



# UK Convenience Stores

## Assignment

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# **An Analysis of the Macro Influences on UK's Convenience Retail Sector**

## **Executive Summary**

The current scenario of UK's convenience retail sector is analyzed in this report by following a systematic procedure. First, the various macro influences that affect the convenience sector are analyzed, and the researchers identified these macro influences after a thorough analysis of various literatures and online documents. An exhaustive study of literatures, government websites, research documents of reputed research companies such as Deloitte (2013) and Verdict Research, (2013) the researchers identified the macro influences on convenience retail sector as decrease in disposable income of households of UK, rise in the price of products and services, slow growth rate of hypermarkets and superstores and change in consumer behaviour pattern. In the second part of the report, the researchers identified key industrial factors that affect the structure of the convenience sector and nature of competition using Porter's Five Forces framework. It is found that the bargaining power of consumers plays an important role in the growth of UK's convenience sector followed by cut-throat competition among rivals, threat of new entrants, availability of substitute products and negotiating power of suppliers. Besides, this analysis also revealed an interesting fact that leaders of the sector such as Tesco Express, Sainsbury's Local, Morrisons and Marks & Spencer are opening new convenience stores at almost every location of UK, and the Co-operatives are also keenly involved in the expansion plan of their existing stores (Reuters, 2013). This trend clearly indicates that convenience stores and online stores are the two promising retail sectors of UK that will grow considerably in the recent future.

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## **Introduction**

In 1930s, UK convenience stores were created mainly to serve the requirements of the local population, and they sold things like confectionary, tobacco and newspapers (CTN). Earlier, the main customers to these convenience stores were men, and they used these stores for buying CTN and rare distress purchases. However, with the growth of the economy and rise in the number of working women, these small stores have undergone a major transformation in the past few decades. According to Kitchen and Proctor (2001), convenience stores are those stores that operate 7 days a week for extended hours in an area less than 3000 sq ft. Although, this definition is based on the first convenience store opened by Southland Corporation, 7Eleven in USA in the year 1930, we can say that this definition has changed considerably in the recent years. As per the latest report of Institute of Grocery Distribution (IGD) (2013), the convenience stores can be classified into 5 categories namely –Convenience Forecourts, Co-operatives such as The Southern Co-operative and The Co-operative Group, Convenience Multiples such as Tesco Express and Sainsbury's locals, Symbol Groups such as SPAR, Premier and Londis, and Non-affiliated Independents.

In 1844, Rochdale Pioneers opened the first co-operative store in UK, and since then, the co-operative segment has expanded worldwide with its development activities. In many European countries such as Finland, Denmark and Switzerland, co-operatives form an important part of the retailing segment. However, in UK, the growth of the co-operative sector stopped post World War II, and only mergers between these stores have helped them to make a comeback in the UK retailing

scenario (Kitchen and Proctor, 2001). Now, there are more than 51 co-operative societies in UK alone, and is operating on product sectors such as household, garages, food, milk, funerals, travel, insurance, farms and chemists. These co-operatives command a 4 percent of the total retail sales in UK, with its core business mainly in food retailing. During the same period, the bargaining power of consumers also gave birth to 'symbol groups' such as SPAR, Premier and Londis, which offered a satisfying buying experience to its consumers through bulk buying.

## **Analysis of the macro influences on the growth of UK Convenience Stores**

In the 20<sup>th</sup> century, UK's retailing sector changed considerably, with the formerly governing independent stores losing out to large or multiple retailers that gained cost advantages by operating a chain of stores. During the 1990s, the small convenience stores slowly started losing its influence on customers due to a number of reasons such as limited availability of products, poor quality of food material, and high prices. But, today, by inventing distinct selling strategies like discount sales and selling of products at low profit margins, and by targeting the needs of the local population, these small stores are slowly regaining its lost position. The total number of convenience stores in UK now stands at 47,090, which has grown by 9.6 percent year after year (IGD, 2013). Although, this rapid growth in the convenience store channels can be attributed to a variety of factors, decrease in disposable incomes, changing consumer behaviour, increase in the price of products due to inflation and sluggish growth rate of superstores and hypermarkets can be stated as macro influences on the growth of UK's convenience retailing sector.

### **Decrease in disposable incomes**

According to a survey conducted by Office for National Statistics (2010), the disposable income of people living in different parts of UK varies greatly, and the recession had impacted the growth rate of disposable income of UK households adversely. Regions like Nottingham have recorded a disposable income of 10,702 pounds per household, and City of Kingston Hull has a disposable income of 11,149

pounds per household (ONS, 2010). The low disposable income in these regions are said to be due to the large number of student population in these areas.

