



Responding to Discount

A New Business Model
for Food Retailers?



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by McKinsey & Company

The Coca-Cola Retailing Research Council, Europe

The Coca-Cola Retailing Research Council Europe (CCRRCE) is dedicated to the development of a better understanding of the food retailing and allied merchandise distribution business in Europe. The focus of its energies is to identify and then to study selected critical issues and problems and to present the findings in a suitable forum, so that full advantage can be taken to further develop the effectiveness of the food retailing distribution business.

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Preface

The 2005 Report of the Coca-Cola Retailing Research Council Europe summarises the results of an extensive study on the growth of European discount grocery retailers and the implications of this growth for non-discount supermarkets and hypermarkets. The Project was commissioned by the Council and carried out by McKinsey & Company. It benefited from the extensive involvement of leading retailers who sit on the Council and discussions with a broad set of industry experts, as well as a major survey of 10,000 European grocery shoppers recently completed by McKinsey's European Retail Practice.

The Project's prime objective is to highlight the trend towards value, which both underpins the remarkable growth of discount and offers avenues for non-discount retailers to fight back. It focuses on how discounters successfully serve certain groups of price-focused shoppers as well as on some of the limitations of the discount model. And while the Report touches upon some of the many implications for manufacturers of consumer packaged goods, the core of its effort is centred on developing solutions for non-discount grocery retailers.

This topic is clearly central for grocers throughout Europe. The Council hopes that CEOs and others involved in setting strategy for these organisations will find the Report useful as they make their decisions in this complex arena.



Executive Summary

The underlying trend towards value

On the face of it, discounters look like the biggest challenge facing the grocery retail sector today. But dig a little deeper and you will find it is not the discount phenomenon alone that is changing the face of European grocery retail. The bigger disruptive force - and the greater opportunity - comes from shoppers' rising expectations of value.

Shopper segments define value differently

Discounters have certainly had an influence on shoppers' expectations. They have taught shoppers to expect quality products at low prices. The extensive shopper research that McKinsey & Company recently undertook shows that discounters are offering good value to European shoppers who care about price above all else. But that's only 20% of the total market. The remaining 80% of shoppers care about a lot more than just price. How well are they being served?

How the discount model works

The discounters have a powerful approach for delivering on the price components of value. Given that all shoppers are becoming more demanding on price, there is a lot that non-discount players can and should learn from the discounters in this area. Accordingly, the Report takes an in-depth look at the mechanics of the discounters' business model.

Limits of the discount model

At the same time, however, the limits of the discount model are becoming more apparent. One sign of this is the fact that discounters' rapid growth has been fuelled mainly by new store development rather than strong like-for-like sales. Discounters are growing in part because regulation allows them to open more quickly and easily than their non-discount rivals. Though this does not lessen the discount challenge, it does suggest that the appeal of the discount model to shoppers is not as strong as some may have thought.

Discounters are adjusting to shopper and marketplace trends

Perhaps realising this, discounters are modifying their approach to suit different market environments better and to appeal to a broader cross-section of shoppers. They are expanding their product ranges and including more branded products. They are also investing more than ever before to market their proposition to shoppers. How far they can travel down these routes without upsetting their business model remains unclear.

Even while that uncertainty remains, grocery retailers should pause and consider what can be learned from these low-price competitors. Most importantly, discounter success signals an underlying shift in shopper sentiment towards value. This trend towards value is changing the rules of the game for all retailers, not just those who face an imminent discount challenge.

Meeting the bar on price

Price is not the only component of value, but it is the largest one. Therefore, to win on value, a retailer must first have competitive prices on Key Value Items - the SKUs that most influence shoppers' price perception. Understanding the mechanics of the discount operating model offers other retailers a new mindset with which to approach cost reduction. While slavish imitation of them is unlikely to be a path to success, discounters can be an invaluable source of ideas for taking cost out to meet shoppers' rising expectations for low prices.

Raising the bar on value

Merely meeting the bar on price, however, will not be sufficient to thrive in an increasingly demanding environment. Retailers must also "raise the bar on value" by tailoring their offer to suit their target shoppers' definitions of value. To serve some segments, this will require a step change to actual and perceived prices. For other segments, a dramatic improvement in benefits is in order. The Report offers some examples, from Europe and abroad, of retailers who have been successful by becoming "famous for" something that their shoppers care about. Bringing such efforts to life is an activity to which each retailer can and should apply its organisational creativity.

Setting your agenda – Success will mean winning on value

Whether a new business model is needed to compete successfully will vary based on the retailer's starting point, the segments it aims to serve, and the competitive environment in which it operates. Given that most retailers already run a large base of stores, the first line of attack should be refining the existing model. At the same time, the diversity of shopper needs may make serving very diverse segments within a single format impossible.

Grocery retail will continue to change, constantly revising expectations of value upwards and generating higher demands on operations. As the shift towards value continues, not all traditional grocers will survive: those who fail to respond risk opening space in their market, which discounters will readily seize.

To win in this new environment, grocers must adopt a relentless focus on delivering value to shoppers based on accurate and timely insight. The stakes are high and the challenge has never been greater. By responding decisively with an integrated approach centred on shoppers' definitions of value, non-discount grocers can secure their future in this new value-driven world.

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