Mercadona: Adapting the business model in years of recession[1]

Oriol Amat, UPF

Josep Francesc Valls, ESADE

Summary

Over recent years, Mercadona has consolidated a leading position in the food retail sector in Spain. Its business model is based on solid pillars: motivated employees, excellent process to deliver the highest quality at the lowest price, satisfied customers, satisfied society and generating shareholder value, all with a mind fixed on the long term. From 2007, with the onset of recession, this model has increased customer perception as central to all decisions and has been undergoing significant innovations that have enabled the company to continue to increase its market share. This case describes the main features of the business model where relevant measures have been implemented to address the recession. This is intended to expose a real case of a company that has managed to move forward, even in years of recession, thanks largely to the cost-cutting policies that have been accompanied by other measures related to employees, processes, suppliers and shareholders.

Key Words

Total quality, integrated suppliers, business model, selling prices, cost-reduction

[1] Published in *Revista de Contabilidad y Dirección* (Review of Accounting and Management), number 11 (2010). www.accid.org
The authors thank Mercadona and specially Oriol Montanyà, for the information provided.

1. Presentation

In 1977, the parents of Juan Roig, the current president of Mercadona, the company created under the Meat Group Roig. A few years later, in 1981, Juan Roig acquired the parent company. This purchase was made jointly with his wife Hortensia and his brothers Fernando, Trinidad and Amparo. At that time Mercadona had eight stores.

After more than two decades, it has managed to transform itself into the leading food distribution in Spain and the fifteenth world leader in its sector (Deloitte 2010). Today it is the second largest of its fastest growing sector globally, behind Wal-Mart.

Of the major milestones over the years the following are the highlights:

1982: First company to use bar code scanners in stores

1986: Implemented free customer card

1988: Inauguration of the first logistic center in Turia Riba-roja, it was the pioneer for having a fully automated system

1988: Acquired Superette Supermarkets, which had 22 stores in Valencia

1989: Acquired a distribution and development company for shopping malls, which gave presence in Madrid

1990: Juan Roig and his wife acquired majority of the capital

1991: Acquired Dinos and Super Aguilar

1991: Began to exchange electronic data

1993: Implemented strategy, 'Always Low Prices' (SPB), which later resulted in the Total Quality Model

1996: Created the following brands: Bosque Verde, Hacendado, Deliplus y Compy

1996: First agreement was signed between company and all employees

1998: Acquired Paquer stores and Vilaro supermarkets in Catalunya

1999: All company employees have permanent contracts

2000: First integrated meeting

2001: First free child daycare for employees

2003: First company to make an ethical audit

2004: Steering Committee posed all stores closed for Sunday's

2007: Ranked world's fourth most valued company for corporate reputation

2008: Realigned Total Quality Model

2009: Back to the simplicity for maximum quality with minimal prices. Signed new agreement with the Unions 'Equity Plan Agreement' for 2010-2013

In 2009, Mercadona reached 62,000 employees with a turnover of 15.505 million Euros and 270 million Euros in net profit (see Figure 1). The spectacular growth has been mostly achieved organically. That is, increasing the opening of new stores and increasing sales per square feet in existing stores. In recent years it increased selling area at a constant 8% per year.

	1995	**2000**	**2005**	**2006**	**2007**	**2008**	**2009**
Sales (Million of Euros)	1.340	3.366	10.338	11.158	13.986	15.379	15.505
Profits (Millions of Euros)	7	52	183	241	336	320	270
Number of stores	200	493	960	1050	1137	1210	1264

Figure 1. Mercadona sales and profit evolution from 1995 to 2009.

2. The business model

A business model is a set of choices made by the company and the consequences created by this elections. The elections are mainly for human resources, core competencies, processes (value proposition, value chain, distribution channel, revenue model and cost) and target customers.

The overall objective of Mercadona is to satisfy all customer needs for food, housekeeping, personal hygiene and pet care. If we sum up, we can identify one of the distinguishing aspects of the company as it aims to satisfy all stakeholders: customers, employees, suppliers, society and shareholders. As Juan Roig said, *"For us to be satisfied, we have to satisfy others*". This objective will be displayed with slogans such as *"permanent employees, fixed providers and regular customers*". Supporting this statement we can find a business model with significant characteristics of its customer orientation.

