidl?] decide to offer their full range of products online? Perhaps more importantly, can they gain a bigger share of the grocery market at the expense of the Big Four in United Kingdom? Some experts believe that this strategy is untenable. According to retail consultant Graham Soutl, the discount supermarkets' initiative of entering the online shopping market runs the same risks and problems that other supermarkets have faced. He believes that the uniqueness of these supermarkets lies in their simplicity and low cost, which they might be putting at risk when they start to sell food and groceries online. Simply put, the complexity of the e-commerce industry might not fit their low-cost business model.

Sources: Sarah Butler, "New Tesco Discount Chain Could Launch as Early as September," *The Guardian*, July 22, 2018; Zoe Wood, "Tesco Shuts Its Non-Food Website, Tesco Direct," *The Guardian*, May 22, 2018; Miles Brignall, "Tesco 'Planning' Discount Chain to Take on Aldi and Lidl," *The Guardian*, February 11, 2018; Zoe Wood, "Low Prices and No Frills: Can Tesco's Secret Plan Defeat Lidl and Aldi?" *The Guardian*, September 15, 2018; Jessica Lindsay, "Why Is Tesco Direct Closing and Is There a Closing Down Sale?" *Metro*, June 8, 2018; Matthew Chapman, "Aldi

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CASE STUDY QUESTIONS

- 3-13** Analyze the cost leadership strategy of Tesco based on Porter's Competitive Forces Model. Why would it be a smart move to close one of its online shopping sites?
- 3-14** Do you think Aldi and Lidl's strategy of venturing into e-commerce is a good idea?
- 3-15** Comment on Tesco's strategy of opening a discount chain. Do you think it could recover Tesco's former market position? Explain your answer.
- 3-16** How much potential do you see for virtual stores (like the ones Tesco introduced in South Korea) in the United Kingdom?