

Discounters

Discounters have disrupted the retail market for good, but what does this mean for traditional retailers?

The prolific rise and disruption caused by the discounters has been well documented and discussed. However, conversations on this topic often focus on Aldi and Lidl's impact on the grocery sector, overlooking a wider set of discounters that are having a similar effect on other segments of the UK retail market. We explore this broader definition of discounter and the disruption they have caused. Looking ahead, we consider the future of discounters in the UK and what this means for traditional retailers who will invariably be affected.

Before exploring the impact discounters have had on the UK retail market and the consequences for traditional retailers, it is important to understand what we mean by discounters as it takes more than low prices to be a discounter.

Discounters are characterised by limited ranges and lower SKU counts that focus on fast-moving lines. This consolidated buying power allows them to achieve lower cost prices which they then pass onto customers in everyday low prices. Fewer SKUs also means lower operating costs across the business, this combined with reduced service levels on areas which price-focused consumers consider less important, such as staffing levels and store fit out, create a no-frills approach to retailing with a significantly lower-cost operating model.

"We sell a wide but disciplined range of products at everyday best prices which are consistently and significantly below those offered by both specialist and general retailers. We offer a range of categories ... but in each we focus on just the best-selling products"

– B&M Annual Report, 2015

Rise of the discounters

Media coverage of the discounters' recent success can overlook the long history of these stores. Many of these successful discount retailers have been part of the UK market since the late 1970s (when Home Bargains, B&M and Poundstretcher were founded) and the concept of discounters actually dates back over 100 years (see figure 3). Since their introduction in the late 1970s discounters have been quietly growing their store estates. Pound shops came a decade later with Poundland opening its first store in 1990,

at around the same time the German discounters, Aldi and Lidl, entered the UK. Throughout the 1990s and 2000s these retailers continued to add new stores each year and to serve cash-constrained consumers. It was the 2008 financial crisis that provided the favourable conditions that allowed the discounters to rapidly grow and take significant market share.

The economic downturn put a squeeze on consumer spending power and more households, including customers from more middle-class backgrounds, turned to value-retail or discount stores to keep costs down. This broader base of consumers found a shopping experience that was far removed from the first-generation hard-discounter proposition they may have previously associated with such

retailers. The stores were brighter, more appealing and the product range wider and better quality.

Alongside these changing consumer attitudes, traditional high street retailers were struggling, providing a strong supply of available retail sites

with reduced rents. This allowed the discounters to expand their footprints and secure better locations. Since 2007 the number of discount stores has almost doubled (see figure 1) and the total market size has grown on average at 15% a year.

Not all discounters have experienced unprecedented success. Poundstretcher and Wilko have achieved limited sales growth and lower profitability compared to their peers. While there are more consumers shopping at discount stores

WHAT IS A DISCOUNTER?

Discounters are defined by more than just low ticket prices...

Defining characteristics:

