CORPORATE STRATEGY IN UK FOOD RETAILING, 1980-2002

BY GEOFFREY OWEN

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Introduction

Over the past thirty years the structure of the UK food retailing industry has been transformed. This has been brought about partly by a change in shopping habits – the shift from the High Street to edge-of-town or out-of-town superstores – and partly by the emergence of a few, large companies as dominant players in an increasingly concentrated industry. The three biggest supermarket groups, Tesco, Sainsbury and Asda, now account for nearly 40 per cent of the market (Table 1). Of these three firms, the outstanding success story in the past decade has been Tesco. It dislodged Sainsbury from the No 1 slot in the mid-1990s, and has since extended its lead, both in sales and in stock market value. Sainsbury is now in danger of being overtaken by Asda, which since 1999 has been owned by Wal-Mart of the US.

Table 1 Grocery market shares in June, 2001, and December, 1990 (% of total grocery sales)

	2001	1990
Tesco	16.5	9.7
Sainsbury	11.6	11.0
Asda	9.6	6.8
Safeway	7.5	7.1
Somerfield	4.7	5.0
Morrisons*	3.4	1.4
Marks & Spencer	2.7	3.4
Waitrose*	2.1	1.7
Iceland	1.6	1.2
Coops	5.5	8.2
Total of above	65.2	52.8
Other retailers	34.8	47.2

**The figures for Morrisons and Waitrose are IGD estimates calculated from published reports and accounts; the others are calculated from figures provided directly by retailers*

Source: Institute for Grocery Distribution

Other retailing groups which have tried to compete directly with the Big Three on a national scale, notably Safeway, have faced great difficulty in doing so. Safeway is currently the fourth largest retailer, but its profits growth, though improving recently, has been sluggish over the past decade. At the time this paper was being finalised, Safeway was the subject of several competing take-over bids, some coming from other supermarket companies (Morrisons, Sainsbury, Tesco and Wal-Mart), some

from financial groups. Whatever the outcome of this contest, Safeway is unlikely to survive as an independent business.

An alternative strategy for British food retailers has been to specialise, either regionally, as Morrisons has done in the North of England, or by differentiating themselves through a distinctive product offering. Thus Waitrose (owned by the John Lewis Partnership) and Marks & Spencer operate mainly at the upper end of the market, charging higher prices offset by better quality. Somerfield, which was built up by a series of acquisitions in the 1980s and 1990s, is trying to compete – so far with limited success – by concentrating on relatively small town-centre stores, as opposed to the superstores which provide the Big Three with the bulk of their profits.

The purpose of this paper is to describe the variations in performance among the principal companies, dealing mainly with the period after 1980, and to consider how far success and failure can be explained, or at least illuminated, by the theories of competitive strategy which academics have put forward in recent years.

Historical background – the early post-war years

At the start of the post-war period the bulk of the UK food retailing market was in the hands of independent grocers and the Cooperative societies. Although some multiple retailers - that is, companies owning ten or more stores - had established themselves in the inter-war years or earlier, their share of the grocery market in 1950 was only 20 per cent. Over the next twenty years there was a gradual increase in concentration, driven in part by the trend towards self-service, first in existing shops and then in purpose-built supermarkets (Table 2).

Table 2 Concentration in food retailing 1950-1971
(figures show percentage of total grocery sales in each year)

	1950	1966	1971
Multiples with 10 or More stores	20.0	36.3	44.3
Cooperatives	23.2	16.7	13.2
Independents	56.8	47.0	42.5

Source: UK Census of Distribution

The supermarket was a retailing idea which originated in the US in the 1920s and spread to the UK after the second world war; one American supermarket operator, Safeway, established a UK subsidiary in 1962, and its presence helped to diffuse knowledge of US retailing techniques. Supermarket operators achieved higher labour productivity and lower costs than conventional high-street grocers. In addition, by increasing the number of supermarkets under their control, the leading multiples acquired greater buying power vis-à-vis their suppliers, and were able to negotiate lower prices. This was resisted by food manufacturers, which tried to prevent price-cutting by retailers through the use of Resale Price Maintenance (RPM), a legal provision introduced at the end of the 19th century and widely enforced in the inter-war years. However, RPM was steadily eroded during the 1950s, and was made illegal in 1964 through the Resale Prices Act.

By the mid-1960s the multiples accounted for just over a third of the market, and they dominated the supermarket sector, owning two thirds of the 2,130 supermarkets then in operation. The five leading companies at that time were Tesco, Sainsbury, Allied Suppliers, International Stores and Fine Fare, but none of these five had established a clear lead over the others, and there were at least a dozen other supermarket groups, mostly operating on a regional basis, which were growing fast. The structure of the industry was still fluid.

Tesco was the creation of Jack Cohen, one of Britain's most successful post-war entrepreneurs. Cohen's origins were as a street trader in East London, and his retailing style – "pile it high and sell it cheap" – was aimed at price-conscious consumers.[i] Tesco went public in 1950, and much of the company's growth during the next two decades came through share-based acquisitions; one of the biggest deals was the purchase of the 217-store Victor Value chain in 1968. Cohen was an enthusiastic advocate of trading stamps (another American innovation) as an inducement for shoppers to patronise his stores; he signed up with Sperry & Hutchinson, issuer of Green Shield stamps, in 1963 and became one of that company's largest clients.

Sainsbury was also a London-based firm, but much older than Tesco. John James Sainsbury, who founded the business in 1869, started as a retailer of fresh foods and later expanded into packaged groceries such as tea and sugar. His trading philosophy, as stated on a sign outside his first shop in Islington, was "Quality perfect, prices lower".[ii] During the 1950s and 1960s, with the company now run by the founder's grandson, Alan, it was a pioneer in the development of own-brand goods; the aim was to offer products that matched the quality of nationally branded goods, but at a lower price.[iii] It expanded more cautiously than Tesco, eschewing acquisitions, and it never offered trading stamps. Until 1973, when it went public, the company was wholly owned by the Sainsbury family, and most of the senior positions were held by family members; John D. Sainsbury (later Lord Sainsbury of Preston Candover), a member of the fourth generation of the founding family, took over the chairmanship from his uncle in 1969, and held the post until 1992.

Of the other three market leaders in the mid-1960s, Allied Suppliers had been formed in 1929 by the merger of several long-established grocers, including Home & Colonial, Liptons and Maypole Diaries; these subsidiaries continued to trade under their own names. International Stores was one of the oldest multiples, having been founded as International Tea Stores Company in the 19th century; in 1972 it was acquired by British American Tobacco, then pursuing a strategy of diversification away from tobacco. Fine Fare was the retailing subsidiary of the Canadian-controlled Associated British Foods, a leading food manufacturer.

These five companies had about 20 per cent of the market between them, but the economies of scale which they enjoyed were not so great as to prevent other supermarket groups from challenging or even overtaking them. Moreover, the independent grocers were not giving up without a fight. To counter the buying power of the multiples, some of them formed voluntary buying groups, and this, together with the development of cash-and-carry wholesaling, helped to limit the scale advantages of the multiples.[iv]

However, the independents were at a competitive disadvantage for another reason: they lacked the financial capacity to invest in large new stores. Several of the supermarket operators had gone public, and their greater financial fire-power proved decisive during the 1970s as food retailing became a more capital-hungry operation.

The 1970s: rise of the superstore

The 1970s saw the start of a shift away from the High Street to edge-of-town and out-of-town superstores – that is, stores with at least 25,000 square feet of selling space; the first-generation High Street supermarkets were generally around 5,000 square feet or smaller. At the start of the decade there were just over 30 of these big stores in operation; by 1980 the number had increased to nearly 300. Site acquisition skills were critically important for the larger supermarket operators; by pre-empting the best sites in areas close to large centres of population they could hope to secure what almost amounted to a local monopoly.[v] There were also some regional economies of scale – for example, in buying advertising time on commercial television.