2.1. All about the people

To achieve the commitment, satisfaction and motivation, of people working in the company, Mercadona has higher average wages, investments in training staff higher than its competitors (609 Euros per employee in 2009), all employees have permanent contracts with a bonus-incentive system. In 2009, it distributed 200 million Euros among its employees. Wages are based on four sections and have a fixed and a variable part based on experience, responsibility and performance. When an employee starts working with Mercadona they take a six-week course of staff training. This helps to encourage the staff to work harder for promotions. In 2009, 793 employees were promoted. All managers are the result of internal promotion. Another peculiarity of its human resource policy is that it focuses on the balance of personal and family life with work. In this sense, it wants its employees to work close to home and therefore offers five months of maternity leave instead of four, which is the law. Another example of this policy is that, as a rule, the stores are not opened on Sundays. Mercadona also offers its employees up to 86 combinations of hourly schedules.

2.2. Excellence in processes to achieve the highest quality at the lowest price

In the late eighties, the competitors based their strategy on the supply of certain products, with strong advertising support; they were encouraging customers to shop at their stores and in addition to those offered products, the rest of the basket purchase. Mercadona tried a similar strategy however it didn't work. Therefore, in 1993 it began its policy of '*Always low prices without reducing the quality'*, it removed its advertising and did the same promotions and offers to maintain a minimum unit price throughout the year. The aim is for consumers to be aware that at Mercadona they can always find the best prices available, regardless of the month, day or product of choice. The competitive advantage achieved through a determined policy to support the products offered are a better money value regardless of who is the manufacturer. Thus, replacing tough negotiations with suppliers in order to lower costs with long-term contracts and commitment to the integrated suppliers, which are 103 companies where it maintains relations with long term positive agreements. It is a win-win situation in order to offer private label products (Hacendado, Bosque Verde, Deliplus and Compy). Between the company and the integrated suppliers the books are always opened in order to permit transparency in processes, margins and information on investment risks. Mercadona's strategic alliance brings the boss know-how together with threshold prices, sales volume, quality of the set, etc. and integrated suppliers knowledge about the product, continuous improvement and operations excellence. To achieve total quality Mercadona controls the quality assurance on all products from the suppliers. These branded products are substantially different from the traditional white label, as they are the products where the customer can visualize Mercadona brand and also the vendor who manufacturers most of the leading brands. Another feature of the integrated supplier is that the relationship is based on mutual trust as it seeks to establish a relationship *"for life".* They are companies that can meet several specific requirements:

- Owners must have 'passion' for what they do
- Must be leaders in their respective areas (Examples: Casa Tarradellas, Conservas Escuris, Grupo Siro, RNB which are market leaders in Spain)
- Must be prepared to make continuous improvements in accordance with customer needs
- Produce the highest quality items at the lowest price
- Share a similar business model as Mercadona concerning quality

Logistically, Mercadona uses outsourced transportation, as it does not offer their own transportation.

Mercadona has always been distinguished by its innovative lower costs while maintaining and or improving quality. Some examples are: switching fruit into bulk packaging, offering sliced ham, meat trays instead of meat counters, plastic lids in exchange for easy open cans, electronic invoicing and improving store environment. It has also introduced innovative products such as sausage without casing, individual pastry packaging, tea packets without the staples, gluten free ice-cream, bread without preservatives, vacuum-packed frozen seafood without shells.

In 2010, various brands of Mercadona have been present in most product categories, which represent a 38% market share within its own stores. That is at the same level as manufactured brands.

2.3. The boss satisfied

In Mercadona the boss is the client for which, you have to get the *"highest quality, maximum range, maximum service, minimal budget and minimal time".* One of the keys to success is to continually listen to the customer (opinion surveys, meetings with neighbours to learn where new stores have opened, open houses, suggestion boxes in supermarkets). Customer Service has more than 70 people that serve over 500,000 customers per year. Mecadona complaints are perceived as opportunities for improvement and have been organized through 1,800 meetings, which involved more than 100,000 homes to showcase products and receive suggestions. According to the 2009 STIGA Index, Mercadona was ranked number one in customer satisfaction.

Mercadona does not appear to the client as a simple supplier but as a prescriber to the total purchase (total distributor). It is not just selecting a range of products to put on the shelf but the company prescribes global purchasing and ensures a guarantee on both price and quality. According to a Mercadona survey, the reasons to choose Mercadona are mainly the following: Value for money (82.8%), Location (79.2%), Having quality products (71.5%), Brand-quality (62.7%) and Always good prices (61.6%).

