

# Business model of aldi | pest, 5 forces



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## **Analyse the business model of supermarket chain Aldi**

### **Introduction**

Aldi, a German supermarket chain, entered the UK market in 1990 and now operates a network of over 500 stores (Aldi, 2014). The competitive landscape for UK supermarkets is fierce (Sandberg, 2013) with many different strategies being adopted, each aligned to a different segment of the market. Aldi focuses on delivering a basic, value for money shopping experience (Naslund, 2013). Such a cost leadership strategy and lower cost structure enables discount companies to enter and take a larger percentage share of the market (Harvard Business Review, 2005).

As consumers focus on saving money in times of recession, the business model used by Aldi presents an opportunity to save money on weekly food shopping whilst still buying healthy food. Supermarkets following a low cost leadership strategy often stock the same product as their rivals but deliver it under a different service model (Harvard Business Review, 2005). Smaller companies, such as Aldi, do not spend as much time publicising their plans or marketing their products, this can create competitive advantage as they are less exposed to public opinion. This leads to an information gap, however it also allows them to develop and grow quickly whilst adapting to the changing trends (Skordili, 2013). The increased demand for cheaper food is better served by discount retailers. It also removes a significant cost associated with in store branding, technology and functionality, enabling the same or similar products to be offered cheaper.

The external business environment is made up of two elements; the general macro environment which takes a wide lens view of the environment in <https://assignbuster.com/business-model-of-aldi-pest-5-forces/>

which the business operates and the micro view which focuses on the specific industry or sector in which the business operates (McLean, 2005). The external environment refers to events or trends, which are relevant to the business, as well as being uncontrollable by the business. The external environment directly contributes to the success or failure of the business, for example in 2010 Aldi left the marketplace in Greece citing unfavourable external factors as the reason (Skordili, 2013). By understanding the external environment leaders make better decisions (Kefalas, 1981); knowing the likely impact of that decision and knowing what might affect the organisation in the future. The external business environment is changing faster than ever (Mason, 2007) and therefore being able to understand, anticipate and adapt to changing trends is a key leadership skill (Kotter, 1996).

This essay presents an analysis of the external business environment in which Aldi UK operates. Analysis of the general macro environment using PEST before a more focused analysis of the retail supermarket sector is conducted using Porter's Five Forces Model in order to draw conclusions.

### **The External Business Environment**

Stacey (2011) explains that the dynamic of this macro external market place can be categorised into a number of headings for the purpose of analysis. PEST allows a business to periodically scan the environment to anticipate future trends as well as identify current challenges. PEST scanning splits the environment into 4 key factors: Political, Economic, Social and Technology. This is a commonly used, simple model which allows the general market to be scanned.

The micro external environment was described by Porter as being concerned with getting raw materials to consumers, suppliers to buyers and how the connection are made in a competitive way (Linstead, Fulop and Lilley, 2004). In this model the specific sector or market in which the organisation operates is analysed, this allows the specific market challenges within that sector to be understood for that organisation. To undertake this micro level analysis Porter created a model called the Five Forces which looks at the interaction between the forces. At the heart of the model is 'competitive rivalry' which is impacted by 4 other forces:

- Power of suppliers
- Threat of new entrants
- Power of customers
- Threat of substitutes

Porter argued success was created by the organisations ability to negotiate with suppliers to get the right prices which enable a low cost leadership model or enable larger margins. By putting itself in this position the organisation remains in the driving seat.

### **PEST Analysis**

There are a number of factors which Aldi need to consider as part of their PEST analysis of the UK marketplace.

#### **The Political Environment**

- The UK elections in May 2015 may result in a change of government. A new government may impose new legislation, tax implications and market conditions. Furthermore, with some of the parties pledging a

European referendum as part of their campaign, such a move could lead to the UK leaving the European Union which, as a German company, may present a further risk which will need to be addressed.

- Employment legislation continues to change on a regular basis, 2015 has already seen significant changes with the introduction of shared parental leave (ACAS, 2015). There are continued discussions around the extension of paternity leave. Such changes have an economic impact on the business but also create risk that staff may take a case to tribunal.
- It is proposed that zero-hour contracts will be abolished in 2015 (ACAS, 2015), as a supermarket it is likely that seasonal staffing is used in busy periods such as Christmas. Without zero hour contracts this could become harder to staff and more expensive.
- As a European company, EU legislation is also a factor to consider as any change at a EU level will also have a direct impact on the organisation.

### **The Economic Environment**

- As the UK economy moves out of recession, there could be a change of buying behaviour from low-cost stores back to mainstream supermarkets. This shift could have a detrimental effect on market share. Aldi may need to consider how to compete in such conditions, if at all.
- During times of financial pressure consumers turn to cheaper food suppliers (Skordili, 2013), which has created an ideal market for Aldi in the UK and has contributed to its growth.

- This may in turn change demand, supply and fundamentally affect pricing creating instability in the company as customers go back to higher priced competitors.
- A change in government may also create a different in tax requirements, which could become more costly.
- Success is created through a finely tuned supply chain, with distribution and logistical capability becoming one of the key competitive weapons available (Sandberg, 2013). Aldi operates a model which has created success in Germany where the main point of competition is price, with consumers preferring lower levels of service and a narrower choice to enable a lower price (Fernie and Arnold, 2002).