One of the pioneers in superstores was a new entrant, Asda. This company was born out of Associated Dairies, which was founded by a group of dairy farmers in Yorkshire in the 1920s and subsequently expanded into food processing; it went public in 1949. In 1965 it formed a new subsidiary, Asda Stores, with the idea of operating large, out-of-town supermarkets in abandoned warehouses, and selling a wide range of non-food items as well as food at low prices. Some of these stores had as much as 50,000 square feet of selling space – a type of store that later became known as a hypermarket. The name of the parent company was later changed to Asda Group, and the business expanded rapidly during the 1970s.

In the south, particularly in and around London, the two biggest companies were Sainsbury and Tesco. Sainsbury's policy was to invest in uniform, well-designed stores with a strong emphasis on quality; its slogan was "good food costs less at Sainsbury". During the 1970s the average size of Sainsbury stores rose from 10,000 square feet to around 18,000 square feet; the first edge-of-town store, with 24,000 square feet of selling space, was opened in Cambridge in 1974.

Although these larger stores contained some non-food items, they were not intended to match what Asda had been doing in the north; Sainsbury focused more single-mindedly on food. To participate in the hypermarket sector, Sainsbury formed a joint venture, known as Savacentre, with British Home Stores. The first Savacentre store was opened in Washington, Tyne and Wear, in 1977; nearly half the space, amounting to some 35,000 square feet, was devoted to textiles, electrical goods and hardware. Another diversification took place in 1979, when Sainsbury formed a joint venture with the Belgian retailer, GB-Inno-BM, to set up a chain of do-it-yourself stores under the Homebase name.

Tesco, having expanded fast in the two preceding decades, ran into problems during the 1970s. Several of the companies which it had acquired, such as Victor Value, had not been properly integrated, and many of the stores were small and poorly located. Tesco competed almost entirely on price, with an assortment of items which were often perceived by consumers as inadequate and of mediocre quality. All this was aggravated by Jack Cohen's reluctance to hand over the reins, or to abandon a retailing style which, especially in comparison to Sainsbury, was looking old-fashioned; this was particularly true of Tesco's reliance on Green Shield stamps.

These uncertainties were not resolved until the end of the 1970s. This period marked the start of Tesco's resuscitation, led by Ian MacLaurin, who had emerged from the post-Cohen power struggle as chief executive.[vi] In 1977 Tesco launched what it called Operation Checkout, an across-the-board price-cutting campaign partly aimed at countering the threat from the new breed of discounters such as Kwik-Save

(see below).[vii] A key decision was to abandon Green Shield stamps, thus saving some £20m a year and helping to finance price reductions. Although other groups, including Sainsbury, also cut prices in the 1977-79 period, the effect of Operation Checkout was to lift Tesco's market share and to set the company on a path of expansion which continued into the 1980s. This involved a big investment in "conforming" stores – large single-storey buildings, with flat car parks - and a stronger commitment to own-label, in emulation of Sainsbury.

Of the other contenders, Allied Suppliers (which had been acquired by Sir James Goldsmith, the financial entrepreneur, in 1972), was losing ground at the end of the 1970s, while International Stores and Fine Fare were just about holding their position. There were still several strong regional groups, such as Morrisons in Yorkshire, Hillards in the north east and William Low in Scotland, most of them run by the founding entrepreneur or members of his family. Another challenge came from Kwik-Save, a limited line discounter founded by Albert Gubay in North Wales in 1958. By the end of the 1970s it had 156 stores with a net selling area of just over 1m square feet, mainly in the North, the Midlands and South Wales.

At the top end of the market Waitrose was building a profitable business, mostly in the South, targeting affluent, middle-class customers. Marks & Spencer followed a similar approach, with a strong emphasis on product innovation; it was a pioneer in the development of chilled foods, working closely with a few carefully selected suppliers – the same formula which had worked well over many years in clothing.

Thus at the end of the 1970s food retailing was a fast-growing, dynamic industry, with continuing scope for innovation in products and services, and in retailing formats. While there was a trend towards concentration, the identity of the ultimate winners was not yet clear. Sainsbury and Tesco had a locational advantage, in that the largest part of their business – and most of their superstores – was located in London and the South East, the most affluent part of the country. But other supermarket groups, notably Asda, were gaining ground, and, as the next decade was to show, there was no shortage of entrepreneurs eager to catch up with the market leaders.

The 1980s: golden age

The 1980s are often seen as a golden age for UK food retailing. Thanks in part to the deregulatory zeal of the Thatcher government, planning requirements for out-of-town developments were eased, leading to a rapid growth in the number of superstores and, to a lesser extent, hypermarkets. This coincided with changes in logistics and distribution, as retailers took advantage of the latest advances in information technology. EPOS (electronic point of sale) scanning systems were used to automate reordering and to link via EDI (electronic data interchange) into the computer systems of the suppliers.[viii]

These developments led to a change in the relationship between the supermarket groups and the suppliers. The retailers took control of functions that had traditionally been performed by manufacturers, including physical distribution, packaging, advertising, product design and product development; in many product areas retailer brands replaced manufacturer brands.[ix] While Sainsbury had been the leader in own-brand development, others began to catch up (Table 3). The image of own-label was shifted towards quality and innovation, and became a crucial ingredient in building the retailer's corporate identity and reputation.[x]

Table 3 Trends in own-label packaged groceries among major food retailers 1980-1992 (own-label sales as % of total sales)

	1980	1992
Sainsbury	54	55
Tesco	21	41
Safeway	28	35
Asda	5	32

Source: Neil Wrigley and Michelle Low, Reading retail, Arnold 2002, p61

Among the larger companies, the big winner in the 1980s was Sainsbury. Under the paternalistic leadership of John Sainsbury, it built on its reputation for quality and good value. In 1985 the chairman was able to report that over the preceding ten years profits had grown from £15m to over £168m, a compound annual rise of 30.4 per cent – after allowing for inflation a real annual growth rate of 17.6 per cent. The company was also investing heavily in new technology. During the 1980s the proportion of sales passing through EPOS scanning checkouts rose from 1 per cent to 90 per cent.

The company's growth was still largely based on food, with only a modest contribution from the Savacentre business (of which Sainsbury took full control in 1989). There was, however, diversification outside the UK. In 1983 Sainsbury bought a 21 per cent stake in Shaws, a New England-based supermarket group; the holding was raised to 100 per cent in 1987; the aim was to create a high-quality regional food retailing business based on the same principles as the UK-based operation.[xi] At the end of the decade Sainsbury was widely regarded as one of the world's best-run retailers.

Meanwhile Tesco continued its revival. MacLaurin, now chairman as well as chief executive, assembled a cohesive management team which developed uniform policies for pricing, stock planning, buying and own-label performance, mostly based on imitating what Sainsbury had done. The worst of the stores inherited from the Cohen era were eliminated, and Tesco began to build a store portfolio that stood comparison with Sainsbury. (The Victor Value chain was sold in 1986.) The company's financial position improved to the point where, in 1985, it was able to launch a successful £145m rights issue to finance the capital spending programme; two years later it paid £228m for Hillards in the north east. By the end of the decade Tesco was opening more new superstores than Sainsbury, prompting anxieties among some commentators that the pace of expansion was too risky.

Asda, by contrast, lost its way during the 1980s. Its store portfolio was ageing, and, with Sainsbury and Tesco mounting a strong attack in Asda's northern heartland, it needed to change its product range to include more fresh foods and to develop an own-label business. One response was for Asda to go national by buying more stores in the South, but the expansion was badly handled. In 1989, when it bought 61 stores from Gateway for £705m (see below), it was widely thought to have overpaid for second-class sites. As profits came under pressure, Asda began to push prices up, moving away from the strategy on which its earlier success had been based.

