Shopping trends mean blocking the big Sainsbury's-Asda merger may not protect customers

By Yasemin Kor

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The proposed merger of supermarkets Sainsbury's and Asda is now off the table as the regulator has ruled against it, saying it would lead to higher prices for consumers.

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The merger would have created the largest supermarket in the UK in an already concentrated market where the market shares of the top four players add up to a whopping 68% of the total market.

Under any other circumstance, it would have made a lot of sense to block a merger of this scale. But given the conditions at this time in food retail, stopping this deal won't necessarily protect customers. There is fierce competition in the industry, ruling out the possibility of increasing prices.

Supermarkets have been hit by multiple disruptions in the past couple of decades, and the traditional way of shopping for groceries in big stores has been declining, replaced by discount stores, convenience stores, and online shopping.

The biggest challenge comes from the new discounters like Aldi and Lidl. They put even the traditional UK discounters such as Walmart's Asda to shame with their hard-to-match low prices. The Aldi phenomenon has swept through the UK. It has opened numerous new stores since 1990, luring customers with aggressive prices, good quality products, and advertising that trumpets blunt price comparisons.

Among several factors that drive Aldi's cost advantage is its no-frills, small store format, stocked mostly with own brand products. This gives the company the ability to work with and negotiate the best prices from their long-term suppliers. Further savings are made by having customers do some of the work, such as opening boxes and taking carts back. And the product selection is very limited, with one or two choices for most products.

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These days, Aldi and Lidl are no longer underdogs. Together, they command over 13% of the market, as the fifth- and seventh-biggest players in UK. Their model is the antithesis of the mainstream supermarket business model, which is based on a large variety of products, alternative brand choices, customer service, and in some cases store ambience and experience.

Changing habits

While the traditional supermarket model hasn't entirely lost its appeal, consumer expectations and shopping habits have changed in multiple ways. Today's consumers prefer lower prices, but they also want high-quality fresh produce and other products. They value convenience in shopping, but they also shop in multiple stores to get what they want. Increasing numbers are shopping online. But supermarkets still haven't figured out the best way to respond to these disruptive changes.

When customers shop more locally and frequently, the large-format supermarkets outside of town and city centres no longer generate enough sales. The grocery business is a high-volume, low-margin trade where steady customer traffic matters. Without high sales volume and fast inventory turnover, supermarkets cannot cover their "fixed costs" like rent, technology and staff. Opening new convenience stores helps to reclaim the lost business but doesn't compensate for diminishing large store margins.

When it comes to the steady growth of online food shopping, all major players offer this, but they often rely on the click-and-collect method, which has marginal profitability due to added labour costs. Highly-automated fulfilment centres are more efficient, but they require substantial investments upfront.

Adding up the loss of sales to convenience, discounters, and online, many traditional UK food stores are suffering from reduced profitability.

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Bold and risky

Enter the Sainsbury's-Asda merger. This was a bold and risky move as it would have increased both companies' exposure to retail disruption. But it would have also given the merged companies a stronger base to respond to discounters and the online shopping trend.

Food manufacturing firms have much better profit margins than supermarkets. So increasing their power against key suppliers is one way supermarkets are trying to survive. While this may not have enabled either company to match Aldi-Lidl prices, they could have narrowed the gap.

Sainsbury's also planned to leverage Asda stores for Argos pickups, a catalogue retailer owned by Sainsbury's. This would have helped them better use their big stores, while expanding the reach of Argos. Plus, a combined response to online sales would have created significant economies of scale when investing in the necessary infrastructure to meet customer demand for online shopping.

So blocking the Sainsbury's-Asda deal may strengthen the hands of Aldi and Lidl. Perhaps that's good news as they can grow and make their low prices available to more customers. But there may be other implications.

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Customers today enjoy having the luxury of shopping at different types of stores. A rapid rise of new discounters and online models may not allow enough time for supermarkets to adapt and traditional store options may fade away as a result, reducing options for consumers in the future.

Even if they survive, an increasingly singular focus on price competitiveness and cost cutting can have other consequences. It can harm farmers and food producers with little power to negotiate, leading to the loss of small and midsize farms or putting added pressure on the environment and farm worker health. Plus, food quality may suffer under pressure to rapidly cut costs.

Aldi and Lidl have managed to achieve good environmental standards along with efficiency by working with their suppliers over a long period of a time, albeit for a relatively narrow range of products. If other players are pushed to match the cost advantages for a substantially larger range of products in a short time period, compromises in other important areas can happen. So more competition may not turn out to be better for consumers after all.

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