

# THE ENDGAME IN EUROPEAN GROCERY

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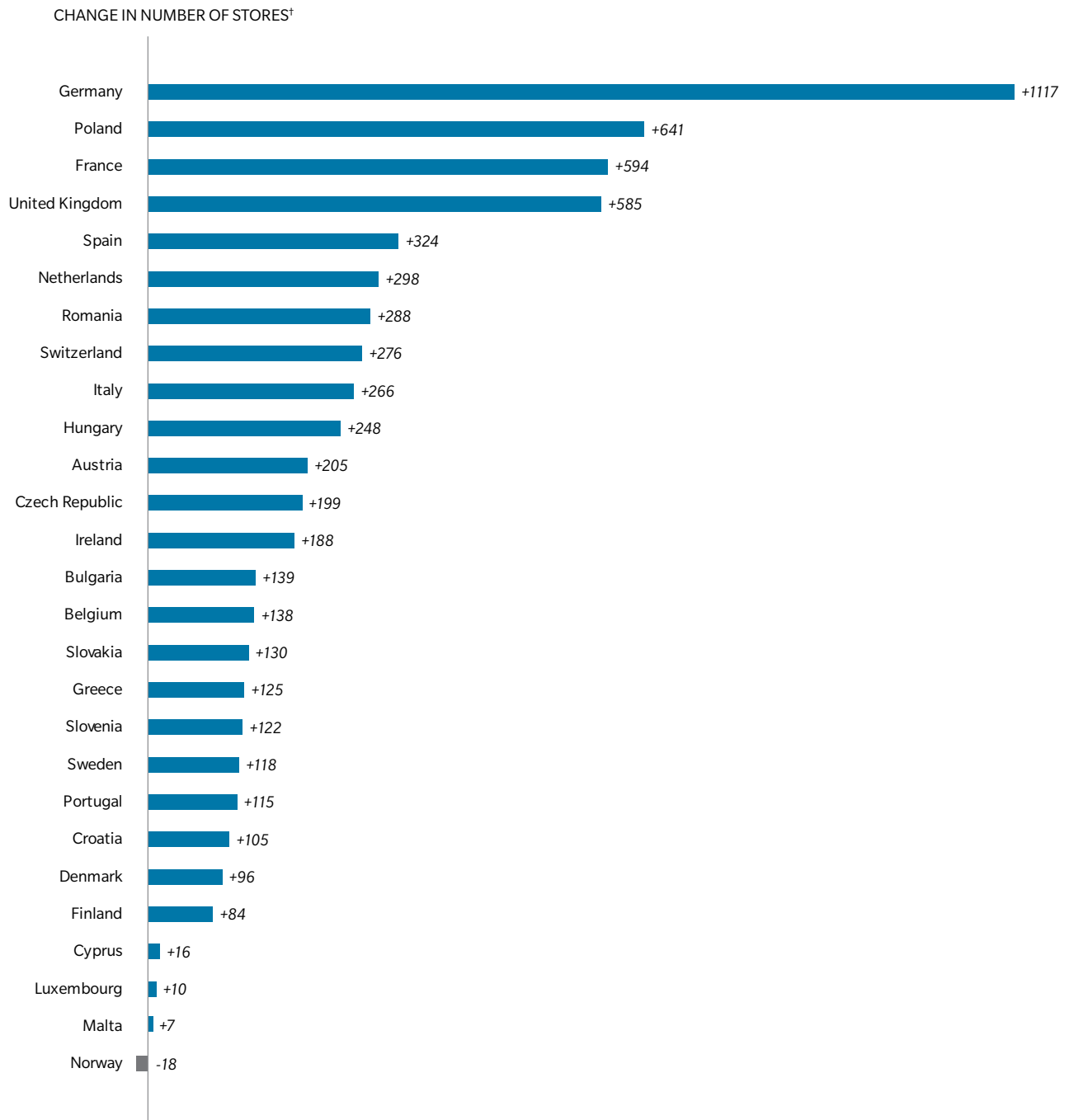
*Against a weak economic backdrop, old growth models based on store expansion, national consolidation, and diversification are no longer delivering the like-for-likes board members and investors want to see. As well as a saturated marketplace, there is increasing competition from discounters and newer online retailers like AmazonFresh. In response, we believe that the European grocery market will begin consolidating internationally so that, by 2025, the total number of large grocers in Europe will have halved.*