Another ill-judged move was to diversify out of food into furniture, with the acquisition of MFI, the flatpack furniture chain. The argument was that food retailing was becoming a mature industry, and that Asda could develop a new source of growth by acquiring another high-volume, low-price, out-of-town retailing operation. However, the two businesses did not mix, and 1987 MFI was sold in a management buy-out. Although some good decisions were taken during this period (notably the partnership with George Davies, formed in 1989, to develop the "George" range of clothing), Asda's financial position deteriorated to the point where, by the end of the decade, it was close to breaching its debt covenants.

During this period several of the smaller regional multiples found it impossible to keep pace with the huge capital investments being undertaken by the big groups. Many of them relied on "first-generation supermarkets in first-generation types of location", mainly high streets with new superstores not far away.[xii] The costs and risks involved in shifting from their existing sites to superstores were daunting, and most of them preferred to sell out.

The main challenge to the market leaders during this period came from two new entrants, Argyll and Linfood Holdings.

The former was the creation of three Scottish businessmen – James Gulliver, Alistair Grant and David Webster. Gulliver's background was in retailing; he had been chief executive of Fine Fare during the 1960s. Grant was a marketing specialist, having worked with Gulliver at Fine Fare and previously with Unilever. Webster was a merchant banker. In the early 1970s they acquired control of Oriel Foods, a quoted company engaged in food manufacturing and wholesaling. The plan was to use Oriel as the vehicle for further acquisitions. However, in 1974 they accepted an offer for Oriel from RCA Corporation of the US.

Gulliver, Grant and Webster stayed with RCA for three years, but in 1977 they struck out on their own. James Gulliver Associates was formed – the name was later changed to Argyll – and it embarked on a series of opportunistic acquisitions. Its first move into food retailing came in 1978 with the purchase of Morgan Edwards, a grocery distributor which owned the Supavalu chain of discount stores. The next step was to buy back Oriel Foods from RCA; this brought with it a retail chain, Lo-Cost Discount Stores, which was merged with Supavalu.

In 1981 Argyll moved into a higher league with a hostile £91m bid for Linfood Holdings, a wholesaling and retailing group which had annual sales of over £1bn; Argyll's own stock market value at the time was only £46m One of Linfood's attractions for Argyll was the Gateway supermarket chain, together with some hypermarkets built in partnership with Carrefour, the French retailer. However, the bid was referred to the Monopolies Commission, and Argyll withdrew. Linfood (later re-named Dee Corporation), under a newly appointed chief executive, Alec Monk, went on to become a major force in food retailing.

Argyll then turned to Sir James Goldsmith's Allied Suppliers, making an agreed £101m offer for a business which, though it had stagnated under Goldsmith's ownership, had some valuable retailing brands. Argyll, now run by Grant following Gulliver's retirement, used Presto, one of the Allied chains, as its principal retail brand, with Lo-Cost being maintained as a discount operator. The construction of larger stores was speeded up, and regional distribution centres were established.

The next big opportunity came in 1987, when Safeway Food Stores, the UK subsidiary of the American Safeway, was put up for sale, and Argyll bought it for £681m. The purchase was financed by a £600m rights issue, which was three times over-subscribed – an indication of the City's confidence in Argyll's management

team. The merger with Safeway put Argyll in fourth place, with 9 per cent of the market, ahead of Asda, but behind Tesco, Sainsbury and Dee.

Safeway's stores were generally in better locations and more profitable than those of Argyll, mainly because of a different product mix – it was strong in fresh foods. An early decision was to convert most of Argyll's Presto stores to the Safeway brand. Immediate savings were made in buying and central services, and there was a push to expand Safeway's own-label products. By 1991 the number of Safeway-branded stores had risen to 310 (including 81 new stores), and the average store size had risen to just under 20,000 square feet. The Safeway deal was hailed by commentators as one of the most successful retailing mergers, bringing together Argyll's experienced management team with a strong but somewhat under-developed retail brand.

Meanwhile Alec Monk at Dee, having escaped the takeover bid from Argyll, was busily creating his own supermarket empire. Two of the biggest acquisitions were of International Stores, bought from British American Tobacco in 1984, and Fine Fare, bought from Associated British Foods in the following year. By this time Dee had over 1,100 stores, most of them trading under the Gateway banner, and it had nearly 12 per cent of the market, not far behind Tesco (Table 4). Most of Dee's outlets were small, high-street stores. Monk argued that there was a future for well-run conventional supermarkets as well as the large out-of-town stores. "Not everyone has a car or wants to shop miles from anywhere", he said.[xiii]

Table 4 Market shares in 1986 (per cent)

Sainsbury	12.3
Tesco	12.0
Dee	11.8
Asda	7.2
Argyll	5.5
Safeway	3.5
Kwik Save	2.7
Waitrose	2.3
Bejam	1.8
Morrison	1.4
Hillards	1.0
Others	38.5

Source: Verdict Research

However, by 1987 Monk's acquisition spree was running into problems, mainly because of the difficulty of integrating so many disparate businesses. Some disposals were made in that year, including the Linfood wholesaling operation. The name of the company was changed to Gateway, and a new retailing chief was recruited from the US. Investors remained sceptical, and in 1989 Gateway was the subject of a £2bn takeover bid from a newly formed company, Isosceles; the deal was partly financed by a pre-arranged sale of 90 Gateway stores to Asda. The promoters of the Isosceles bid believed that, after this disposal and extensive restructuring of the rest of the portfolio, Gateway could become a viable competitor; the intention was to re-float the company on the stock market within 3-5 years. However, the bid was highly

leveraged, and it was not clear that the new company would be able to fund the necessary modernisation of the business.

What had emerged by the end of the 1980s was a group of five companies – Sainsbury, Tesco, Asda, Argyll/Safeway and Gateway – which together accounted for more than half of the market. Several of the regional multiples had sold out, leaving only two strong survivors in this category - William Low in Scotland and Morrisons in Yorkshire. The latter, run since 1962 by Ken Morrison, son of the founder, pursued a simple formula of building large, identical stores, mainly in Yorkshire and other northern counties, keeping overheads to a minimum. Profits and turnover rose steadily during the 1980s; at the end of the decade Morrisons owned 46 stores, with an average size of over 30,000 square feet.

While Morrisons pursued a formula not dissimilar to that of Asda (except that it was much less committed to non-food items), most of the other groups responded to the dominance of the "Big Five" through some form of differentiation. One approach was to create a distinctive up-market image, as Waitrose and Marks & Spencer had done. At the lower end of the market, KwikSave, the discounter, continued to prosper, increasing earnings per share at an annual compound rate of 21 per cent between 1985 and 1991; it operated relatively small stores (generally below 10,000 square feet) in high street or edge-of-town sites, and stocked only well known nationally branded goods.[xiv]

The late 1980s marked the high point in the food retailing industry's fortunes. The construction of superstores, coupled with improvements in the efficiency of distribution, had made possible substantial increases in productivity, and higher profit margins (Table 5). This comfortable state of affairs was shattered in the 1990s, setting in train profound changes in the structure of the industry and in the fortunes of the leading companies.

Table 5 Operating profit margins of leading food retailers 1985-1992

	1985	1986	1987	1988	1989	1990	1991	1992
Sainsbury	5.25	5.53	6.09	6.54	7.31	7.61	8.32	8.71
Tesco	2.72	3.10	4.10	5.21	5.86	6.18	6.62	7.09
Safeway	3.57	3.89	4.34	4.69	5.19	5.94	6.74	7.49

Source: Henderson Crosthwaite, quoted in Neil Wrigley, Retail concentration and the internationalisation of British grocery retailing, in Rosemary Bromley and Colin Thomas (eds), Retail change, contemporary issues, UCL Press 1993.