**Disposable income per head across the UK, 2010**

|   | 2010 <sup>4</sup> |
|---|-------------------|
| United Kingdom less Extra-Region <sup>3</sup> | 15,709            |
| North East                                    | 13,329            |
| North West                                    | 14,176            |
| Yorkshire and The Humber                      | 13,594            |
| East Midlands                                 | 14,267            |
| West Midlands                                 | 14,021            |
| East of England                               | 16,392            |
| London  | 20,238            |
| South East                                    | 17,610            |
| South West                                    | 15,653            |
| Wales   | 13,783            |
| Scotland                                      | 15,342            |
| Northern Ireland                              | 13,554            |

Source: Regional GDHI, ONS

Post the economic recession, although the financial situation of UK households has improved considerably, the continuing inflation is outstripping the wage growth. Hence, economists are doubtful whether the rising consumption trend is sustainable. In 2013, the UK retail sales increased by 2.2 percent, and despite the increase in sales, many store groups such as Sainsbury and Tesco states that the consumer's disposable income is not showing signs of improvement. Hence, it is evident that the fall in disposable income is clearly directing the consumers towards cheaper and quality alternatives, and as the convenience stores offers such alternatives, it can be said that the decrease in disposable incomes has led to the recent growth of this sector. According to a recent report released by Deloitte (2013), decrease in consumer's disposable income (fig. 1) is one of the major factors that are changing



the structure of the UK retail industry along with other factors like changing consumer expectations, rise in commodity prices and expansion of retail sales capacity.



Fig.1

Source: [www.deloitte.com](http://www.deloitte.com)

### Changing Consumer Behaviour Pattern

According to a report by Verdict/SAS (2013), store channels that offer convenience and flexibility to consumers will grow in the coming years. The quick home delivery facility offered by convenience stores are driven by the changing consumer behaviour as the consumers prefer convenience of home delivery over visiting large superstores. Although, they tend to visit these stores during weekends as a holiday destination, they prefer to buy products from convenience stores for the flexibility and convenience that they offer during their busy work days. The top-up shopping of UK

consumers is mostly done on convenience stores, and the change in spending of consumer in different sectors (figure 2) is also affecting the overall sales figures of diverse store channels. While the music & video retailing sector is witnessing a decline in sales, the food and grocery product sector leads the sales figures, which shows the influence of consumer decision on the UK convenience retailing sector.

