How should Aldi strengthen their position in the U.S. market?

Case Study: Aldi

30th Oct 2017
Zürich, Switzerland
Our Problem Statement
How should Aldi strengthen their position in the U.S. market?

Fierce competition in U.S. retailer industry

Which segment of the retailer industry should Aldi focus on for their expansion?

How should Aldi compete in the U.S. market?
Presentation Overview

1. Introduction: U.S. Retail Industry
2. Grocery Store Industry
   a. KPIs and key characteristics
   b. Porter's 5 Forces
   c. Industry Overview
3. Department Store Industry
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   b. Aldi SWOT Analysis
6. Recommendation
   a. Strengthen Grocery Store Presence
   b. Store Location
   c. Online Presence
   d. Organic Food Line
   e. U.S. Customer Behavior
7. Summary
Retail Industry Analysis

Introduction: U.S. Retail Industry

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Introduction to Retail Industry in the U.S.
Definition and performance

The retail industry is a sector of the economy that is comprised of individuals and companies engaged in the selling of finished products to end consumers.

U.S. retail industry features the largest number of large, lucrative retailers in the world. In 2016, U.S. retail sales reached $4952.63 billions, 20.8% of worldwide retail sales.

Retail Industry Segments

**Grocery store**
- ALDI
- LIDL

**Department store**
- JO-ANN
- Sears

**Supercenter**
- Walmart Supercenter
- Costco

**E-tailers**
- Amazon
- eBay
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Retail industry performance by segment in the U.S., 2015

- Profit margin: 1.5%
- Annual growth: 1.3%

**Profit margin**

- Big-Box & Department Store Retailers
- Warehouse Club & Supercenter Retailers
- Supermarkets & Grocery Stores
- E-tailers

**Annual growth**

- Big-Box & Department Store Retailers
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**Profit margin: 5.5%**
**Annual growth: 3.5%**

### Retail Industry Market Shares by Segment in the U.S., 2015

- **Warehouse Club & Supercenter:** 9.7%
- **Supermarkets & Grocery Stores:** 12.2%
- **Others:** 68.4%
- **E-tailers:** 6.2%
- **Big-Box & Department Store:** 3.5%

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**Profit margin: 5.5%**
**Annual growth: 3.5%**

### Retail Industry Performance by Segment in the U.S., 2015

- **Big-Box & Department Store Retailers**
- **Warehouse Club & Supercenter Retailers**
- **Supermarkets & Grocery Stores**
- **E-tailers**

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*Strategic Management Course
Aldi case study: The Dark Horse Discount*
Grocery Store Industry Analysis

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Grocery Industry in the U.S.

Grocery store is a retail store that primarily sells food

Grocery stores in the U.S. accounted for 90% of the country's food and beverage store sales.

<table>
<thead>
<tr>
<th>Major product segmentation(2015)</th>
</tr>
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<tbody>
<tr>
<td>Fresh &amp; frozen meat 8.4%</td>
</tr>
<tr>
<td>Other non-food items 11.3%</td>
</tr>
<tr>
<td>Frozen foods 11.4%</td>
</tr>
<tr>
<td>Dairy products 12.1%</td>
</tr>
<tr>
<td>Beverages (including alcohol) 19.1%</td>
</tr>
<tr>
<td>Fruit &amp; vegetables 2.2%</td>
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<td>Drugs &amp; health products 3.1%</td>
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The grocery industry is mature.
- Annual revenue: 584.3 billion
- Profit margin: 1.5%
- Annual growth: 1.3%
- Stores number: 65,000
- Employee number: 3.4

The grocery industry is fragmented:
The overwhelming majority of these retailers are small businesses.

In the Future, the grocery industry will be consolidated:
Driven by merger and acquisition activity among the leading operators.

Top four players’ sales of the total grocery industry has increased from 17% in 1992 to around 31% in 2015.

Top four players:
- (31%) The Kroger Co.
- (15.4%) Safeway
- (6.6%) Publix Super
- (5.5%) Delhaize America LLC.

Main players:
- (69%) Small- to medium-sized local market operators.

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Grocery Industry in the U.S.
Porter’s Five Forces

**Threats of New Entrants**
- Low barrier to entry
  - No license required
  - Low taxes, low initial investment
- New entrants lack competitiveness
  - Life cycle stage (mature)
  - Consolidation of market

**Intensity of Competitive Rivalry**
- e.g. The Kroger Co
- Safeway Inc

- Low market concentration.
- Low diversity of competitors.
- Homogeneous products.