The 1990s: a new environment

The precipitating event was the severe recession which followed the so-called Lawson boom. The recession struck just as many of the superstores that had been constructed in the late 1980s were coming on stream. There was overcapacity in the industry, and the competitive situation was further aggravated by the arrival of Continental discounters such as Aldi from Germany and Netto from Denmark.[xv] Attracted by the high margins being earned by the leading British supermarket groups, these companies believed they could compete profitably at the bottom end of

the market with a formula that had proved successful on the Continent. Some commentators predicted that these "hard" discounters might win as much as 15 per cent of the market.

By now there was less scope for the multiples to gain sales from the independents; the combined share of the market held by the Coops and independent grocers had come down from about 50 per cent in the late 1970s to 24 per cent, and any further erosion of their position was bound to be gradual. Among the multiples, most of the smaller regional chains had been acquired, and, with the five largest firms now accounting for 62 per cent of the market (Table 6), any further gains in market share would mostly be at each other's expense.

Table 6 Market share changes 1985-1992 (per cent)

	1985	1992
The five majors	47	62
Next four	8	11
Other multiples	16	4
Coops	13	11
Independents	15	13

Source: Verdict Research

Another problem was that sites for new superstores were becoming scarcer and more expensive; freehold site costs for new superstores were driven up by 30 per cent between 1989 and 1992, and the average site capital cost for a new Tesco superstore rose from £15m to £22m.[xvi] To make matters worse, new planning rules were introduced by John Gummer, Secretary of State for the Environment in the Conservative government led by John Major, marking a shift away from the relaxed approach of the Thatcher years.[xvii]

A "race for space" was under way, putting pressure on the companies' finances; Tesco, Sainsbury and Safeway all launched big rights issues in 1991 and 1992. Although these capital-raising exercises were successful, there was concern among investors about whether the retailers could achieve adequate returns on the investment that they had been making in superstores, and, more generally, whether the industry had gone "ex-growth".

The political climate became more hostile in the course of the decade, with growing concern that the big supermarket groups were using their market power to squeeze suppliers and to earn higher profits for themselves. This led to a full-scale inquiry into the industry by the Competition Commission in 1999.[xviii] Although the Commission absolved the supermarkets of making excessive profits – it noted that the real price of food had declined between 1989 and 1998 – it expressed concern about local monopolies and made a number of recommendations on relations between retailers and suppliers. The report was not as damaging as had been feared, but it underlined the extent to which the industry was now exposed to more critical scrutiny from politicians and the press.

These changes in the external environment prompted different responses from the leading supermarket groups. Why did some firms adapt more successfully than others?

Corporate strategies in the 1990s

Tesco

The recession at the start of the decade hit Tesco hard. Although profits rose in 1990 and 1991, it was clear by the summer of 1992 that sales growth was slowing down and that margins were under pressure. Some commentators argued that Tesco was being squeezed between the discounters on one side and higher-quality competitors such as Sainsbury and Safeway on the other. As Lex in the Financial Times noted, "the risk is that Tesco will have neither the brand image nor the price competitiveness to compete in a mature market".[xix]

Part of the problem was that Tesco's core customers were younger and more heavily indebted than Sainsbury's, and so worse affected by the rise in interest rates. Moreover, in seeking to emulate Sainsbury during the 1980s, Tesco had allowed its image to become blurred. Its prices had tended to rise so that they were almost on a par with Sainsbury's, and considerably higher than Asda's.

The issue for MacLaurin and his colleagues was how to halt the slide, regain the confidence of investors and ensure that Tesco had a distinctive position in the market. In 1992 he appointed Terry Leahy to be the company's first marketing director, with the task of formulating a recovery strategy. Leahy's appointment reflected Tesco's realisation – which came earlier than in the other big supermarket groups – that the demanding conditions of the 1990s called for a more "customer-focused" style of management, rather than the buyer-dominated approach which had been the norm in earlier decades.

After conducting extensive market research among some 250,000 shoppers, Leahy reached a clear conclusion. Tesco was perceived to have let its customers down; in benchmarking itself against Sainsbury, it had lost touch with its core clientele. Leahy's response, set out in a paper presented to the board in May, 1993, was a series of measures aimed at regaining the trust of its customers. This included, most importantly, lower prices – matching Asda rather than Sainsbury. A new low-price label, Tesco Value, was launched as a direct response to the discounters; by the end of 1993 Tesco claimed to have opened up a price gap of 4-5 per cent on Sainsbury and Safeway. Tesco also made its stores more customer-friendly; for example, the "one-in-front" programme was launched to eliminate queues at the check-out counter.

With less scope for building out-of-town stores, Tesco introduced new formats for inner-city locations, Tesco Metro for small high street stores and later Tesco Express, convenience stores usually linked to petrol stations. Because the need for improved performance was so urgent, Tesco was prepared to challenge conventional wisdom in the food retailing industry. An example was the decision to introduce Clubcard, a loyalty card which some sceptical observers dismissed as nothing more than a return to Green Shield stamps. Tesco believed that Clubcard would yield valuable information about shopping patterns, and that the gains arising from a better understanding of customers would outweigh the costs of operating the scheme. As MacLaurin put it, "Clubcard will enable us to recreate the old tradition of a shop manager knowing all the people who shop in his store".[xx]

Through its price reductions and other marketing initiatives, Tesco was trading lower margins against higher volume, and the result was an increase in sales and, after a lag, in profits. A further boost to market share came in 1994, when Tesco made a successful takeover bid for William Low, Scotland's leading supermarket group; it

defeated a rival offer from Sainsbury, which was making a rare foray into the takeover market. Low's Scottish stores were renamed Tesco Scotland, and a programme of refurbishment was set in train. In 1995, thanks in part to the Low acquisition, Tesco achieved market leadership, pushing Sainsbury into second place.

Tesco could now shift from recovery to growth. Leahy, who became deputy managing director in 1995 and chief executive two years later, adopted a four-point strategy: to continue to grow in the UK; to push more strongly into non-food; to diversify into services; and to expand overseas.

The first of these objectives was to be achieved partly by new store building, partly by acquisition. Tesco continued to roll out new superstores where sites were available, and, in 1996, it opened its first hypermarket, under the Tesco Extra name; by 2002 it had 41 of these stores in operation. At the same time it strengthened its position in inner-city areas by building more Tesco Metro and Tesco Express stores. Another major acquisition came in 2002, when Tesco bought T & S Stores, one of the largest British chains of convenience stores. This transaction underlined Tesco's determination to dominate all segments of the food retailing market; most of the acquired stores will be renamed Tesco Express.

As for non-food, Tesco pushed more strongly into clothing, home entertainment, health care and personal care products; opticians were installed in several stores. The strategic importance of the non-food side was that margins were generally higher than in food, and could to some extent support competitive pricing in food. By the end of the 1990s the proportion of Tesco's selling space devoted to non-food was approaching that of Asda (Table 7).

Table 7 Non-food space allocation in 1999 (% of total selling space)

Asda	43.6
Tesco	36.3
Safeway	29.5
Morrisons	27.9
Sainsbury	26.1
Savacentre	48.7
Somerfield	21.6
Waitrose	15.6

Source: Verdict Research

In services, Tesco set up a bank in 1997 in partnership with Royal Bank of Scotland; four years later it had over 2.5m account holders and the joint venture was making annual pre-tax profits of some £40m. A variety of services were offered, including credit cards, motor insurance policies and other general insurance products; Tesco claimed that customer acquisition costs were 25 per cent of the banking industry norm. The move into banking underlined Leahy's determination to promote Tesco, not merely as a supermarket chain, but as a brand.