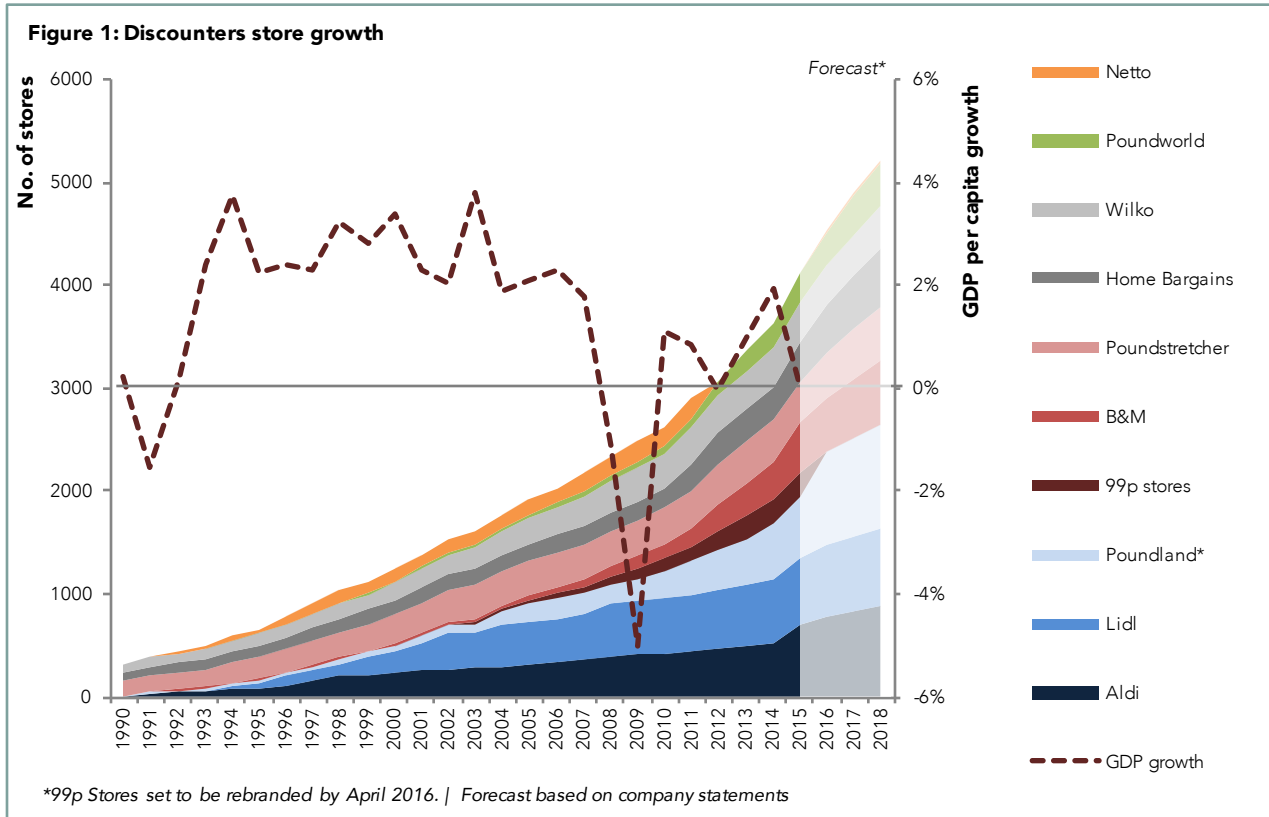
- Stock a smaller range of high volume SKUs to deliver lower prices from economies of scale
- Value for money through everyday low prices
- Reduced operating costs from limiting service levels (e.g. lower staffing levels and less investment in store fit)

Common traits:

- Located on inexpensive sites, struggling high streets and newer spaces with discounted introductory rents
- Limited multichannel capabilities
- Single price points (e.g. pound stores or rounded prices)

Can be confused with...

- Cash & carry wholesalers (e.g. Costco, Booker)
- Retailers with low prices (e.g. Primark)



in the UK, there is also increased competition in this space. This mixed financial performance could continue a consolidation trend in the market, with Poundland acquiring 99p Stores in 2015.

What next for discounters

Even after the UK economy returned to growth in 2010, consumer attitudes towards discounters had shifted permanently and the discounters have now established themselves as a lasting fixture in the retail landscape. Their success led to interest from investors and various injections of private equity capital in the sector over the last 5 years culminated in the IPO of Poundland and B&M in 2014. This has enabled aggressive store roll out that looks set to continue. Our research indicates that discounters are expecting to open 1,000 stores over the next 3 years (see figure 2).

In February 2015 Lidl announced a long term target of 1,000 UK stores with the intention to enter more affluent areas, including 280 stores planned for London alone. This is in addition to the £1.5bn investment they will make over the next 3 years to refurbish existing stores, which will involve the installation of self checkout tills and customer toilets. The company also announced plans to enter the US market in 2018.

Lidl's strategy reflects a trend amongst discounters, who are evolving their propositions to capitalise on their broader acceptance by UK consumers and maintain the exceptional growth rates they have achieved in recent years. Discounters are extending product ranges, building multichannel capabilities and generally shifting focus away from the single priority of keeping costs low. Lidl, Aldi and Poundland have all used TV advertising campaigns, with Lidl using theirs to promote their latest clothing range. There are also subtler touches that indicate this shifting priority, Aldi introduced a premium product range called 'Deluxe' and Lidl now sells cut flowers and have introduced a fresh bakery section to some of their stores.

Although this continued development of the customer proposition by discounters will contribute to sales growth and customer acquisition, it will also invariably add complexity to the operating model and cost. Longer term there is a risk that discounters become too big and less nimble, sacrificing the very traits that have enabled their success and leaving space at the bottom of the market. For example, the easyGroup opened their first food store in February 2016, a true representation of a hard discounter: 76 items all initially priced at 25p, no brands and shelves stacked like in a warehouse. Looking back, this mirrors what happened to retailers like Marks & Spencer, Woolworths and Walmart in America, who all began life as what we have defined as discounters and through success developed into more sophisticated traditional retailers.