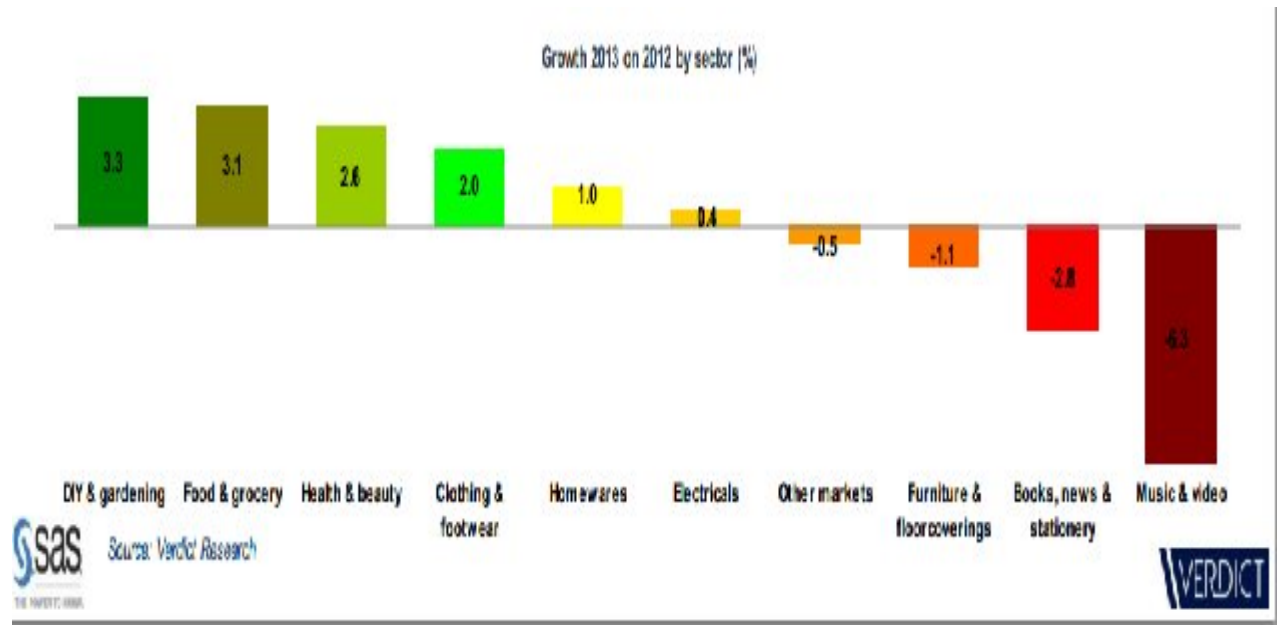


Fig.2

**Increase in the price of products**

The cost of raw materials and food prices are increasing globally, and this has affected the UK retailing sector adversely. In 2008, the businesses faced supported demand in the marketplace, and the input costs were low when compared to the current scenario. However, now the demand of consumers is constrained, and input costs are rising at an alarming rate. As a result, UK retailers are forced to increase the cost of the products, and hence this has affected the buying decision of consumers (Guardian, 2012). Real estate prices are also soaring, and due to this

trend, superstores and hyper stores are slowly losing the battle with small convenience stores. In addition, the devaluation of sterling from the year 2009 has led to increase in the cost of imports. As competitive pricing is the key factor that determines the purchase decision of the consumer, the rise in price of products in every product sector plays a vital role in the growth of UK convenience stores.

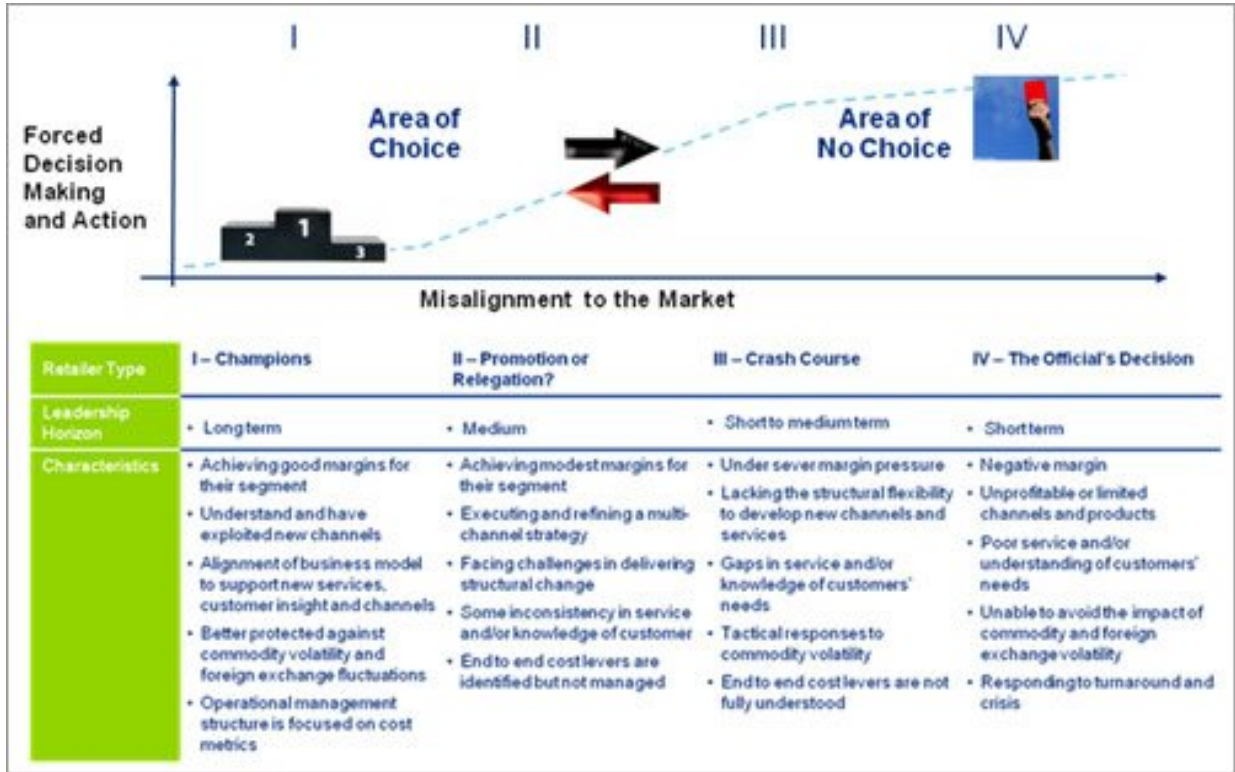
### **Sluggish growth rate of superstores and hypermarkets**