Tesco moved into overseas markets later than Sainsbury and did so with a different strategy. Whereas Sainbury targeted the US, Tesco went first to Continental Europe, buying the Catteau supermarket chain in Northern France in 1993. However, this proved to be a mistake. Catteau was a weak player in a market dominated by discounters and by hypermarket operators such as Carrefour; the chain was sold shortly after Leahy became chief executive. Tesco then decided to focus on less developed markets, principally in Eastern Europe and in Asia, working closely with local partners. By 2002 Tesco was operating 174 stores in these countries, most of them hypermarkets; they represented 42 per cent of the group's total selling space. If, as some commentators believed, the international food retailing industry was in the early stages of consolidation, Tesco seemed well placed to participate as an acquirer rather than a target.

The UK remained by far the most important source of Tesco's profits, and the aim was to keep ahead through innovation: "unique differentiation is a prize that can only be won by continually being first".[xxi] Tesco was the first High Street retailer to offer internet access and the first in internet-based retailing. The on-line service was launched in 1999, and by the end of 2002 weekly sales were running at just over £10m; more than 100,000 British households were taking deliveries of goods ordered through the Tesco website.

Sainsbury

The 1980s had been glorious years for Sainsbury, and at the start of the new decade the group looked impregnable. As the Financial Times commented in 1991, "it would be churlish to question its medium-term ability to deliver the goods. The group boasts a 12-year record of dividend increases of 20 per cent or more. Earnings per share have risen by as much for nearly as long, and there is little sign that the sequence is about to be broken".[xxii] In the middle of that year the company raised £489m in new equity to fund the expansion of superstores. But perhaps because of its long period of success Sainsbury was slow to respond to the new environment.

There was no sense of urgency during the recession of the early 1990s, as there was at Tesco. When Lord Sainsbury retired at end of 1992, to be succeeded as chairman and chief executive by his cousin, David Sainsbury, this brought about a change in management style – more consensual, less hierarchical – but not in strategy or in corporate beliefs about the company's place in the market. The impression of continuity was reinforced by the appointment of Tom Vyner, who as buying director had been a powerful figure under the old regime, to be deputy chairman and joint managing director in charge of UK supermarkets.

Sainsbury, it seemed, was stuck in an old grove, while Tesco and Asda (see below) were emerging from crisis or near-crisis to become more formidable competitors.[xxiii] Yet the company was not immune to the intensification of price competition, and at the end of 1993 it announced price cuts on 300 of its most popular own-label lines. Significantly, this came three months after Tesco had launched its Tesco Value line. A few months later Sainsbury announced that margins had fallen, that the pace of new superstore construction would slow down, and that it would write down the value of some of its properties.

In 1994 Sainsbury announced a new town-centre format, Sainsbury Central, again a response to Tesco's Metro, which was already established in five locations. The loss of the takeover battle for William Low was a disappointment (like Tesco, Sainsbury had long been under-represented in Scotland), and it was followed by an unwise

response to Tesco's Clubcard. Tesco's initiative was dismissed by David Sainsbury as a return to Green Shield stamps, but the company was soon forced to backtrack, introducing its own Reward Card a year later.

A strategic review in 1995 led to the launch of the Sainsbury Economy label. But again Sainsbury appeared to be lagging behind its rival. Commentators were drawing invidious comparisons between Leahy's role in Tesco and the lack of a "young Turk" marketeer in Sainsbury.[xxiv] Some new ventures were successful, notably the launch of a retail bank in partnership with Bank of Scotland, and Sainsbury continued to build up its supermarket business in the US; in addition to Shaws, Sainsbury bought a minority stake in another supermarket group, Giant Food, based in Washington DC, although this shareholding was subsequently sold when Ahold of the Netherlands made a full bid for the company. Sainsbury also enlarged its Homebase do-it-yourself business by buying Texas Homecare from Ladbroke for £290m. But these moves did little to allay concern among investors about the grocery business in the UK.

In 1996 the company reported its first fall in profits for 22 years. David Sainsbury announced management changes, involving the appointment of two chief executives, one in charge of UK supermarkets and Savacentre (Tom Vyner) and the other responsible for Homebase and the US (Dino Adriano). Finally, in 1998, David Sainsbury himself resigned from the company to pursue a career in politics. He was succeeded as non-executive chairman by George Bull, who had been chairman of Diageo, the drinks group, and Adriano was promoted to be group chief executive. However, this proved to be no more than an interim move. Adriano was moved sideways in 1999 to take charge of strategy, while his deputy, David Bremner, was given responsibility for UK supermarkets.

This period of management uncertainty came to an end in 2000, when an outsider, Peter Davis, was brought in as chief executive. Davis was an experienced manager who had spent ten years with Sainsbury between 1976 and 1986; he had left the company, it was said, because he saw that a non-family manager was unlikely to reach the top. He had subsequently served as chief executive of Reed International, the publishing group, and then of Prudential Assurance.

The appointment was welcomed by City analysts, who felt that Sainsbury had at last done what should have been done a long time before – bring in an outsider capable of "thinking the unthinkable". The hope was that Davis would "fix" Sainsbury just as an outsider had "fixed" Asda in the early 1990s (see below). However, conditions in the market were more competitive than they had been ten years earlier, and the recent entry of Wal-Mart underlined the size of the task facing the new chief executive.

Within a few months of his appointment Davis had to announce another steep drop in pre-tax profits. He warned shareholders that there were no easy solutions to difficulties created by prolonged under-investment; systems and distribution were said to be "years out of date" and many of the stores needed refurbishing. The immediate task was to increase operational efficiency. The short-term goal, to be achieved by 2004, was to lift operating profit margins from the current level of 4 per cent to the 6 per cent achieved by Tesco and Morrisons. Davis also made it clear that the company would concentrate more single-mindedly on its core business; the Homebase do-it-yourself operation was put up for sale – it was eventually disposed of at the end of 2000 for just under £1bn. Some observers wondered whether Sainsbury might also sell its US food retailing operations, which had generated little cash over the preceding ten years, but Davis believed that Shaws was a sound business capable of good profits growth.

By 2002 some progress had been made. Profits were improving, and the chairman, George Bull, told shareholders that there had been a “huge, tangible change in the culture of the company”. Several long-standing weaknesses, notably the inefficiency of the supply chain, had been tackled. There was also a stronger push into non-foods, especially clothing. The Savacentre chain was re-launched, and Sainsbury was now operating a range of formats, including Central and Local, comparable to those of Tesco. In 2002 the Reward card was dropped in favour of a joint loyalty card, known as Nectar, operated in partnership with Debenhams, British Petroleum and Barclaycard.

The central question was market positioning. Could Sainsbury differentiate itself from Tesco and Asda by re-emphasising its traditional focus on quality, at the cost of slightly higher prices? Some analysts believed that the market was polarising between quality and value, and that Sainsbury was the only major retailer directly addressing quality. According to this view, even though Sainsbury was smaller overall than Tesco, its larger average store size, higher margin mix and higher prices should more than offset its scale disadvantages in purchasing.[xxv] An opposing view was that “to do a Waitrose” on a national scale was not feasible; there was no room for a mass-marketing, quality-orientated retailer, and Sainsbury might be in danger of retreating into a middle class niche.

Asda

At the start of the 1990s Asda was in a desperate financial state – weighed down by debt, losing market share to Tesco and Sainsbury, and struggling with unsuccessful diversification into furniture and carpets. The first steps towards recovery came at the end of 1991, with a £57m rights issue and the appointment of a new chief executive. This was Archie Norman, a former McKinsey management consultant who had worked at the Kingfisher retailing group since 1986. Norman set about a cost-cutting programme which included a halt to the store refurbishment programme, a pay freeze for the company’s 71,000 employees, and the sale of several peripheral businesses. With advice from McKinsey, he then embarked on a strategic redirection of the company, the main thrust of which was to return Asda to its roots as a discount retailer.