Weak demand, a decline of traditional growth engines, and the aggressive growth of specialist competitors such as discounters (Exhibit 1) will continue to drive the next ten years' of change in European grocery. As the pressure mounts, expect to see more headlines about price wars, stock value erosion, races to form buying alliances, and even the occasional market exit. With this in mind, we think there are four questions grocers should be considering today to ensure a successful future, listed below and explained in more detail in the rest of the article:

-  **1** How can we deliver a step change in our approach to cost?  
Cost leadership is becoming a necessity.
-  **2** How can asset productivity be increased?  
Only business models with high levels of asset productivity will survive.
-  **3** What are our options to grow internationally?  
Scale matters – and international growth is one of the few ways to drive scale.
-  **4** What more could we be doing to hold on to and build customer relationships?  
With new competitors on the scene, increasing the 'stickiness' of customers is crucial.

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Exhibit 1: Aldi and Lidl growth in Europe 2004 versus 2014



† Aldi Nord plus Aldi Süd plus Lidl

Sources: Planet Retail and Oliver Wyman analysis

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# 1. HOW CAN WE DELIVER A STEP CHANGE IN OUR APPROACH TO COST?

In all areas of the cost base, adapting incrementally is unlikely to be enough. Successful businesses will be those that deliver a clear step change; those who watch and then react will fall behind.

The majority of retailers understand the importance of cost only too well and incremental cost reduction is a core element in most businesses' strategic plans, year in, year out. However, we suspect that for many these efforts do not go far enough and that becoming a cost leader will come down to step changes in two areas: buying power through scale, and leaner, smarter operations.

To achieve the scale needed to negotiate improved terms from suppliers, buying alliances like those shown in Exhibit 2 will continue to form and grow, and we think all retailers should review their options for joining or building an alliance. Retailers not participating in these buying groups must ensure they are able to deliver world-class procurement, for example by using data to create a real advantage in supplier negotiations (see our report *Smarter Arguments for Higher Profits: Reversing the Information Asymmetry*).

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## Exhibit 2: European grocer buying alliances

### EMD

- Axfood
- Groupe Casino
- Markant
  - dm
  - Globus
  - Kaiser's Tengelmann
  - Kaufland
  - Müller
  - Rossmann
- Norges Gruppen
- SuperGros
- ...et al.

### ALIDIS

- Edeka
- ITM Entreprises
- Grupo Eroski

### COOPERNIC

- Coop Italia
- Delhaize Group
- E.Leclerc†

### Since 2014

- Groupe Auchan
- Metro Group

### In France

- Carrefour + Dia + CORA
- Groupe Auchan + Systeme U
- ITM Entreprises + Groupe Casino

### AMS

- Ahold
- Booker
- Dansk Supermarked
- Esselunga
- Hagar
- ICA
- Jeronimo Martins
- Kesko
- Migros
- Morrisons