2.4. Corporate Social Responsibility

According to the New York Reputation Institute, Mercadona is the ninth company in the world for Corporate Social Responsibility (CSR). This type of consideration is not coincidental since it was the first Spanish company to have an ethics audit in 2003. It has had various policies, such as '*Silent Night*' in order to reduce complaints from neighbours from loud noises, from 2007 to 2009 complaints from residents reduced from 1008 to 418 per year.

2.5. Satisfied shareholders

As a company for profits, Mercadona could not be successful if the above actions were not accompanied by an adequate level of profitability. 2009 was a difficult year because of the economic crisis, but its financial profitability (Net profit/Equity) amounted to 16.7% which was very good. Despite the benefits achieved, the level of dividends has always been very prudent since most resources generated were intended to be self-financed, which allowed the company to capitalize sufficiently.

The business model is summarized in Figure 2. At the base are the aspects of Human Resources, then Processes, Customer and Finance. In this figure we can identify Mecadona's strategic map with the key success factors where the arrows express the cause and effect relationship between these various factors.

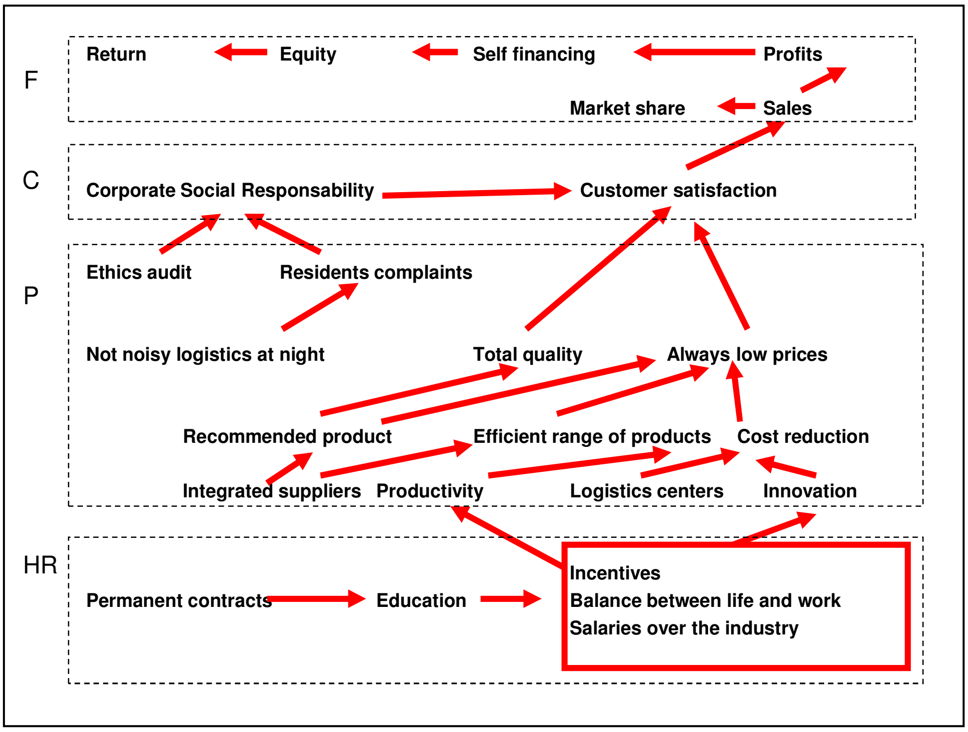

Figure 2. Abstract of the Mercadona business model divided into Human Ressources, Processes, Customers and Finance

3. Measures taken to achieve progress in the years of recession

In late 2007 Mercadona began to feel the effect of the global financial and economic crisis which in 2010 continues affecting the business environment. The critical point was that customers could keep buying the same, with the same level of quality, despite having a smaller budget. The paradigm was achieving that customers were keeping the same consumption rate, suppliers maintaining the same gross margins, worker upholding their jobs and or positions and investors continuing with their capital investments. At this time, the company began working on the realignment process. They had to sell more units and therefore they increased the number of customers needed. To cope with the new environment, from 2008 to 2010, Mercadona had taken more than 600 measures to cut costs. This can be classified into the following types:

- Improvement in internal processes: Meetings were held with all 103 integrated suppliers and most of the rest of 2000 suppliers in order to identify improvements. Among which the elimination of everything that costs money and does not provide value to the process or product and increases the price to the customer. These enhancements affect packing, packaging, product design, transportation, etc. Examples of savings can include: Container of milk without glossy paper (2.6 million Euros in savings per year), shower gel packaging with less plastic (250,000 Euros in savings per year), containers and cans without screens (1,500,000 Euros in savings per year), printed information leaflet inside the package (200,000 Euros in savings per year), reduction of air in cereal packets and nuts (900,000 Euros in savings per year), elimination of trays and fixed weight in fruit and vegetables (175 million Euros in savings per year), improvements in the stack of broths and soups, lower ceilings in stores to save energy.

To reduce logistic costs, it has eight logistic centers and two satellite warehouses scattered throughout the Spanish territory and promotes the integrated suppliers to install their factories close to those blocks. This measures, which has meant back-to-basics, has saved 10 million Euros a year.

- Set rationalization: To increase productivity, they have analyzed the brands that were in the stores and found that in some cases there were to many brands (115 fruit juices, 250 dairy desserts, 18 oven mitts). Therefore, the number of brands decreased from 9,000 to 8,000. This has generated some controversy since 1000 brands have been removed. This has caused the loss of some customers and that several competitors have responded with favorable agreements with suppliers for Mercadona discarded. The company justifies this by saying that in Spain there are over a million brands, but with the 8,000 selected will amply cover the needs of its customers, saving time and improving productivity.
- Reduced Prices: Seeks to implement quickly and cost reductions agile (both processed and raw materials) to the final price of the product.
- Less benefits: To further lowering the final prices for products, it reduced its net income by 16%, half the previous year.

With all the measures in 2009, it achieved lower costs by 10% (i.e. 1500 Million Euros), increasing productivity by 3%, reflected in lower selling prices and increased market share which means an average increase of about 100,000 new customers per day, 80 per store. Since the economic crisis began in 2007, the company has increased its number of customers. In 2010, more than 4.3 million households are customers of Mercadona. Figure 3 accompanies the profit and loss accounts of Mercadona for the last three years and also those of several competitors.

The companies that are struggling usually have two common features. On the one hand, their business model is obsolete, yet on the other, they have followed a financial policy where they paid risky dividends with little excess capital injections from its shareholders. The economic crisis creates difficult situations for many companies, but there are companies that move like Mercadona based on continuous innovations to lower costs and also maintain a conservative financial structure.

4. Conclusion

In short, the leadership of Mercadona is based on solid pillars: motivated employees, excellent processes in order to deliver the highest quality products at the lowest prices, satisfied customers, satisfied society and creating value for its shareholders.

In a period of great difficulty, Mercadona has managed to grow and generate financial and social wealth. The work force has been maintained and there was an increase of 500 employees in 2009. The Management is not confused and is characterized by innovation in achieving cost reduction with the highest quality, continue to invest in human resource issues (training, incentives), reduction of benefits to lower selling prices more and strengthen long-term relations with suppliers. These policies favor a winning business model. Another feature of Mercadona is that it is conservative with its finances, it funds most of its investments with contributions from the shareholders or the resources generated by it.

Looking ahead, the challenges are to maintain leadership and continue to innovate to keep customer love and move opposite of what competitors do. For example, companies such as Bon Preu have reacted to the reduction of Mercadona suppliers to the extent of increasing the number of brands for clients so they have more choices. Other companies such as Carrefour and Alcampo have initiated major advertising campaigns in order to convince customers that their price targets are lower than those of Mercadona. Eroski and Caprabo have continued using competitive intelligence as to derive the most information about its customers to increase loyalty. Another challenge is the internationalization of Mercadona. To do this, it will be essential to continue working as hard as usual and think what customers like as they go, if you lose the competitive advantage. In fact Mercadona's motto for 2010 was *"Chasing the cent".*

References

ACCID (2006): "Nuevas tendencias en control y contabilidad de gestión", *Revista de Contabilidad y Dirección*, Asociación Catalana de Contabilidad y Dirección, Barcelona.

ACCID (2008): "Innovación", *Revista de Contabilidad y Dirección*, Asociación Catalana de Contabilidad y Dirección, Barcelona.

Blanco, M. y Gutiérrez, S. (2008): "El empleo del modelo de gestión de la calidad total en el sector de la distribución comercial en España: El caso de Mercadona", *Universia Business Review*, First Quarter 2008, p. 40-63.