The aim, as the mission statement put it, was to be “Britain’s best value fresh foods and clothing superstore” and to achieve this “by satisfying the weekly shopping needs of ordinary working people and their families who demand value”. The company redesigned 140 of its 200 stores to emphasise the values associated with the new strategy. “We aren’t going to be like anybody else”, Norman said, “we are going to be like Asda”.[xxvi] The programme was financed by a second rights issue, the success of which reflected investors’ growing confidence in Norman and his team. A separate format was established for Dales, a limited line discount chain similar in format to Kwik-Save but with a wider range of products

By 1995 the recovery plan was on track, the debt burden had been substantially eliminated, and Asda was able to report a 35 per cent increase in pre-tax profits. Asda appeared to be coping with the more competitive environment rather better than Sainsbury. At a time of severe pressure on prices Asda’s large stores, stocking a wide variety of non-food products as well as food at low prices, were a competitive advantage. Norman announced a large capital spending programme involving the construction of six superstores a year at an annual cost of £250m, and a stronger push into own-label brands.

In the following year Norman resigned as chief executive to pursue a political career, to be succeeded by his long-time colleague, Allan Leighton. No change in strategy resulted, but there was some concern inside and outside the company about whether Asda could maintain the rate of growth that it had achieved during the recovery years. This prompted, first, an abortive bid for the Welcome Break motorway service stations and then, in 1997, exploratory merger talks with Safeway. When these talks broke down, Asda turned to another potential partner – Kingfisher, a diversified retail group which owned Woolworths, Superdrug, Comet and B & Q – but there was no agreement on terms.

The company insisted that a merger was not essential, and indeed its low-price formula appeared to be working well. As the Financial Times put it, “faddish industry trends like loyalty cards or expanding into internet shopping have been avoided. Instead, a powerful winning formula has been developed. Open large stores and pull in the shoppers with a compelling, low-price food offer. Sell them attractive non-food items, like a branded clothing range, and up goes the gross margin. This can then be invested in food, and the process starts again”.[xxvii]

Yet there was a limit to how long this formula would last as the UK market matured. One possibility was to look for growth overseas, as Tesco and Sainsbury had done. Another was to diversify into other branches of retailing, and this was the logic behind the revival, early in 1999, of the plan to merge with Kingfisher. The argument was that Kingfisher would use Asda to sell products from its chains, while Asda would find new high street outlets for its food and for its George clothing range. (Unlike Tesco and Sainsbury, Asda had decided against introducing its own high-street stores.) Such a merger would also allay fears among Asda’s investors that the number three in a mature industry, physically restricted by a tight planning regime, could be running out of steam. In the event, however, the proposed Asda-Kingfisher combination was overtaken by a bid for Asda from Wal-Mart of the US.

Although Wal-Mart’s earlier foray into Germany had not been wholly successful, most observers thought the combination with Asda would work well.[xxviii]Their cultures were similar, and both firms were focussed on large stores, high volume and low prices, although there were also important differences - Wal-Mart was predominantly a non-food retailer, and, unlike Asda, had not sought to promote own-brand products.

A first step was to modernise Asda’s IT and distribution systems, and to clean up a store portfolio which still contained some poorly located outlets arising from earlier acquisitions. Plans were announced for the construction of bigger stores comparable to Wal-Mart’s supercentres in the US; the first move in this direction came in 2000, with the opening of an Asda/Wal-Mart store in Bristol. But planning restrictions made expansion of this type difficult – hence the speculation that Wal-Mart might seek to enlarge its UK store through further acquisitions.

As for pricing, there was no evidence in the first three years after the acquisition that Wal-Mart wished to start a price war, but its superior buying power in non-food products was making itself felt. According to one report, Asda’s basic George jeans cost £14.99 before the Wal-Mart take-over. By 2002 the price was down to £7, because Asda was paying 50 per cent less for its denim.[xxix] It was clear that Asda, with the resources of Wal-Mart behind it, would be a more formidable competitor.

Safeway

By the early 1990s the impetus to profits growth that had come from integrating Argyll and Safeway was slowing down. Although Safeway had become the third largest retailer (thanks partly to the decline of Asda and Dee), its sales, at £4.5bn, were far below those of Sainsbury at £7.8bn and Tesco at £6.3bn. The average size of its stores was also smaller than that of its two bigger rivals, and it was less well placed in the lucrative markets of London and the South East. Safeway was facing a strategic issue that was to dog it for the rest of the decade. Could it prosper as No 3 to Tesco and Sainsbury, or should it differentiate itself, either by moving into Waitrose territory or going down-market towards the discounters?

One possibility, at the start of the decade, would have been to take over, or merge with, Asda when that company was in the depths of its financial crisis. This was seriously considered by Grant and Webster, and, on paper at least, it would have provided substantial economies of scale. The plan would have been to convert Asda stores – or at least those Asda stores which were worth keeping – to the Safeway brand. The combined group's sales volume would have been well above that of Tesco and Sainsbury. But the risks of taking on Asda in its weakened state were forbidding; its store portfolio was mixed, and at that stage the Safeway brand looked to have ample growth potential, without need for large-scale acquisitions.

Over the next few years competitive pressures intensified. Pre-tax profits fell by 13 per cent in the year to April, 1994, prompting a wide-ranging strategy review, assisted by McKinsey and known as "Safeway 2000". This involved the sale of the Lo-Cost discount operation, and the re-design of the Safeway stores to appeal to the family shopper. Safeway was the first of the large supermarket groups to follow Tesco with a loyalty card, and other retailing innovations were introduced.

Although profits fell again in 1994-95 because of restructuring costs, the "Safeway 2000" programme bore some fruit, and the company appeared to be making progress in creating a distinctive image for its stores. But the scale problem had not gone away (Table 8), and it was doubtful whether, in the long run, Safeway could survive as a relatively weak number three, pursuing roughly the same strategy as the two leaders. Anxiety on that score led David Webster, who had taken over as chairman in 1997 after Grant's retirement, to open merger talks with Asda. These talks were called off after a few weeks following a leak to a Sunday newspaper, then briefly revived in the early months of 1998 before breaking down again. The outcome, if the negotiations had been successful, would probably have been the disappearance of the Safeway name and the emergence of a stronger Asda, still focussing on discount prices but with a bigger volume to support it; this might have achieved a more secure future for Safeway than continuing to pursue a "me-too" strategy, struggling to keep up with Tesco and Sainsbury with inferior resources.

Table 8 Food retailers in 1997-98

	Tesco	Sainsbury	Asda	Safeway	Morrison
Total sales (£bn)	14.6	10.8	7.6	7.0	2.3
Operating profit (£m)	866	734	404	426	147
No of stores	586	391	219	486	85
Sales area (m sq ft)	14.6	10.9	9.1	10.1	3.1
Avge store size (000 sq ft)	24.9	27.8	41.8	20.7	36.0
Sales per sq ft (£ pa)	1002	1020	849	708	773
Op profit per sq ft (£ pa)	59.4	69.1	45.1	43.3	49.6

Source: Verdict Research

For Safeway, the public failure of the Asda talks left the company potentially vulnerable to a bid. Another possibility, explored shortly after the talks with Asda had collapsed, was to merge with Marks & Spencer. The rationale was that M & S occupied a niche position in food, offering mainly up-market products but also – because of the clothing side – patronised by a large number of customers. A merger with Safeway would have given the M & S food business additional volume, and made available Safeway's out-of-town superstores – a retailing format in which M & S was poorly represented. The Safeway name would have disappeared and the M & S food business would have become, in effect, a larger and more profitable version of Waitrose. However, M & S decided not to proceed, apparently on the grounds that a Safeway acquisition would have turned the group into more of a food than a clothing retailer, and exposed it to competition from food specialists such as Tesco and Sainsbury.[xxx]

By the early months of 1999 Safeway was coming under renewed criticism from investors. Its shares had under-performed the food sector by 30 per cent over the previous five years; it had been pushed back into fourth position by Asda; and it did not have enough stores of adequate size to offer a comprehensive non-food range. In July Safeway announced the appointment a new chief executive, Carlos Criado-Perez, who had held senior posts in Wal-Mart's international division.

