

**Point of view**

# **The 3 As:**

**Aldi.**

**ASOS.**

**Apple.**

**The future of retail.**

# Overview

## The 3 As

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**It is no secret that the retail market has changed significantly in the last few years. Today's consumers expect convenience, transparency and value for money.**

They compare prices and product reviews on their 4G phones, they search for the best deals in store and online, they shop anytime, anywhere and on any device. When austerity met technology the impact on consumers, and therefore retailers, was deep and long-lasting. Economic conditions may be beginning to change for the better, but consumer behaviour is not expected to change.

The best performing retailers in this climate are those who have a rigorous focus on understanding their customer and apply that understanding through a differentiation on price, product or convenience. We have identified three retailers that will be future winners based on these criteria. At first glance, they have little in common; each operates a fundamentally different business model. However, they all understand what their customers want, and that understanding applied in different ways has led each to grow significantly above the industry average.

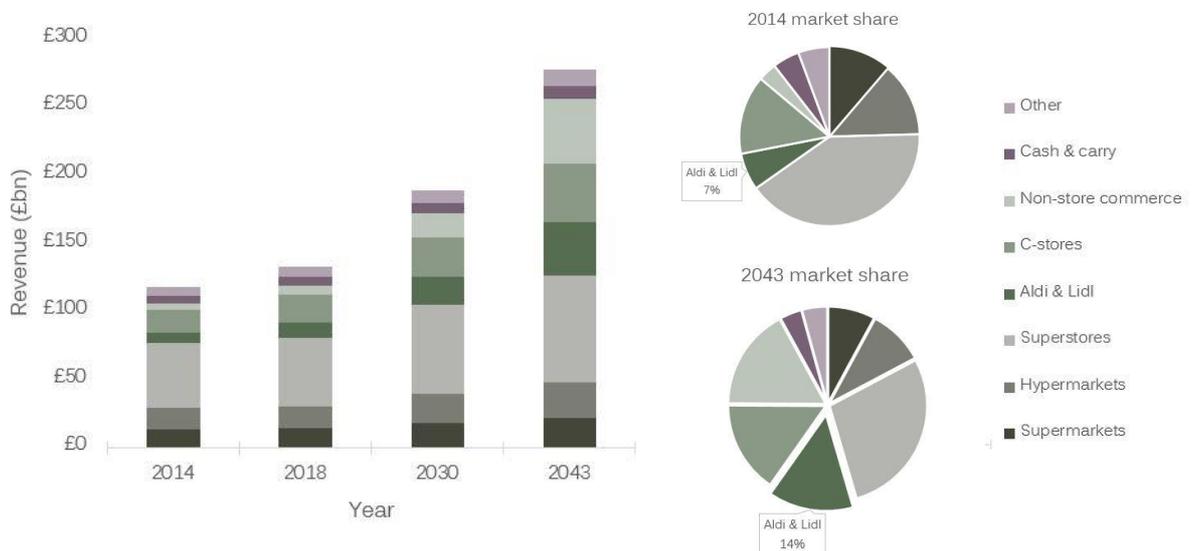
Our three winners are Aldi, Apple and Asos: the 3 As. In a series of articles published over the next few months, we will examine what makes each so successful. Our final article in the series will compare and contrast the lessons learned from each and explain how that knowledge can be applied to your business. We are launching this series with the 2013 Retail Week UK Retailer of the Year: Aldi.

**Introduction: a market disrupter**

Aldi excels at bringing costs down, keeping prices low for its customers and keeping operating costs to a minimum. This relentless focus on cost has resulted in Aldi UK's year on year sales growth of 20% followed by 35.3% sales growth in the 12 weeks to 30 March 2014 (Source: Kantar Worldpanel). This stunning performance reflects a long-term growth trend by the discounter rather than anything temporary. We expect the rapid growth rate of Aldi and Lidl (Aldi's closest discounter rival) to continue to disrupt the UK grocery market in the medium term and then continue stealing market share so that over the next 30 years their combined market share will have doubled. The rapid growth of the market share of both convenience and eCommerce alongside the discounters, is likely to squeeze the market shares of the traditional 'big box' formats (hypermarkets, supermarkets and superstores), dominated by the multiples, from 66% to 45% (see below). We expect discounters, convenience and eCommerce to cannibalise in the region of £7.6bn sales from the major multiples in the next five years.