Deloitte (2010) : *«Global Powers of Retailing 2010 »,* http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Consumer%20Business/dtt_globalpowersofretailing2010.pdf

Magretta, J. (2002): "Why business models matter", *Harvard Business Review*, May.

Mercadona: Annual accounts for the years 2005 to 2009.

Ricart, J.E. (2007): *"Competing through business models",* IESE Business School, Barcelona.

Rocafort, A. (2008): *"Contabilidad de costes",* Profit Editorial, Barcelona.

Valls, J.F. (2010): *"Reinventar el negocio para vender más barato",* Profit Editorial, Barcelona.

	Mercadona			LIDL			Bon Preu			Dia	
	2009	**2008**	**2007**	**2009**	**2008**	**2007**	**2009**	**2008**	**2007**	**2008**	**2007**
Sales	99,82%	99,83%	99,82%	99,50%	99,52%	99,59%	91,41%	91,17%	91,46%	90,75%	91,59%
+ Other Operating Income	0,18%	0,17%	0,18%	0,50%	0,48%	0,41%	8,59%	8,83%	8,54%	9,25%	8,41%
Operating Revenue	**100,00 %**	**100,00%**	**100,00 %**	**100,00 %**	**100,00 %**	**100,00 %**	**100,00 %**	**100,00 %**	**100,00 %**	**100,00 %**	**100,00 %**
Operating Expenses	75,93%	75,59%	74,95%	77,02%	77,77%	78,71%	75,04%	75,39%	77,08%	78,41%	75,21%
Gross Margin	24,07%	24,41%	25,05%	22,98%	22,23%	21,29%	24,96%	24,61%	22,92%	21,59%	24,79%
-Other Operating Expenses	6,52%	6,35%	6,32%	9,78%	9,86%	9,02%	9,41%	9,43%	9,26%	7,81%	9,98%
Value Added	**17,55%**	**18,06%**	**18,73%**	**13,20%**	**12,37%**	**12,27%**	**15,55%**	**15,18%**	**13,66%**	**13,78%**	**14,80%**
-Staff Costs	12,53%	12,21%	12,20%	8,29%	8,14%	7,88%	11,10%	10,68%	10,42%	9,15%	9,34%
-Depreciation and Amortization	2,41%	2,70%	3,00%	2,07%	2,31%	2,07%	2,18%	3,28%	2,57%	2,29%	2,49%
-Impairment of assets	0,04%	0,14%	0,00%	0,28%	0,00%	0,03%	0,00%	0,00%	0,00%	0,03%	-0,05%
Earnings Before Interest and Tax (EBIT)	**2,56%**	**3,01%**	**3,53%**	**2,55%**	**1,92%**	**2,29%**	**2,27%**	**1,22%**	**0,68%**	**2,32%**	**3,02%**
+Financial Income	0,15%	0,36%	0,29%	0,41%	0,31%	0,37%	1,04%	1,10%	1,13%	1,18%	1,45%
-Financial Expenses	0,17%	0,20%	0,20%	1,54%	1,13%	0,98%	0,35%	0,24%	0,19%	0,16%	0,10%
Ordinary Profit Before Tax	**2,54%**	**3,17%**	**3,62%**	**1,42%**	**1,10%**	**1,69%**	**2,95%**	**2,07%**	**1,62%**	**3,34%**	**4,37%**
-Extraordinary Results	0,05%	0,06%	0,00%	-0,05%	0,09%	0,03%	-0,10%	-0,01%	0,35%	1,60%	-1,31%
Profit Before Tax	**2,50%**	**3,11%**	**3,62%**	**1,37%**	**1,19%**	**1,72%**	**2,86%**	**2,06%**	**1,96%**	**4,94%**	**3,06%**
-Corporate Tax	0,62%	0,86%	1,04%	0,43%	0,42%	0,66%	0,84%	0,67%	0,68%	1,18%	0,38%
Profit for the year	**1,87%**	**2,25%**	**2,58%**	**0,95%**	**0,77%**	**1,06%**	**2,02%**	**1,40%**	**1,28%**	**3,76%**	**2,68%**

Figure 4. Profit and Loss accounts of Mercadona, LIDL, Bon Preu and Dia. Data in percentage of operating revenues. Source: Based SABI