The problem was how to distinguish Safeway from Tesco and Sainsbury, and how to minimise its scale disadvantage. According to estimates made by the Competition Commission, Tesco was able to negotiate significantly lower prices from its suppliers than Safeway – averaging about 3 per cent on big-selling branded items.[xxxi] Criado-Perez's response was to introduce selective deep discounting – the so-called high/low pricing formula, making deep price cuts on a limited set of products for a limited period. (Criado-Perez also abandoned Safeway's loyalty card, arguing that these cards were no longer an effective marketing tool.)

The new approach to pricing was one of the four pillars of Safeway's strategy, the others being "best for fresh foods", "best for customer service", and "best for product availability". Criado-Perez envisaged a five-year programme of developing the stores along these lines, to be completed by 2004. Yet the City remained unconvinced, and throughout 2002 there was renewed speculation about a bid for the company. In January, 2003, Safeway announced that it had agreed merger terms with Morrisons; under this scheme the smaller but more highly valued Yorkshire firm would take control of the Safeway business and re-brand most of the Safeway stores to Morrisons. However, the announcement prompted a flurry of counter-offers from other groups, and the contest was unresolved at the time this paper was written.

Somerfield

When Isosceles, a newly created financial group led by David Smith and backed by several big investing institutions, bid successfully for Gateway in 1989 and took the company private, the plan was to restructure the business and refocus it on what were called "middle ground" outlets, falling between the big out-of-town superstores and smaller, inner-city neighbourhood shops; the average size of the stores was between 5,000 and 10,000 square feet. Once this exercise had been completed, the company would be re-floated on the stock market. However, Isosceles was highly leveraged, and some of the planned disposals of non-core businesses took longer than expected to complete. Financial strains led to the enforced departure of David Smith and other executives in 1991.

In the following year the business was re-launched by a new chief executive, Bob Willett, and the Somerfield name was introduced, alongside the existing Gateway and Food Giant chains. Two years later, with yet another chief executive, David Simons, in command, the company announced that it was changing its name to Somerfield, and most of its stores would trade under that brand; the Gateway name would disappear, although Food Giant would be retained as a discount operation. Simons admitted that Gateway had been "a sick giant suffering from a lack of direction, lack of identity and chronic under-investment", and that the transition from Gateway to Somerfield meant "transforming every aspect of the business".[xxxii]

By 1996 the recovery had reached the point where flotation became feasible, and Somerfield was successfully launched on the stock exchange, with a market value of around £600m. At the time of the flotation the company's market share had fallen to 5.3 per cent, its lowest level for two years, but Simons claimed that the company was now clearly positioned in the market, and that the business would benefit from what he saw as the trend back towards high-street shopping. The aim was to become the UK's strongest neighbourhood food retailer.

Questions remained about whether, at a time of intense competition both from discounters and from the bigger chains, Somerfield could generate adequate growth in sales and profits. Concern in the City increased when Somerfield decided, in 1998, to acquire Kwik-Save. This company, after performing well in the 1980s, had found itself squeezed between the Continental discounters on one side and the bigger groups such as Asda and Tesco on the other. It had also made the mistake of expanding its product range from about 600 to about 2,500 lines, pushing up costs and prices. Kwik-Save, it seemed, had wandered into no man's land, where it was neither a hard discounter nor a superstore group.[xxxiii]

Observers questioned whether putting together two very different businesses would solve either's problems. The initial plan was to convert most of the Kwik-Save stores

to the Somerfield name, but the group continued to suffer from a disparate store portfolio, the result of numerous ill-digested acquisitions. At the end of 1999 Simons, facing strong criticism from the City, announced plans to sell a third of the company's 1,400 stores. He admitted that the group had underestimated the difference between Somerfield and Kwik-Save, and had failed to support and maintain the Kwik-Save brand.

A few months later Simons resigned, and John van Spreckelsen, formerly chief executive of Budgens, the convenience food retailer, was brought in as chairman. The new strategy was to keep Somerfield and Kwik-Save as separate businesses, while sharing common services in such areas as information technology and corporate finance. By mid-2002 – half way through what was seen as a five-year recovery programme – the company announced a return to the black, and dividends were resumed after a two year break. But, as with Safeway but in a far more acute form, the positioning issue remained unsolved.

Morrisons

Floated on the stock market in 1967, Morrisons has achieved a 35-year unbroken track record of sales and profits growth; the company joined the FTSE100 in April, 2001, and its market capitalisation moved well ahead of that of Safeway; some 40 per cent of the shares are owned by the Morrison family.

The driving force behind the company's growth has been Ken Morrison, son of the founder. He has followed a consistent policy of building large, uniform stores; the average Morrisons store has a sales area of 40,000 square feet. The company so far has not followed Tesco and Sainsbury in opening smaller inner-city stores. The company's main areas of strength are Yorkshire, Lancashire and the North East, although it has recently been building stores in other parts of the country, principally the Midlands, East Anglia and Scotland.

Morrisons sells mainly food at low prices - slightly more half of all products sold are own-label – and is unusual in owning some of its suppliers. Morrisons has a much smaller involvement in non-foods than, say, Asda or Tesco, although it does offer banking services in partnership with HSBC. According to one recent study, the Morrisons team "believe their abilities lie in being a quality grocer and would rather not risk diluting their image by attempting to be anything more".[xxxiv] Morrisons does not offer loyalty cards, preferring straightforward selling through "value for money, unbeatable customer service and a pleasant shopping experience".

Ken Morrison's management style emphasises simplicity, discipline, and tight control of costs. The management structure is flat, with a close-knit team which has worked together for many years. Morrisons' return on capital employed has been consistently at or near the best in the industry (Table 9).

Table 9 Return on capital employed in 1995-1999 (adjusted for depreciation)

	1995	1996	1997	1998	1999
Tesco	14.4	15.2	15.5	17.4	16.2
Sainsbury	19.7	16.6	12.8	14.4	15.0
Asda	15.1	17.0	16.9	17.1	15.7
Safeway	16.5	17.4	17.8	14.0	13.2
Morrisons	19.7	18.8	18.2	18.1	18.8

Source: Supermarkets, Report by Competition Commission, HMSO 2000, Appendix 8.7

Morrisons appears to have suffered no serious cost penalty arising from its relatively small size compared to Tesco, Sainsbury or Asda. Any disadvantage arising from less buying power is offset by other efficiencies, notably in operating large stores of uniform size. The main challenge facing the company has been how to maintain the rate of growth, since to do so it has to expand into parts of the country which are already well served by its competitors. By the end of 2002 it had overtaken Somerfield to become the fifth largest food retailer in terms of market share, but it will still a long way behind the leaders. Early in 2003, to the surprise of many observers, Morrisons decided to attempt a spectacular leap into the "big league", by taking over Safeway.

The aim of this merger, as set out in a statement jointly issued by the two companies, was to "create a major new national force in UK food retailing". The plan was to re-brand Safeway's larger stores (that is, those with over 15,000 square feet of selling space) under the Morrison name, while keeping the Safeway name for the smaller "convenience" stores, mostly located in inner-city areas; sales per square foot in the larger Safeway stores would reach current Morrisons levels within three years of the merger. The two companies predicted cost savings of about £150m, of which half would come from increased volumes and enhanced buying power, half from combining the two head offices and other central functions. Sir Kenneth Morrison would become executive chairman of the combined group, and most of the other key posts would be held by Morrisons managers. David Webster and Carlos Criado Perez, respectively chairman and chief executive of Safeway, would resign.