Figure 2: Store rollout plans

Company	Current stores	Stated expansion plans
Aldi	700	40 - 50 stores a year, 80 new stores in 2016
Lidl	650	40 stores a year, long term target of 1,000 stores
Poundland*	840	Long term target of 1,000 stores
B&M	472	50 stores a year, long term target of 850 stores
Poundstretcher	409	Reach 500 stores in 2017
Home Bargains	384	Reach 700 stores by 2020
Wilko	379	100 new stores over the next 5 years
Poundworld	280	150 new stores over the next 3 years
Netto	9	Initially 15 trial stores, followed by national rollout if successful

**includes 99p Stores*

Figure 3

THE HISTORY OF DISCOUNTERS

- 1878** ● **Five & dime stores** – FW Woolworth opens first discount store in the US with all items priced at 5 or 10 cents. The Woolworth's model reduced overheads by simplifying duties of sales clerks
- 1884** ● **"Don't ask the price, it's a penny"** – M&S started as a penny store when Marks opened his first bazaar in Leeds, categorising products by price he quickly removed the more expensive goods when the penny section thrived
- 1909** ● **Woolworths opens first UK store**
- 1913** ● **Aldi opens first store in Essen, Germany**
- 1970** ● **Woolworth estate peaks at 1,141 stores**
- 1976** ● **Home Bargains opens first store in Liverpool**
- 1978** ● **B&M opens first store in Blackpool**
- 1981** ● **Poundstretcher opens first store**
- 1990** ● **Aldi enters UK and Poundland opens first store**
- 1992** ● **Tesco value range** – introduced by Tesco to combat threat of discounters
- 1993** ● **Lidl enters UK market**
- 2008** ● **Financial crisis hits UK** - Government nationalises Northern Rock, Woolworths goes in to administration and in September Asda's Income Tracker reaches lowest point
Woolworth's collapse means new stores for discounters...
 - 57 Poundland
 - 47 99p Stores
 - 43 B&M Bargains
 - 22 Poundstretcher
 - 15 Home Bargains
 - 15 Wilko
 - 7 Poundworld
- 2010** ● **UK economy returns to growth**
- 2013** ● **Discount market grows 21%**
- 2014** ● **Poundland and B&M make initial public offering**
- 2015** ● **Aldi replaces Waitrose as sixth-largest supermarket chain**

Disruption across the retail sector

The growth of discounters has hurt traditional retailers who trade on being value-for-money. Aldi and Lidl's share of the grocery market has more than doubled since 2009, with a combined share of 9% in 2015 and Aldi displacing Waitrose as the sixth-largest supermarket chain in the UK.

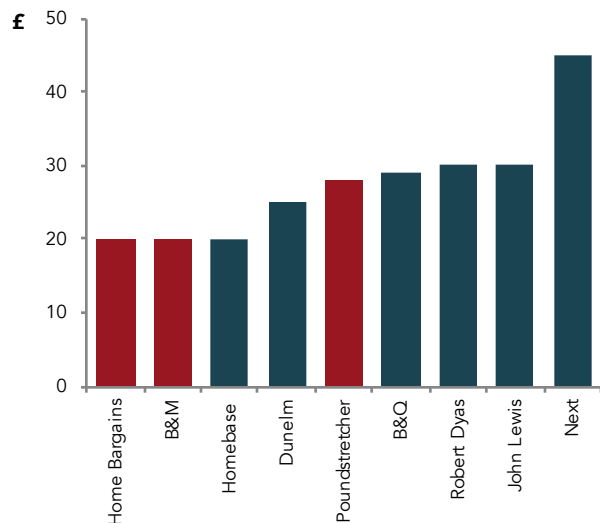
This disruption is not confined to the grocery sector. Our research (see figure 4) shows that general merchandise discounters like B&M, Home Bargains and Poundstretcher are able to price products that undercut comparative items at both high street general merchandise stores and specialist retailers. This means the list of affected retailers is extensive.

Retailers can often overlook the threat posed by discounters by thinking of them as "niche" or that their target consumer is not a "discount shopper." However, the deep change in consumer attitudes towards discount retailers means that discount shoppers are no longer just individuals who can't afford to shop elsewhere. The acceptability of these retailers has reached a point where almost anyone could be a discount shopper for at least part of their basket.