Currently, the sales of products by large hypermarkets and superstores accounts to 74.1 billion pound, and the sales is predicted to increase only by 8.2 percent till the year 2018. This sluggishness in the growth of hypermarkets and superstores can be attributed to a variety of factors like change in consumer spending pattern, effect of economic recession and rising inflation. On the other hand, this slow growth of UK superstores and hypermarkets will allow the convenience stores to expand its operations in new areas, and also they will be able to offer products at a competitive rate to their consumers (Rediff, 2013).

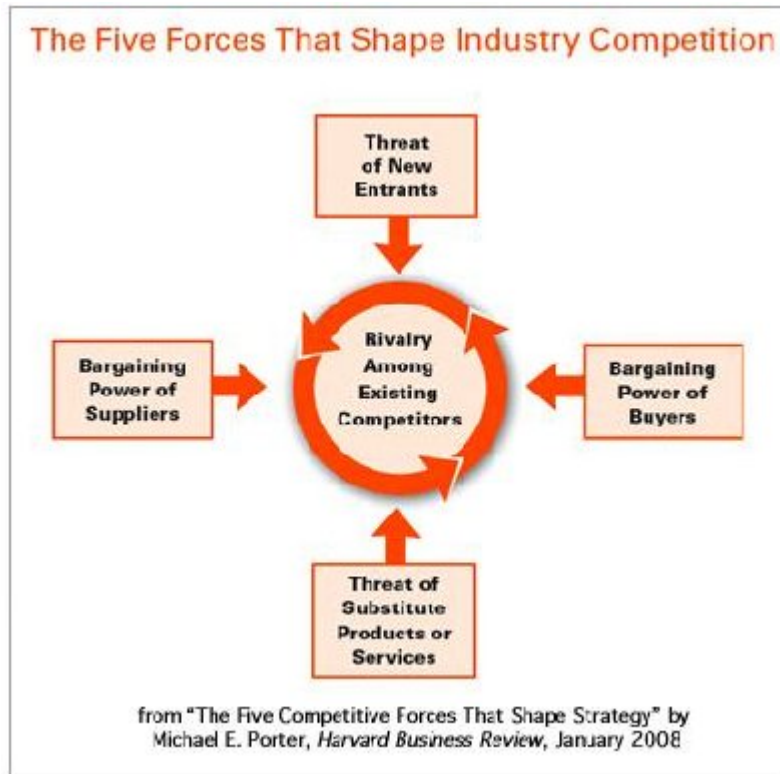
Deloitte (2013) report on Operating Model Alignment framework describes the types of business challenges faced by UK retailers. According to the Operating Model Alignment framework, UK retailers can be classified under 4 categories namely Champions, Promotion or Relegation, Crash Course and the Official's Decision. Champions are defined as retailers that have achieved good profit margin for their segment, and they understand the exploitation of new channels thoroughly. Those retailers that fall under the Promotion or Relegation category have achieved modest profit margins, and are executing multi-channel strategies. The retailers that fall under the Crash Course category are those that face severe margin pressure, and lack the necessary structural flexibility to develop new channels. The retailers

under the Official's Decision category are those that maintain a negative margin, and are having unprofitable stores or products.

Although, the Operating Model Alignment framework defines the UK retailing sector as a whole, the same framework can be applied to UK's convenience retailing sector as the small store owners can be easily divided under the above 4 categories. Besides, based on the type of retailers, the macro and minor influences that will affect the retailer can be determined. For instance, if the convenience store owner is a Champion, the various factors that may affect the business will be foreign exchange fluctuations, commodity volatility and change in consumer behaviour. For the Promotion or Relegation retailers, the factors that may affect their performance will be misinterpretation of consumer behaviour, ineffective management of cost levers and inability to make structural changes to its store format. For convenience stores under the Crash Course and the Official's Decision category, along with the challenges faced by the Champions and Promotion or Relegation, other factors such as gaps in servicing and understanding the consumer's need can be stated as the factors that will affect their growth performance.



Now, let us analyze the industrial factors that affect the UK convenience sector using Porter's Five Forces framework.