The industry in 2003

Although the Morrisons bid came as surprise, most commentators had been arguing for some time that the existing structure of the industry was unstable. Some were predicting the emergence of a duopoly, consisting of Tesco and Asda/Wal-Mart, leaving the other players scrambling to find a viable place in the market. This probably under-estimated the strength of Sainsbury's brand and market position, despite the long period of under-performance during the 1990s. The future of Safeway was more problematic – an improved store portfolio, but still uncomfortably placed in terms of scale and positioning.

In the event, the future of the industry was thrown into doubt by the announcement of the proposed Safeway/Morrisons merger, which was followed by several competing offers for Safeway from other groups. Several of these offers – notably

those involving Wal-Mart, Sainsbury and Tesco – raise serious competition issues and will almost certainly be referred to the Competition Commission. Morrisons argued that its offer for Safeway would be the best outcome for competition, since the combined group would still be in fourth position among the leading supermarket groups, with a market share slightly behind Asda and Sainsbury, and well behind Tesco.

Meanwhile, among the smaller firms not involved in the battle for Safeway, Waitrose and Marks & Spencer looked secure, but the firms that lacked a distinctive market position were finding the going harder. Somerfield's lowly market capitalisation (Table 10) reflected continuing uncertainty in the City about the company's future, reinforced by a flurry of senior management changes. There were similar doubts over Iceland, originally a frozen-food specialist and now, following the merger with Booker, part of the Big Food Group. Even Budgens, a relative minnow with just over 100 neighbourhood stores in the South and East, was feeling the heat from the inroads made by Tesco and others into the convenience-store sector.

Table 10 Market capitalisations of leading food retailers, June 2002 (£bn)

Tesco	16.7
Sainsbury	6.7
Morrison	3.1
Safeway	2.9
Somerfield	0.6
Big Food (ex-Iceland)	0.4
Budgens	0.2

Implications for theories of strategy

The recent history of the UK food retailing industry can be divided into two periods – a period of profitable growth between the mid-1960s and the early 1990s, and a period of maturity, slower growth, and more intense competition between the early 1990s and 2002.

In the first of these periods the clear winner among the large supermarket groups was Sainsbury. This company had accumulated, earlier in its history, resources and capabilities which proved to be a powerful source of competitive advantage. The resources included a brand image which had been built up over many years; it stood for quality and value for money. Sainsbury had been a first mover in own-brand products, and by the 1970s these were seen by customers as at least comparable in quality to their manufacturer-branded equivalents. Sainsbury's capabilities included expertise in supply chain management, reinforced during the 1970s by an early commitment to IT systems.

Sainsbury had the advantage, shared to some extent by Tesco, of a strong market position in London and the South East (Table 11); this was a product of its history. The company benefited, too, from a consistency of management stemming from family ownership and control. The fact that it did not go public until 1973 was not a disadvantage; unlike Tesco, Sainsbury grew organically rather than by takeover, and, at least during this period, did not need to use its shares as an acquisition currency.

Table 11 Regional market shares in 1999 (%)

	Asda	Sainsbury	Tesco	Safeway	Morrisons
GB	12.7	17.6	21.1	9.3	4.1
London	8.1	29.5	26.9	7.9	0.4
Midlands	12.4	18.2	17.2	9.8	6.1
N. East	18.8	7.8	5.2	4.6	8.0
Yorkshire	15.2	9.7	14.1	6.4	15.5
Lancs	19.9	11.0	15.2	4.6	8.0
South	8.7	22.9	30.1	10.0	0.0
Scotland	18.8	4.9	16.9	19.2	0.5
E.England	8.0	22.6	29.2	5.9	1.1
Wales & W	13.1	14.3	26.1	8.2	0.0
S. West	6.9	15.0	22.1	11.6	0.0

Source: Taylor Nelson Sofres

If the Sainsbury story supports the resource-based view, it can also be seen as example of a well-judged positioning strategy. The 1980s were years of growing affluence in the UK, with an increasing demand for higher quality merchandise. It was an "aspirational" market, and Sainsbury's position at the upper end of the quality-value spectrum was in line with what a growing proportion of British shoppers wanted. Tesco, by contrast, with its down-market image, seemed stuck with a marketing style and product offering more appropriate to the earlier post-war years.

In the case of the three new entrants – Asda, Dee (later Somerfield), and Argyll (later Safeway) – the positioning view seems helpful in understanding success and failure. Asda, with its hypermarkets selling food and non-food at very low prices, opened up a new sector of the market, quite distinct from Tesco and Sainsbury. Until it faltered in the second half of the 1980s, this was a clear strategy, consistently implemented.

Somerfield was the product of opportunistic acquisitions, driven more by financial engineering than by any conception of where the company should be positioned. The focus on medium-sized High Street supermarkets was largely a matter of making the best of a very difficult job; the main problem, which had not been solved by the end of the 1980s, was to make some sense of the heterogeneous collection of stores which it had acquired through its numerous takeovers.

Argyll, on the other hand, was a well-managed business, and its purchase of Safeway was, in the early years, brilliantly successful. But as No 3 to Sainsbury and Tesco, with smaller stores and less representation in London and the South East, it had both a positioning problem and a scale problem. These were bearable in the buoyant 1980s but became more serious in the following decade. With the benefit of hindsight, it might be argued that Argyll missed a great opportunity in the early 1990s when it could have acquired Asda and converted the combined group into the leading discounter among the large supermarket chains – although the management problems involved in integrating the two companies would have been far greater than those that Argyll faced when it bought Safeway some years earlier.

How helpful are the two views of strategy in understanding what happened during the 1990s? Tesco, facing a financial crisis in the early years of that decade, was the

quickest to recognise the change in the market and hence the need to re-position itself – moving away from emulating Sainsbury and concentrating more on price, but also recognising that consumers had become more demanding in other ways. The goal was to be, not so much an aspirational retailer, but a classless one. The new focus on the consumer – symbolised by the appointment of the supermarket industry's first marketing director – paved the way for a series of initiatives, including Clubcard, new store formats, financial services and a stronger drive for non-food sales. This was combined with a strenuous effort to raise operational efficiency in all phases of the business, especially in the management of the supply chain.

For Sainsbury, the long years of success had locked the company into a way of doing business which was no longer appropriate. It was unfortunate (and lucky for Tesco) that the change in the market environment coincided with a change in senior management, leading to several years of uncertainty at the top. Sainsbury was slow to follow Tesco's innovations and slow, too, to match its rival's success in non-food products. Sainsbury had traditionally been much more focussed on food than non-food, and although Savacentre had been launched in the late 1970s, it never received the attention that it needed. A further problem for Sainsbury was that its sales appeal had traditionally been based on quality rather than price, and as the market became more price-conscious it lost ground to the company which had traditionally emphasised price rather than quality. According to some industry observers, it is easier for a supermarket group to add value to price than the other way round.

How much of these variations in performance can be put down to particular decisions taken by particular individuals at particular times? Clearly individuals do play an important part in the story. Archie Norman did fix Asda in the early 1990s; Ian MacLaurin did rescue Tesco at the end of the 1970s, just as Terry Leahy redirected it in the 1990s; perhaps Peter Davis will do the same at Sainsbury. A more obvious example is Ken Morrison at Morrisons, a model of consistency in strategy and management style.

Yet none of these individuals could have achieved what they did without, first, having a view (whether explicit or implicit) on where they wanted to position their company in the market, and, second, having at their disposal resources and capabilities which made their chosen strategy feasible. This was also true of the up-market specialists, Waitrose and Marks & Spencer. Skilful positioning and distinctive capabilities were necessary conditions for success. Those companies which fell back during the 1990s were lacking in one or both of these attributes.

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