

Britain's supermarkets have been eating themselves



Viewpoint
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Change is the law of the life," John F Kennedy said in 1963. "Those who look only to the past or present are certain to miss the future."

A narrative has emerged in the UK grocery industry that the chaos engulfing the leading supermarkets is all down to a dramatic change in shopping habits.

British shoppers, so the story goes, have abandoned their weekly food shop. Instead, they are spending their money across different trips to the supermarket, the local convenience store, a discounter, and the internet.

There is of course some truth in this. Forecasts by IGD, the industry body, show that spending in supermarkets and hypermarkets will fall from £73.7bn a year to £70.8bn over the next five years. At the same time, grocery sales will double for discount retailers and online. Mark Price, the managing director of Waitrose, has said that this represents the biggest change in the industry since the 1950s.

That wave of change in the 1950s – which led to growth of Tesco and Sainsbury's at the expense of the Co-op – was sparked by the invention of the self-service supermarket.

But this time there is a "chicken and egg" debate to be had. Has the change in shopping patterns been sparked by consumers changing their demands? Or has it been led by retailers through the development of new shopping formats and changes in the quality of their stores?

Also, how "seismic" is the change really? The weekly shop is not dead. The IGD forecasts show that supermarkets will still be by far the biggest portion of the grocery industry in 2019, accounting for 35pc of the market. This compares to 24pc for convenience and 10.5pc for discount chains such as Aldi and Lidl.

If the changes are so dramatic, why does the latest Kantar data show that sales are falling for the Co-op, which has more convenience stores than anyone? And why are they falling for Iceland and Farmfoods, two discount retailers?

In results published at Companies House this week, Musgrave GB, the owner of Budgens and Londis,

reported annual pre-tax losses of £63m. Given the supposed revolution taking place, this convenience store business should be thriving.

The answer to this conundrum is that the performance of these companies is being driven by their strategy and its execution, not a change in shopping habits.

The debate about the recasting of Britain's grocery industry should not mask the fact that Aldi and Lidl have dramatically upped their game. The German discount retailers have invested heavily into introducing more fresh food and more British-sourced goods while keeping prices low.

But the debate must also not mask a series of strategic blunders by Tesco, Asda, Sainsbury's and Morrisons in the last few years.

As the quote from JFK highlights, change is part-and-parcel of doing business. It does not necessarily mean that the incumbents in a market will be the worst affected. Frankly, the "Big Four" have got themselves into this mess.

When Mike Coupe, chief executive of

'All of the 'Big Four' have wasted billions of pounds on new stores without growing their market share'

Sainsbury's, presented the company's interim results last week he warned that sales in supermarket would be falling for years and blamed a fall in profits on the pressures in the industry.

In effect, Coupe claimed that Sainsbury's destiny was out of its hands. This did not go down well with City analysts. David McCarthy at HSBC said: "There seems little reason to hold Sainsbury shares. It is structurally disadvantaged against Tesco, it has declining profits and dividends, and as management blames the industry, recovery is not in its hands."

McCarthy claimed that Sainsbury's and its rivals had overseen a "mismanagement of the industry" for the last five years.

This mismanagement is summed up by pricing and the crazy number of stores that the "Big Four" have been building.

Tesco has somehow allowed its prices to become 6pc higher than Asda and at least 15pc higher than Aldi on a typical basket of goods. At the same

time, the range of products it sells has grown by 31pc in the last 18 months, making shopping at Tesco more complicated.

British shoppers have been given fewer reasons to go to Tesco supermarkets. But, this has not stopped Britain's biggest retailer building more shops. Since Tesco's market share peaked in 2007, the company has built enough new stores to cover the same space as the whole of Morrisons today, an extraordinary statistic.

However, Tesco is not alone in building too many stores. All of the "Big Four" have wasted billions of pounds on new stores without growing their market share since the collapse of Lehman Brothers in 2008. With hindsight, Sainsbury's £445m rights issue in 2009 to fund expansion now looks like one of Justin King's worst moves as chief executive. Sainsbury's warned earlier this month that one in four of its stores will struggle over the next five years.

An in-depth report by Goldman Sachs this week laid bare the mess supermarkets are in. The analysts, led by Rob Joyce, said the listed trio of Tesco, Sainsbury's and Morrisons had been "addicted to space" and now need to close one in five shops.

A damning series of charts laid out their failures on price and opening too many stores. Since 2004, the UK grocers had passed on food inflation significantly ahead of European rivals, with food consumer price inflation (CPI) of 4pc compared to 2.6pc in second-place Spain and 1.1pc in the Netherlands. This error was compounded by the fact that between 2005 and 2013 the supermarkets expanded capacity by 50pc, despite UK grocery sales only growing by 32pc.

Goldman's conclusion is that these factors left supermarkets exposed to the structural changes in the market as convenience stores, the internet, and the German discounters emerged as challenges.

But, interestingly, the change in shopping habits has been accelerated by the "Big Four" themselves – they have opened thousands of convenience stores, developed online food shopping, and encouraged consumers to trust own-label food rather than brands, which has opened the door for the discounters Aldi and Lidl.

In effect, Britain's leading supermarket retailers fuelled the changes taking place and then failed to take advantage of them. The Big Four have been eating themselves.