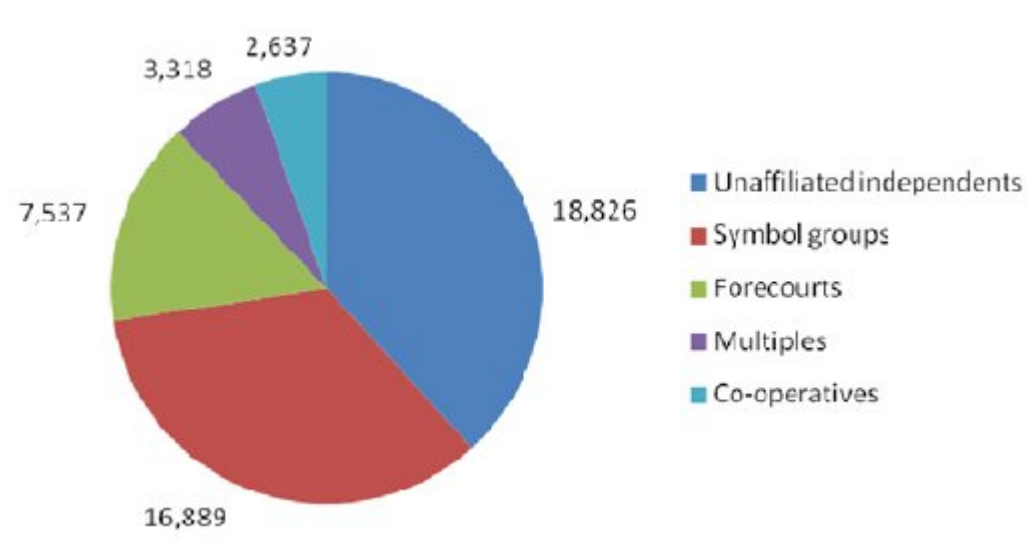
Based on Porter's Five Forces framework, bargaining power of consumers, emergence of new players, availability of substitute products at a lower cost, rivalry among the existing convenience stores and negotiating power of suppliers can be considered as the industrial factors that shape the structure of UK convenience retailing sector, and which determines the nature of competition among the stakeholders. Let us now look at a detailed analysis of the industrial factors that affect the UK convenience retailing sector.

### **Bargaining power of consumers**

Currently, in UK, the convenience store network is growing at 20 percent a year, which in concert with online stores represents the retail industries two top growing categories. UK's 3<sup>rd</sup> largest grocer, Sainsbury's is at present opening at least 1 to 2

convenience stores every week, and many of its competitors are expected to follow this trend for at least another few years. Marks and Spencer’s is also launching new Simply Food stores at different locations in UK, and is planning to double its current 427 food stores in a year or two. While in the earlier days, it was the discount that attracted the consumers, nowadays, consumers are shopping at these small stores for the quality of the offers, which is considered as an equal alternative to the offers of hypermarkets and supermarkets (Reuters, 2013). Presently, the sales through convenience stores are expected to increase at least by 10 billion pounds, which itself demonstrate the bargaining power of consumers as these stores were able to influence on consumers only after restructuring their cost structure and lowering profit margin (BBC, 2013). Moreover, the recent trends followed by these stores demonstrate the negotiating power of consumers, as it has forced these small stores to focus on value, pocket-friendly promotions and heavy investments in private brands.

**Number of Convenience Stores in UK (2013)**



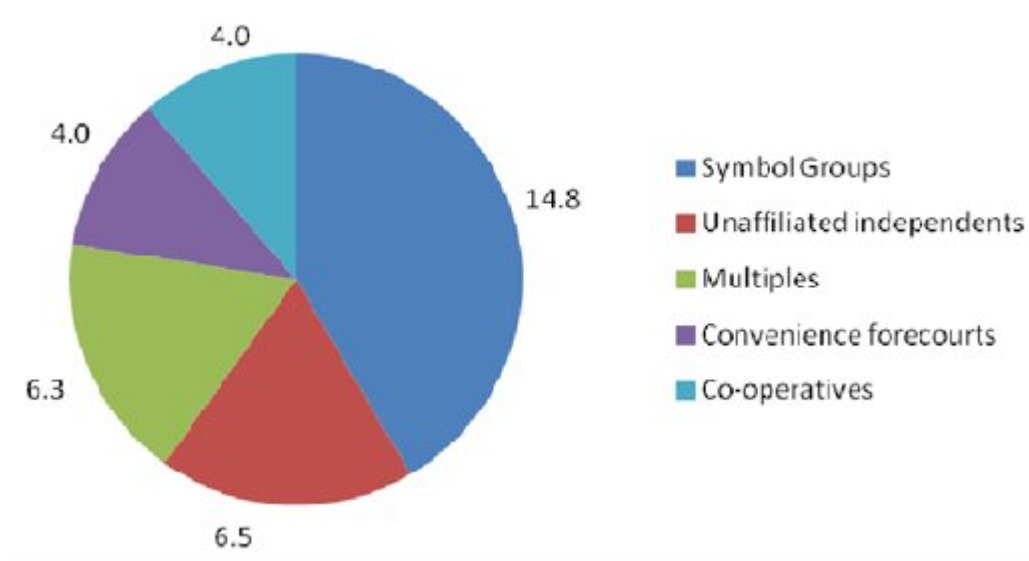
Source: [www.igd.com](http://www.igd.com)