Over the past few years, the Big 4 grocers have chosen not to talk about the threat from Aldi, perhaps in an attempt to starve the discounter of the oxygen of public scrutiny. Dalton Phillips, CEO of Morrisons, has dramatically broken the cosy consensus of the oligopoly and announced a price cut campaign aimed squarely at the discounters. Tesco and Asda have similarly announced price campaigns and we all expect, as customers, to benefit from the inevitable price war. Is Dalton Phillips correct in his assessment that the discounters are a significant threat to Morrison's market share? The simple answer is yes. Will the price initiative work? Perhaps temporarily but over the long term absolutely not. Unless the shareholders of the Big 4 can accept a structurally lower profitability over the long term (good luck with that conversation!), then these price initiatives can only be temporary measures that will not slow the growth of the discounters.

**“We expect the discounters and eCommerce to cannibalise £7.6bn sales from the major multiples in the next 5 years.”**



## Context & the Aldi proposition

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### What's happening in the market?

The problem for the Big 4 is that both technological and economic forces have conspired to encourage the customer to be far more price conscious than in the past, and they will continue to be so. More and more customers are changing their shopping habits and sticking to the change and public acceptance of the whole discounting phenomenon is growing.

Economically, we aren't witnessing a couple of years of austerity followed by a return to the good times. We have experienced 5 years of reduced consumer spending power and this trend is not likely to dramatically change in the foreseeable future. Real wages are at similar levels to those in 2003 with only marginal improvements in sight, resulting in average household spending power remaining subdued.

Technology has enabled the consumer to obtain much clearer visibility of prices across the marketplace. Social media has enabled customers to exchange information, specifically and in general, resulting in price-conscious customers being able to shop around far more efficiently. Retailers play the high/low price strategy at their peril – reputations can be lost very quickly.

### Who are Aldi's customers and what do they value?

As a result, the situation has been conducive for a retailer with a convincing price message to gain market share. Poundland, Primark and others have similarly benefitted.

However, these circumstances are not the only reasons for Aldi's recent success. Copycat strategies based on an assessment that Aldi's success is only due to their price positioning will be misguided. What is certain is that these circumstances have propelled many customers out of their normal shopping patterns to experiment with alternatives. Due to the protracted length of the downturn and recovery, more and more customers are testing out the discounters and repeat shopping is getting them used to a different experience. This factor is important because the very different shopping experience has historically been a barrier to Aldi's growth to date.

The absence of brands, the limited number of product lines and the presentation in shelf-ready packaging and on pallets can be unnerving for first-time customers. In the past, those with higher disposable incomes were often unconvinced 'first-timers' and returned to the mainstream retailers. In recent times, however, due to pressures on household finances and with every subsequent shopping trip, many customers are learning and starting to appreciate Aldi's very powerful and seductive business model. The consistent offering breeds customer trust and ultimately brand loyalty. Compare this to the multiples' endless price campaigns, which can confuse customers. This is the essence of Aldi's threat to the multiples: once customers switch they aspire to continue to shop there.

### How does Aldi make money?

Aldi's value proposition is a simple one: it stocks a private label range of limited lines of the highest quality at consistently the lowest price in the market. The business is able to deliver on this promise as a result of their global buying power per product (wholesale prices can be lower due to the very high volumes shipped per product as a result of the limited range) and a relentless focus on reducing operating expenditure over the long term.

The target audience is the mass market value-conscious customer (affluent or not) who will buy a large proportion of their weekly shop from a single visit to the discount store. These customers are comfortable with the no-frills atmosphere and service and Aldi are happy about them topping up at other retailers. Profitability is achieved through high volume and relentlessly bearing down on costs through operational excellence.