### **The Social Environment**

- Discount chains could be met with a degree of social stigma, as the economy rises individuals may want to shop at more expensive leading names such as Tesco, Sainsbury's or even Waitrose.
- The UK has an aging population (Cracknell, 2010), an older workforce may be more costly in terms of sickness and present further problems for employers. With the introduction of auto-enrolment for pension schemes this adds a further cost to the business as employers will have to contribute to employees pensions.
- As competitors such as Asda, Tesco and Sainsbury's introduce a more diverse range of products including clothing, non food items, opticians, chemists, travel agencies and more which could see a change of buying behaviour.

- Competitors also offer a 24 hour opening service, as the way people work becomes more diverse over time will this see a change in buying habits. Aldi may need to consider this strategy as a way to maintain market share. This will carry increased costs both in terms of overheads and staffing costs.
- There have been a number of international companies highlighted in the press due to their accounting practice and what this means in terms of where they pay their tax (Barford and Holt, 2013) This could lead to a change in favour by UK consumers who may feel increased loyalty to UK established firms.
- By operating a narrower product range, Aldi has moved away from abundance of choice and created a streamlined shopping experience. Busy family life may benefit from this approach of making the shopping process quicker and more focused.

### **The Technological Environment**

- Online and mobile shopping is becoming increasingly popular (Butler, 2013), currently not offered by Aldi this may be a strategy that needs to be considered. This may also need to be enhanced with other technology led initiatives such as in-store media, self-checkout and access to Wifi.
- Technological infrastructures are a key component of the supply chain of the modern business, intelligent stock management and supply is key to success.
- Point of sale systems and checkout facilities are significantly different in larger stores, Aldi operates a traditional conveyor belt approach with

no options for self service. Enhanced service from competitors such as offering to pack up bags for consumers creates a different in store experience however the average time per person will increase.

### **Five Forces Analysis**

Within the grocery sector in the UK there is fierce competitive rivalry. A micro analysis is presented below:

#### **Threat of New Entrants – Low**

The threat of new entrants is relatively low due to the cost of entry and the competitive environments.

- The cost requirement for a new brand to establish itself in the market is high. Building a large retail estate network coupled with stock levels will take significant investment.

As Tesco enters a period of decline, due to what is widely considered unethical practice, bad financial management and abuse of power (Proud, 2015). This may lead to a decline in consumer favour leading to opportunities for merger and acquisition of the brand.

- Threat of Substitute Products – Medium / High By offering a narrow product range, Aldi remains agile to changing trends. Products can be changed quickly in the event of changing market trends.
- Aldi operates relatively small stores therefore limiting the number of products that can be offered. Substituted could therefore be offered by larger stores, with more space to offer an increased product range.



**The Bargaining Power of Suppliers – Low**

- Supermarkets have greater bargaining power than suppliers, often pushing for discounts and favourable terms due to the scale of buying power (Proud, 2015).
- Suppliers may favour larger orders from the bigger competitors, therefore are less willing to offer discounts and offers to the Aldi chain. However Aldi still operates a chain of 500 stores so has a degree of buying power in its own right. It also has the additional power to buy across multiple countries in order to get favourable terms.

**The Bargaining Power of Buyers – High**

- Buyers can make choices about which supermarket to use very easily based on offers, availability of items and ease of access.
- Aldi does not offer a loyalty scheme so there is no additional incentive to return week on week.

**Rivalry among Existing Firms – High**

- The sector is subject to intense rivalry with a focus on cost. Many brands offer to match prices of their competitors and undertake price comparison activities. This fierce rivalry leads to aggressive marketing campaigns with each player trying to win market share from the other. This increase competitive activity creates additional costs through advertising and marketing as well as leading to reduced prices (Linstead, Fulop and Lilley, 2004).
- Aldi operates on a low level of fixed costs in order to deliver lower priced products, with competitors also targeting this lower price point

this presents a risk to Aldi if they are not able or willing to invest in advertising to address such activity.

### **Conclusions**

Aldi operates in a highly competitive market place, both the macro and micro perspectives show challenging market conditions. Whilst new entrants are unlikely there is a clear need to explore changing customer buying trends and how interactive routes to market contribute to customer loyalty. With buying patterns moving towards 24 hour shopping, online marketing and self-service, consideration needs to be made around whether this needs to be included in Aldi's long term strategy.

The UK election in May 2015 presents the most immediate challenge, particularly if that results in a change of government and possible European referendum. Should the UK leave the EU this is likely to present Aldi with a financial challenge as well as imposing possible import restrictions for products. Equally, such a move could also see buying trends move towards British companies.

Aldi continues to thrive in the market, however a change in the disposable income of its customers may also change buying habits. Focus on retention of market share needs to be integrated into the strategic sustainability plans, particularly in the absence of any loyalty schemes. Continual development and alignment to its target market is critically important to maintain market share and ultimately survive.

Consideration needs to be made around what consumers want from their experience. By undertaking market research and focus groups Aldi will be

able to understand what is working and what may be useful to start to consider. In a world where change is the norm it should be expected that all businesses will have to adapt and become more agile to some degree.

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