### CORE

- Colruyt
- Conad
- Coop Switzerland
- Rewe Group†

### Strategic partnership announced in June 2015

- Rewe Group
- E.Leclerc



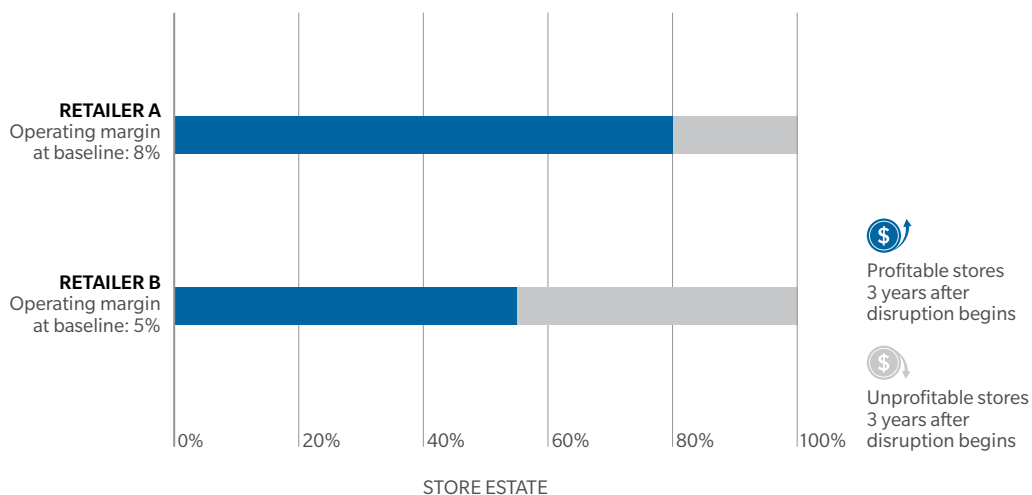
† E.Leclerc and Rewe Group announced in June 2015 their own strategic partnership

Note: Status as of June 2015

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To truly outpace the competition, fresh thinking will be required to take cost out of other areas of the business. For example, you could behave like a discounter and ask if some product ranges could be rationalised in order to reduce cost and complexity in the supply chain. Or you could consider how automated algorithms like those used by lean online retailers could be used to manage more of the day-to-day pricing decisions. These approaches will doubtless involve asking difficult questions and challenging the status quo, but the profitability advantages they create will provide a degree of protection against volume losses other grocers may not have, as shown in the example in Exhibit 3.

**Exhibit 3: Example of how small profitability advantages can reduce the impact of volume loss from online disruption**



## 2. HOW CAN ASSET PRODUCTIVITY BE INCREASED?

With margins shrinking and the future looking uncertain, underperforming stores will be scrutinised, with closures not ruled out. While in many cases long-term leases will prevent outright closures, there are still innovative ways in which the productivity of such sites can be improved. For example, they can serve as pick-up points and host collection lockers, including for other non-competing retailers. In the UK, for years customers have been able to pick up their John Lewis homeware order from a local Waitrose supermarket (both are members of the John Lewis Partnership), and now they can also collect their eBay purchases from one of thousands of Argos stores.

These collaborations can allow one partner to deliver low-cost points of presence and the other to make use of excess space. This is exactly what UK grocer Sainsbury's is doing by opening up Argos outlets in its stores, and the idea doesn't have to be limited to retailer – retailer relationships: P&G allowed Amazon to set up fulfilment operations within its own warehouses in the US to reduce transportation costs and speed up delivery.

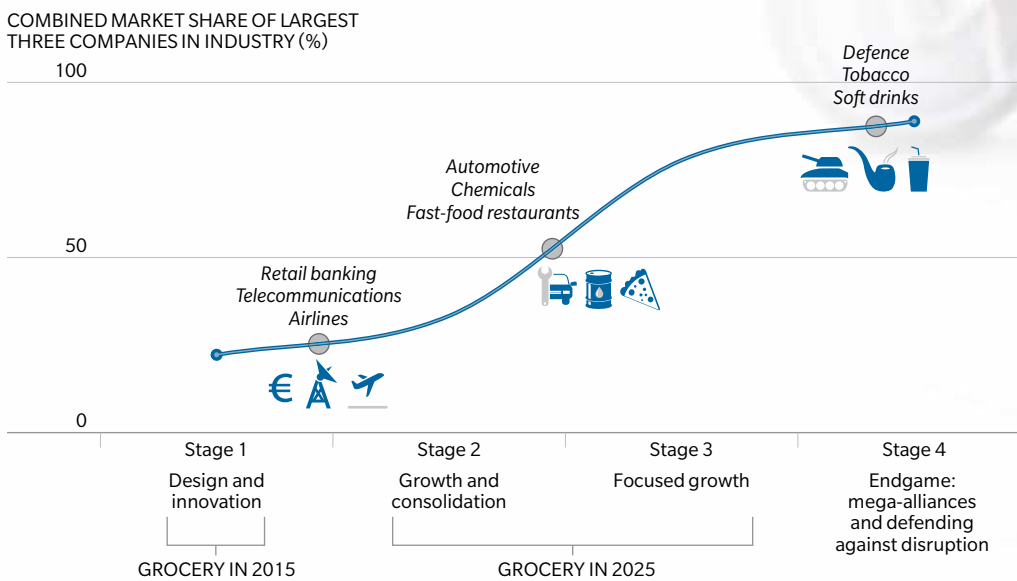
Driving asset utilisation can be a very powerful way of strengthening the economic model of the business. Making better use of the costs you have can be just as important as reducing those costs in the first place.