Aldi would be unable to achieve this operational excellence without its key resource: a highly experienced workforce working within a culture of continuous improvement. Its business model, predicated on low prices and operational excellence, is absolutely clear and is understood by customers, employees, suppliers and the owners alike. This clarity is fundamental to Aldi's success, allowing the business to focus on outstanding execution.

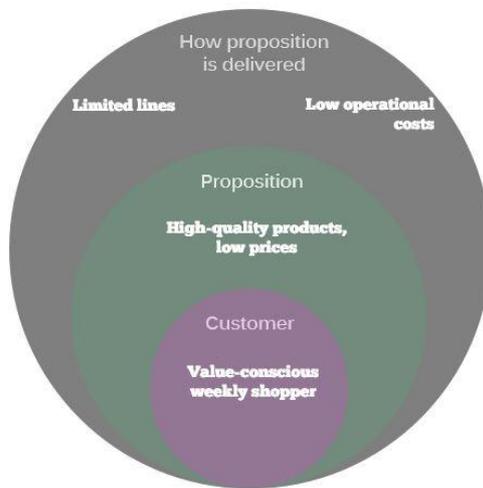
**“I am convinced that the two principles, that of small ranges and low prices, cannot be separated.”**

**Karl Albrecht, Aldi founder**

**The Aldi operating model**

**What does Aldi do to deliver the proposition?**

Sounds simple doesn't it? Conceptually it is, but Aldi's real advantage is that it has patiently improved its operating model to consistently execute the proposition. For a competitor to replicate its success they cannot simply open up a set of similar looking stores and expect the magic to happen. This is what makes Aldi such a difficult organisation to compete against – not only does its proposition increasingly resonate with the customer, its operation is very difficult to mimic. It is useful to understand how the business operates because this explains how it is able to reduce operating costs beyond the wildest dreams of its competition.



The operating model is built around some key principles: standardisation, simplicity and continuous improvement. As much as possible the platform on which the business operates is standardised and implemented down to the smallest detail. There are exceptions, but all the stores have the same design, serviced by the same sized trucks, with products delivered on standard pallets that have been aggregated at regional warehouses of a standard design. This has enabled the development of uniform processes and therefore systems. A consistent approach to doing things is the key first step to driving out complexity: a key ingredient of spiralling operating costs.

Keeping things simple is a mantra. Alterations to ways of working are carried out slowly, systematically and having fully assessed the consequences. This means that when changes are implemented, there is minimal distraction, complexity and confusion, ensuring operational efficiency is maintained. Aldi insist on suppliers adhering strictly to precise specifications with regard to case design and pallet configurations enabling products to be displayed in shelf ready packaging and on pallets on the shop floor. As a result, Aldi has structurally lower head office costs and direct costs (such as product handling and handling operational exceptions) down to the simple fact that there is significantly less activity than in comparable operations. Routines and rhythms are exceptionally smooth due to tight disciplines and there is a relentless attention to detail to iron out inconsistencies.

Aldi is a global business but the operating model is tailored appropriately to each country, region and store. Within a standardised framework, therefore, accountability is devolved throughout the business. Products are sourced nationally but produce and bakery are sourced more locally. Customer complaints are quickly dealt with by the store manager, who orders all products on a daily basis from the shop floor. The UK business has been able to make decisions (such as offering a significantly wider fresh meat range and stocking key brands, such as Coca Cola, to increase the credibility of the whole range) to slightly soften the core 'hard' discounting principles to appeal to the UK customer. With a de-centralised model, corporate head office costs can be reduced even further to a minimum, the business is much more market orientated and with clear accountabilities facilitating highly effective performance management.

Much more importantly, however, the knowledge of 'how things are done round here' is embedded to the finest detail in processes and in the heads of the employees. The buck stops at every level in Aldi. This is not a company where the senior leadership are overworked, while those on the shop floor are rudderless with the middle management just shrugging their shoulders. Direct labour costs and stock loss are minimised routinely and with increasing effectiveness. On the downside, devolving responsibility can result in inconsistencies of performance (such as poor availability and service) and these are the examples that can circulate on social media platforms.