## **Emergence of New Players and Competition among Rivals**

Traditionally, UK convenience stores were run by non-affiliated independents, and for many years they are leading this sector with their competitive pricing and personalized service. However, currently, from corporations to small groups, many players are investing heavily in this sector. In 2000, the merger of Co-operative Wholesale Society (CWS) and Co-operative Retail Services gave birth to Co-operative Group (CWS) Ltd., and hence it became the world's largest co-operative. With more than 1000 shops ranging from small scale convenience stores to large supermarkets, and 39 superstore department stores, CWS remains UK's one of largest food retailer. CWS's move to invest more on small stores than other store channels can be called as an important factor that influenced the growth of UK convenience store sector. Experiments by dominant players such as Sainbury's local and Tesco Express have also played an important role in the re-shaping of this industry. Moreover, the partnerships between firms such as BP-Safeway Petrol Station Supermarkets and Alldays's Victoria Wine Line-up introduced more players into the UK convenience retailing sector (Verdict, 2010).

## **Current Value of UK Convenience Retailing Sector**





Source: [www.igd.com](http://www.igd.com)

### **Availability of substitute products at a lower cost**

Post the economic downturn, struggling with the increasing cost of living, UK households have started looking for quality products at a lower cost. The availability of local brands at a lower cost at these convenience stores proved to be an effective alternative to the highly priced food products manufactured by giant companies. As a result, now the giant corporations such as P&G and Nestle have been forced to restructure their product strategy as they have started introducing products in small quantities with pocket-friendly price tags (BBC, 2011). Hence, it can be said that availability of substitute products is surely a macro influence on the growth of UK convenience store channels.

### **Negotiating power of suppliers**

With the presence of dominating superstores and hyper stores, the UK retailing sector is giving more bargaining power to its suppliers. Earlier, if rejected by the superstores, the suppliers have to depend on independent stores to sell their

produce. However, with the increase in convenience stores, the negotiating power of suppliers has improved considerably as they can demand the best price from their buyers (IGD, 2013). Today, they have the power to neutralize the bullying of superstores by selling their products directly to the new entrants in the UK convenience retailing segment. The increased focus of convenience stores in private brands is also helping these suppliers to sell their products with a slightly improved profit margin.

## **Conclusion**

A detailed analysis of UK's convenience retailing sector reveal that there are several macro factors such as Decrease in disposable income, Changing consumer behaviour pattern, Increase in the price of products and Sluggish growth rate of superstores and hypermarkets that affect the growth of the sector. While economic recession and rising inflation are the primary factors that led to the changes in the macro influences, there are other influences such as focus on value, more investment on private brands, and convenience and flexibility which also plays an important role in the survival of UK's convenience stores. UK convenience stores are open 7 days a week for long hours, and they offer home delivery services to their customers. Hence, by offering convenience and flexibility these stores are gaining an edge over its competitors. Besides, the quality of offer that these stores offer attracts loyal customers, and they prefer to do their top-up shopping in these shops during their busy work days. An analysis of UK's convenience retail stores based on Porter's Five Force framework has revealed interesting facts about the sector. The bargaining power of consumers has forced even big corporations like Tesco and Marks& Spencer, and Co-operatives to open more convenience stores in almost

every region of UK. The entry of new players into the UK convenience store has led to cut-throat competition among the existing players, and they are constantly innovating and introducing new products to stay in the game. The availability of substitute products at a lower price, and the negotiating power of suppliers are also affecting the growth of UK's convenience retail sector. Based on the analysis, we conclude that the convenience sector is set to grow in UK in the coming years, and those businesses that offer convenience and flexibility along with superior quality products can only survive in the cut-throat competitive retail environment of UK.

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