### 3. WHAT ARE OUR OPTIONS INTERNATIONALLY?

It's clear that scale will continue to drive financial strength. However, in many European countries national consolidation has reached saturation point and some regulators are unwilling to allow further take-overs or mergers among the remaining large retailers. The alternative is a strategy long considered out of fashion in grocery retail: international consolidation.

Most industries consolidate as they mature (Exhibit 4), with major players expanding and often buying up competitors – initially within national markets but eventually across borders. On the way, underperformers and slower movers are targeted and absorbed. In grocery, we've seen cross-border consolidation successfully deployed by hard discounters, warehouse clubs, and cash-and-carry stores. For example, Aldi has expanded across Europe and has grown Trader Joe's in the US since it purchased the business in 1979.

Exhibit 4: Consolidation will play out in grocery in a similar way to other industries



A small number of large companies reign in industries such as tobacco, soft drinks, defence, and automotive - and we expect to see grocery starting to move up this consolidation curve in the next decade. In other areas of retail, we already see examples such as furniture (IKEA), clothing (Inditex and H&M), and luxury goods.

Given this pattern, a company's long-term success depends on how quickly and successfully it moves up the consolidation curve. Slower movers will disappear or become targets. Staying out of the contest or ignoring it does not increase your chances of survival.

Sources: Harvard Business Review and Oliver Wyman analysis

In a world of one-to-one, bespoke customer interactions, taking an international view could also open up new and very specific customer innovations. Technology will be a key enabler of this type of innovation: for example a great meal planning app for those on specialist diets would be popular regardless of geography. After all, a gluten-intolerant customer in Spain has more in common with a gluten-intolerant customer in Finland than they might with the average Spanish grocery shopper. Once customers are served in this way, national boundaries will break down even further.

#### 4. WHAT MORE COULD WE BE DOING TO HOLD ON TO AND BUILD CUSTOMER RELATIONSHIPS?

For Europe's major grocery chains, owning the customer relationship is crucial to their long-term future, and traditional retailers will need to fight to keep the customer relationships they once took for granted. New business models have been causing market disruption by fulfilling the traditional retail role in a new way (AmazonFresh, Google Shopping) and by positioning themselves as the final and personal touchpoint in the value chain (Shutl, DPD, Uber). Success and failure will be driven by how well grocers can counter these newer competitors – such as online aggregators and last-mile distributors – to maintain the all-important customer contact.

In such an environment, knowledge is power and asking the right questions of your customer data is essential if you are to successfully develop relationships on an individual basis and build “sticky” proprietary ecosystems with differentiated customer experiences.

Judicious analysis and use of data are key, and an important strength will be the ability to quickly develop apps and information-driven services that are better, more exciting, and more relevant. For example, the menu and diet management app mentioned earlier could provide exceptional personal value for a subset of customers, radically increasing their brand loyalty to that particular business.

## THE ENDGAME

As European grocery markets move toward consolidation, we believe retailers will eventually split into two camps: superpowers and nimble local winners (Exhibit 5).

In this market, there will be fewer grocers than today. Right now there are 25 big names each with over €10BN in revenue. By 2025, we suspect this will have fallen by half – although the survivors will be much, much larger.

