THE RISE AND RISE OF THE DISCOUNTERS IN U.K. FOOD RETAILING

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Discount food shops are the fastest growing part of the U.K. retailing sector. From only two discount chains at the end of the 1980's the number has now increased to 14. All are expanding rapidly and pose a serious challenge to the U.K.'s established food retailers.

Consider the following table to see the extent of this rise in both the number of discount stores and growing sales figures.

	Stores		Annual sales (£m)	
	Dec 1992	Dec 1997	Dec 1992	Dec 1997
Kwik Save	780	950	2,560	3,840
Aldi	63	240	287	1,260
Solo	47	47	170	210
Netto	45	220	168	950
Shoprite	35	210	111	800
Food Giant	20	40	350	770
Pioneer	11	35	110	400
Discount Giant	7	20	64	200
Dales	4	34	77	750
Ed	1	80	4	370
Total	1,013	1,876	3,901	9,550

Both the established food retailers and the City have been surprised by the rapid rise of the discounters. In the 1980's, although many had tried and failed the only successful discount chains of any size in the U.K. market were Kwik Save and Argyll's Lo- Cost. But in 1990 their effective monopoly was broken by the arrival of Germany's Aldi and Denmark's Netto.

In the same year, Shoprite, an Isle-of -Man based company run by sons of one of the founders of Kwik Save, launched into the underdeveloped Scottish market. Later, several of the large grocery chains hit on the idea of converting older, underperforming superstores into discount outlets, spawning Gateway's Food Giant and Solo, Co-op's Pioneer and Asda's Dales format.

In recent months, the discount chains have accelerated their expansion plans:

- In January, Carrefour, the French retail giant, opened its first Ed (an acronym for Europa Discount) store in Maidstone, Kent.
- Costco, the third largest of the U.S ultra- discount format known as "warehouse clubs", signed up two sites in the U.K., Thurrock in Essex which it hopes to open in November and Trafford Park, Manchester.
- Kwik Save said in February that it would expand into Scotland from its North West heartland and increase its opening programme from 50 to 70 stores a year.
- Aldi, having previously concentrated on the North and Midlands, announced a search for sites in the south and have recently secured two sites in the London area.
- In March, Netto said it was looking for 100 sites in Scotland.
- In April. cash and carry operator Nurdin and Peacock said it would open two U.S. style warehouse clubs in the U.K.

The expansion of discount chains marks a move away from the style of food retailing that flourished throughout the 1980's. For nearly two decades after the abolition of resale price maintenance in 1964, when manufacturers lost the right to fix the price at which their goods were sold in shops, the U.K. grocery sector was driven largely by competition on price.That changed in the 1980's with the growth of "value added" retailing from superstores, as practised by Sainsbury, Tesco and Safeway, the "big 3".

These retailers do not claim to have the lowest prices, but do claim to be highly competitive while providing the most attractive "offer" - a concept that encompasses choice,quality, convenience, service, and shopping environment.

They make their money from healthy operating margins which average around 8%, the envy of food retailers all over the globe, because the norm elsewhere in Europe is 2%- 3% and in the U.S.A. between 1% and 2%.

However, the cartel and the high margins they currently enjoy are being seriously challenged by the discounters.The current economic recession has been long and shows no signs of abatement.This has fostered a new price-consciousness in U.K. consumers. At the same time, the top end of the grocery market became so dominated by the big three that would-be entrants had to find new ways of operating.

Enter the discounters, which work on the opposite principle. Typical operating margins are 2 per cent or less, but the stores make money by shifting large volumes of goods. Both start up and operating costs are kept to a minimum by buying or renting cheap sites, spending little on technology or fittings - with goods often sold from cardboard boxes on warehouse racking, or shrink wrapped on pallets, or even displayed on trestle tables and in cheap wire baskets.They stock a limited range of say 1,000 lines and employ few staff. Typically, for example, Aldi has one store manager who has 3 checkout staff and no one else ! The manager uses a pump truck to drag the pallets from the stockroom to the shopfloor where he/ she takes off the shrink wrap and the customers dive in. There is no E.P.O.S system and the checkout operators have to memorise the prices and they are able to get customers through the checkouts at a rate of knots. The customer is not given any carrier bags but they can either buy them or typically they bring their own. They are also expected to put all their shopping back into their trolley and then proceed to a shelf area where they can pack their bags before leaving. So the service and display element is minimal but the difference is that a basket of goods which would cost you say £50 at one of the big 3 supermarkets would cost a mere £28.30 at aldi. This is a very powerful incentive to consumers and not just the hard up DE's, because everyone likes a bargain.

The discount formula can be a powerful one. Efficient discounters can turn round their entire stock every 20 days or less, so they have often sold stock before they pay their suppliers for it. That means their working capital for expansion is effectively provided by their own suppliers. I personally have seen the phenomenal success of Aldi at first hand when I visited a store in the Midlands as guest of Paul Foley, Operations Director. The stock was simply flying out of the store and was incredibly efficient and the customers seemed to love every minute of it.

City analysts agree that discounters are likely to double their annual sales from between £3.5bn and £4bn last year, to £7bn to £8bn by 1996.Their share of the grocery market is forecast to rise from about 9 per cent to 14 or 15 per cent during the same period.