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In order to mitigate against the risk of inconsistency and to realise the benefits of scale, simplicity and a localised offer, Aldi invests heavily in the training and development of its people and in its culture. Continuous improvement in both the design of the operating model and in the performance of individuals, teams and products is the daily business of every individual. Efforts are made to share best practice across teams, individuals are held to account by agreed targets and above all leaders insist on keeping things simple. Whilst the strength of Aldi's operating model has developed slowly over time it is robust because so many of its people have been instrumental in the design, and these people are positioned throughout the business and the business takes active measures to ensure their retention. It is arguably due to this investment that Aldi has less inconsistency in its performance than its closest rival Lidl, and this is reflected in its larger market share.

**Relentless focus,  
relentless growth**

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**What does the future hold for Aldi?**

What about the changing technological environment? What about the proliferation of channels? What about changing consumer habits? Yes, the external environment is changing rapidly but it is precisely in these circumstances that it is vital companies understand their business models. Aldi does and is therefore succeeding by not chasing every trend, instead focussing on executing its value proposition coherently. Aldi understands its value is offering high quality products at low prices to the weekly shopper. There are sufficient value-conscious customers who wish to visit a store to touch and feel the product before purchasing and Aldi is targeting this segment (even the most optimistic online predictions estimate 50% online eCommerce market share). Aldi is not the most dynamic of retailers in its approach to the market, but it doesn't need to be.

Aldi is demonstrating flexibility though, and is testing new concepts such as a c-store proposition at their Kilburn store in London. The store is located on a busy high street where there is no car park and it has been designed to cater for the daily convenience customer. The compromises to the existing operating model are clear as one walks the store – the high number of staff, the tightly packed shelves, more impulse lines to name a few. As with every experiment it is clearly a work in progress. The store is benefitting from very high footfall and this should be seen as a trial for the retailer. Another innovation is the wines and spirits eCommerce offering being trialled in Australia. The offer is only available to customers in Victoria, New South Wales and South Queensland as the retailer cautiously experiments through a new channel.

Will the limited range be a constraint to growth in the future? Interestingly, there is increasing evidence coming out of the behavioural economics field that customers can be put off by ever burgeoning choice. The psychologist Daniel Kahneman, in his book 'Thinking, Fast and Slow', has discussed the fact that humans find rational thinking effortful. He argues there are two systems in the brain: one in which most decisions made are fast, automatic and intuitive (system 1), and one in which decisions are slow, deliberate and effortful (rational thinking - system 2). The brain has limited capacity for system 2. With proliferating options available to customers it can be comforting to visit a retailer where they trust that the limited range on offer is of the highest quality and at the best price. The relative lack of choice can actually be a selling point to customers who are overloaded by marketing cues night and day. In many ways, we would argue, Aldi's proposition is likely to be even more persuasive to many more customers in the future.

**“Aldi is not the most dynamic of retailers in its approach to the market, but it doesn't need to be.”**

## Summary

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Imagine an Aldi stick of rock with the words 'low cost' embedded through its length. Aldi consistently delivers products at the lowest prices via a business model which is designed and built to operate at the lowest cost. The Aldi story is interesting because it is a great example of a business that thoroughly 'gets' its proposition to the marketplace and follows it through in every aspect of its operation. This proposition has a sustainable customer following in the marketplace which is likely to remain and grow in spite of a changing technological landscape and improving economic conditions. By maintaining a consistent market offering it has a loyal customer base that is growing as it extends its reach through steadily building its reputation, store footprint and channels.

The lessons to be learned from Aldi are not about cost. The lessons are about clarity, consistency, value to the customer and a focus on execution. Our advice to the major grocers and to all businesses would be to invest similarly in developing a sustainable proposition to the marketplace, really understanding the customer journey(s), design the operation accordingly and focus all the organisation's energy on execution. What would your stick of rock say?



BOXWOOD

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