Exhibit 5: What grocery retailers will look like in 2025

	THE SUPERPOWERS	THE NIMBLE LOCAL WINNERS
Geography	Strong pan-European presence	National and local
Proposition	Mostly specialists. A few generalists who differentiate through better customer connections and efficient management and operations	Offer tailored at a local level
Survival advantage	Economies of scale	Innovation and creative strategies that can quickly adapt

## WHAT WILL IT TAKE TO BE A WINNER?

Companies who move first and move fast will obviously be in a strong position, but they must ensure they are travelling in the right direction. Regardless of whether your business will be a superpower or a nimble local winner, we think there are three key areas to focus on to help you survive and thrive in the future.

### 1. THINK LONG TERM AND INVEST IN STRATEGY

We encourage retailers to think about where they need to be in five or ten years' time, rather than focussing on where they are starting from today. The aim is to move beyond short-term, incremental steps and instead plan step changes across the whole organisation. This way, you will be able to tackle the latest market disruptions and quickly adapt to ones you may not see coming.

To make a realistic assessment of your position and the options open to you, model the European grocery market as a whole and simulate the biggest, most dramatic changes that could occur. Perhaps the most significant threat to your business will be consolidation, or perhaps it will be a local challenge: either way, forewarned is forearmed.



Study what happened as other industries moved up the consolidation curve in Exhibit 4 and learn from what worked and what didn't. Our article *Trading Places* in the second volume of *Ten Ideas From Oliver Wyman* expands on the benefits of this kind of cross-industry thinking.

## 2. DO THE BASICS, AND DO THEM WELL

As discussed earlier, in a saturated market, like-for-like growth has to come from reconfiguring the existing business to make it more productive. This is why there is so much focus on improving the proposition, increasing operational efficiency, and reducing costs.

A strong unique proposition can reduce customer turnover and be a first step in winning market share. Whether online or in store, identify what customers want and how to give it to them in a way that the competition cannot. Find out what they don't value and look at ways to remove it from your proposition and save both you and them money.

Many retailers are overrun with data yet have not managed to unlock the performance improvement this data can deliver. For example, the right category management app can increase the time that category managers spend pricing products rather than processing the insight data, enabling them to make better decisions and react faster. Similarly, armed with the right supplier negotiation tool, we've helped grocers integrate dozens of different data sources, perform sophisticated value-added analyses, and generate easy-to-consume reports in a format suited to supplier discussions.

## 3. SHAPE THE FUTURE – DON'T LET IT SHAPE YOU

We've mentioned previously the importance of being a leader rather than a follower. Customers don't typically notice copycat strategies, and a rushed response to an unforeseen change usually leads to poor execution at a higher cost. For most organisations, taking control of their own future will mean building more experimentation, risk taking, and agility into their culture. This will help you become "future flexible" rather than "future proof", which we believe is the best way to meet the changes coming over the next decade.

## CONCLUDING REMARKS

The European grocery market will not be significantly larger in 2025 than it is today. What will be different is its composition. After intense international consolidation, there will be fewer large retailers, with those remaining each controlling a greater proportion of the market. If your business doesn't go down this route, perhaps it will be one of the smaller – but still profitable – nimble local grocers who are able to quickly and efficiently meet the needs of a smaller subset of customers.

Either way, to emerge as a winner in this new ecosystem, actions must be taken today. The future will favour those who move now and move boldly – the time for small incremental change is over.

Grocers who can identify where they want to be in 2025, and are bold enough to make the right early moves to get there, have a very exciting future.



## ABOUT OLIVER WYMAN

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialised expertise in strategy, operations, risk management, and organisation transformation.

In the Retail practice, we draw on unrivalled customer and strategic insight and state-of-the-art analytical techniques to deliver better results for our clients. We understand what it takes to win in retail: an obsession with serving the customer, constant dedication to better execution, and a relentless drive to improve capabilities. We believe our hands-on approach to making change happen is truly unique – and over the last 20 years, we've built our business by helping retailers build theirs.

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