That will have a big impact on the shape of the food market in the U.K. Shoppers are likely to benefit from increased price competition throughout the sector. The crucial question is whether limited line formats can make their prices so tempting that even committed superstore shoppers cannot ignore them.Will shoppers in the nineties become astute and shop for basic lines at the discounters, followed by top up shopping from Sainsbury et al for more fancy lines that are not stocked by the discounters? Will some shoppers discount the discounters because of their lack of range, style, ambience and service?Which retailers will suffer the most by the increased pressure from the discount sector? What will the impact of the warehouse clubs be on the sector in the nineties? Finally, what are the big three doing to counter the growing threat from the overseas discount predators?

Some of these questions are rhetorical and need to be reflected upon. However, the last question is the one I wish to focus on first.

The imminent arrival of Costco has galvanised the big three into action and they have banded together to form a united front by employing a public relations company to handle adverse media criticism of their legal actions to try and block Costco's store opening programme. Briefly, the big three are claiming that Costco and other warehouse formats are retailers not wholesalers, despite the fact that customers have to pay a subscription to be a club member (between$25-$35 in the U.S.) and as such should be subject to the same planning regulations as British based retailers.

The supermarkets' opposition has hindered Costco's plans to open three warehouse clubs in Britain. One development planned for Trafford Park, Manchester, was looked on favourably by the local authority, but has since been abandoned after its planning application was called in by the Department of the Environment. Another, at Bushey, in Hertfordshire, also received the blessing of the local council, but is now being scrutinised by the department after written complaints from the supermarkets. In each case, the planning authorities set conditions limiting sales to club members.

A third warehouse, already approved by Thurrock borough council in Essex and also subject to these conditions, is in doubt after the supermarkets went first to the High Court and then to the Appeal Court to contest the council's decision. Costco has already spent millions developing the site which is less than four weeks from completion.

Cargo Club is developing a site at Wednesbury ,near Birmingham, but Tesco informed the company it was seeking a judicial review to quash the planning consent. The case has also been taken up by Sainsbury and the Office of Fair Trading is monitoring events closely amid claims of anti-competitive behaviour.

The legal battle continues but Costco are determined to open in Thurrock in November. So why are the big three so worried? Clearly, the warehouse clubs are a roaring success in the U.S. where they have been established for 17 years and sell everything from cornflakes to computers and tyres to turnips, at prices that are up to 50% cheaper than other retail outlets. It is true that you have to buy in bulk but in the States, whole neighbourhoods and extended families nominate a shopper to buy in bulk and then split packs down. The savings can be enormous and food retailers in the U.S. have been severely affected. So the big three do not want to sit back and do nothing.They are putting up a legal fight and seem to be worried without really admitting it in public.

What other methods are they using to block or counter the growing threat of the discounters?

- **Non selling of sites to the discounters**.

  Aldi's expansion plans are, for example, being severely hampered by the refusal of the big three retailers to sell them their redundant inner city sites. They will sell them to other retailers who can sometimes be persuaded to part with them later.

- **Price fighting lines**

  Because price is the main attraction of the discounters, the big three are trying to counter this in those stores that are geographically close to Aldi and Netto stores by having price fighting lines that are a lot cheaper than usual. Sainsbury, for example, have introduced several "tertiary lines"- brands that carry unfamiliar names and which are unsupported by advertising. A source within the company has admitted that sales of these lines have not been successful and underlined the fact that none of these goods have been sold as "loss leaders".

- **Promotions**

  All of the big three are stepping up their promotional activity with offers on selected lines and multi packs, buy 2 get 1 free etc.

  However, these tactics are carried out on a fairly small scale because the big three do not wish to erode the cosy cartel they have nurtured for the best part of the last 5 or 6 years.

- **Exerting buying influence with suppliers**

  In 1990, the "big three" and other food retailers warned suppliers not to supply Aldi because they were selling goods too cheaply. Suppliers were warned that they would lose business and promptly stopped supplying Aldi who in turn complained to the Office of Fair Trading who ruled that it was unfair competition and amounted to restriction of trade.

- **Discount formats**

  One solution is of course to open your own chain of discount formats to counter the competitive threat. So we have seen Savacentre (Sainsbury), LoCost (Safeway), Food Giant and Solo (Gateway), Dales (Asda),Shopping Giant and Pioneer (Co-Op) all set up in recent years. Yet they are not as lean and mean as Kwik Save, Aldi and Netto when it comes to such things as having a low cost base, stock turn and return on investment. For example, in 1990 Kwik Save had a wage bill of 6.1% and an occupancy cost of 0.1% expressed as a percentage of sales. Aldi is estimated to have a wage bill of 5% and occupancy costs of 1%.

- **Public relations**

  The big three have been in the driving seat in grocery retailing for some time and they will use whatever tactics they can to preserve their stranglehold and 40% share of the market. One such tactic is public relations and in recent television appearances by Sir Ian MacLaurin (Tesco), Alistair Grant (Safeway) and David Sainsbury (Sainsbury), they have all tried to play down the growing menace of the discounters whilst accentuating the positive aspects of their grand expansion plans and their desire to offer choice, value, quality and service to a more discerning consumer base.

In conclusion, it must be said that the big three will still be successful in the nineties and beyond due to their entrenched power and customer offer. However, it is fair to say that the likes of Asda and Gateway will suffer considerably in those parts of the country where price is the most important factor in store choice and may lose ground to Aldi and Netto.The warehouse clubs will become more established over a period of time but even if 30 clubs open over the next five years, the supermarkets stand to lose only £600 million in food retail sales - equivalent to less than 1 per cent of the market.

There is plenty of cake to go round but some of the fat boys will have to make do with a slightly smaller slice.