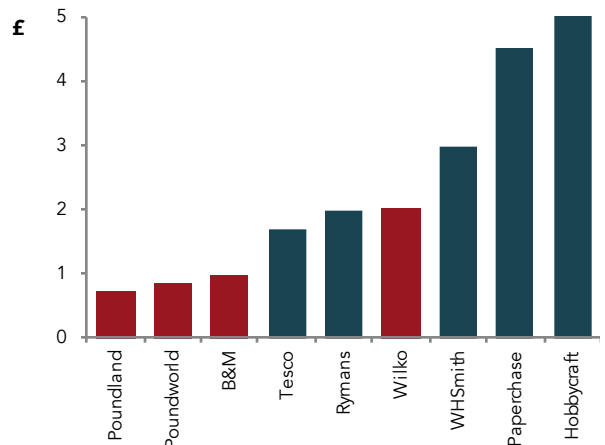
Unlike the French grocery retailers (see case study), the UK's big four grocers were slow to react to the threat of the discounters because they were pre-occupied with looking at each other as competition. They continued to benchmark their proposition and pricing against the other big four when they were losing customers to discount stores. This oversight could be replaying itself in other sectors, as value-for-money and high street retailers fail to recognise general merchandise discounters as legitimate competition.

Figure 4: General merchandise price benchmarking

30L pedal bin



50 C6 white envelopes



What can traditional retailers do?

While it's not clear for how long the discounters can continue to grow sales and stores at recent rates, it is clear that their position in the UK retail market is secure and that traditional retailers will need to take steps to address the threat they present. We believe there are three strategic options available to traditional retailers in the face of these challenges.

Compete – Offer better quality and better prices

- Reduce prices on known-value-items
- Introduce entry level pricing that is competitive with discounters
- Maintain quality, in the past retailers have lost out by reducing quality to compete on price and underestimating the customers' ability to discern quality

Differentiate – Focus on what discounters can't provide or don't do well

- Emphasise better store experience and service levels through format development
- Focus on continuing to build multichannel capabilities that support a broader product offering that will meet customer demands on a more consistent basis
- Prioritise communicating product quality rather than price
- Invest in product design and development to offer products that discounters will find difficult to mimic, e.g. exclusive designer ranges

Learn – Where possible adopt the principles of the discounters that have made them successful

- Introduce a cultural change by introducing principles like Lean Six Sigma to reduce internal complexity and its associated costs from the operating model
- Focus on everyday low prices that are easier to administrate and better communicate value to the customer
- Consolidate ranges and remove slow-moving lines

Finally, "if you can't beat them, join them," in 2014 Sainsbury's announced a joint venture that would bring Netto back to the UK after it exited in 2010. Given

CASE STUDY: FRANCE

How the French grocers fought back against the discounters

Like in the UK, discounters experienced rapid growth in the French market in the 1990s and 2000s. Their market share of the French grocery market peaked in 2009 at 14%, falling back to 12% in 2014 and remaining stable in recent years. French grocers focused on building multichannel capabilities and investing in convenience formats to fight off the threat presented by Aldi and Lidl.

Unlike their UK counterparts, the French grocers were quick to employ bold pricing strategies. They closed the gap on the price of branded goods to be just 5% more than discounters and on private label goods they were 9% cheaper than the discounters in 2013/14.

To do this French grocers put in place a number of initiatives:

- Improved own-label budget product lines and reviewed pricing
- Removed multi-tiered private label proposition to focus on clear value-for-money price points
- Worked with suppliers to significantly reduce price of branded goods
- Focused on every day low pricing and moved away from more complicated promotions

Sainsbury's south-eastern and middle class customer bias, it is unlikely to result in sales cannibalisation and in the meantime Sainsbury's CEO, Mike Coupe, has said that "Netto stores have taught us a lot about discounters."

Of the three approaches, retailers may have the most success if they learn from discounters to reduce cost and complexity at all points that do not impact the customer and invest these savings to compete on price and differentiate their propositions.

Summary

Having achieved rapid growth in sales, store numbers and customers since the 2008 financial crisis, the discounters are set to be a permanent feature of the UK retail market. It is not just the big four grocers who are affected by this and to handle this disruption traditional retailers will need to compete, differentiate and learn.

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