→ **Fierce competition**
→ **Price war**

**Threats of Substitutes**
- Internal substitute: healthier food
  - Local farmers
  - Natural and organic food
- External substitute: cheaper, convenience
  - Warehouse clubs, supercenters
  - One-stop-shop

**Bargaining Power of Suppliers**
- Low bargaining power of suppliers
  - High switching cost of suppliers
  - Agriculture market is fragmented
  - Expanding supply chain

**Bargaining Power of Buyers**
- High customer bargaining power
  - Low switching cost of customers
  - Well informed about the product
  - Price sensitive
Grocery Industry in the U.S.
Current Trends and Key Takeaways

Supermarkets & Grocery Store Retailer Revenue Growth

Segment revenue: with an annual rate of 0.8%
Segment profitability: with increasing promotional activity
New entrants growth: with an annual rate of 0.1%
M&A activity: to gain economies of scale.

Retail Trends

Average supermarket square feet
Natural and organic foods:
- 7.9% increase from 2015 to 2016
- 8000 local farms in the USA
- 50% Americans intend to eat healthier
Local food: 53% Americans seek out locally grown foods
Online shopping: 4.5% annual growth

Source:
Infographic of the Week: Organic Food & Beverage Sales Reach $29.2 Billion in 2011 Available at: https://foodtechconnect.com/2012/05/07/infographic-organic-food-beverages-reaches-29-2-billion-in-2011
Challenges of Grocery Industry

- **Supercenters**: They are expanding grocery offerings, becoming one-stop shops. → **Convenience**
- **Grocery stores & discount stores**: PRICE SENSITIVE customers shop locally and in small amounts → **Low price**
Department Store Industry Analysis

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Department Store Industry

Current Situation

Department store market share fell to 35% (2015) from 45% (2007) worldwide.

US department store sales have been declining for over 10 years, in total and as a percentage of total retail.

**Definition:** A retail establishment offering a wide range of consumer goods in different product categories known as “departments”.


- No. of Employees: 1.7 mn (2002) → 1.3mn (2016)*
- Key players: Target, Nordstrom, Sears, J.C Penny, Walmart


*Equity research, Credit Suisse, 2017


*U.S. Bureau of Labor Statistics
Department Store Industry
Porter’s Five Forces

Threats of New Entrants
- High entrance barriers:
  - capital requirements (huge stores)
  - incumbent advantages (experience, positioning, brand)
  - product differentiation

Intensity of Competitive Rivalry
e.g. Walmart, Sears, JC Penney

Price pressure since:
- high fixed costs
- low switching costs
- rivals are big players

Threats of Substitutes
- Substitutes:
  - online shopping (low switching costs, attractive price-performance trade-off)
  - supercenters

Bargaining Power of Suppliers
- Power of suppliers increases:
  - many players are leaving → harder to make deals with fair prices

Bargaining Power of Buyers
- Increasing bargaining power:
  - low switching costs
  - consumers more price sensitive since recession

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Aldi case study: The Dark Horse Discount

Group A2: X. Li, T. Tseng, H. Xu, X.Y. Yang, X.C. Yang
30.10.2017
Department Store Industry
Current Trends and Key Takeaways

Segment profitability

- still positive, thanks to cuts in expenses (workforce, stores)
- eroded by fast fashion, discounters and online shopping (high product overlap)

Trends

- Recession has decreased discretionary spending (not essential)
- Department stores have reduced size and opened outlet versions
Department Store Industry

Dynamics

Department Stores
- Profitability +
- Growth --

Supercenters
- Profitability ++
- Growth ++

Sears
JC Penney
Kohl's

Walmart
Target

How department stores are adapting
- expanding grocery offerings (becoming supercenters)
- ones with more differentiated brands fare better
- improve online stores
- reduce real estate
- supply chain efficiency

30.10.2017

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## Grocery vs. Department stores

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### Five forces

| Competitive rivalry | Intensifying competition → price war | High fixed costs → price pressure |
| Threats of entrants | Low barriers but lack competitiveness | High barriers → no entrants |
| Threats of substitutes | Internal → healthier | Supercenters, e-tailers |
| | external → cheaper | |

### Conclusion

- **Grocery Store**: Stagnant growth and profitability, require cheaper and healthier foods
- **Department Store**: Decreasing revenues, customers migrate to supercenters and e-tailers
Grocery vs. Department stores

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| Threats of entrants | Low barriers but lack competitiveness                                         | High barriers → no entrants                                                        |
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Conclusion

- Stagnant growth and profitability, require cheaper and healthier foods
- Decreasing revenues, customers migrate to supercenters and e-tailers

More attractive market
Aldi

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Aldi Culture & Operations

**Culture**
- Frugality
  - Secrecy, low profile
  - Offer products, not services
  - Goal: sustained growth → small wins count

**Operations**
- Cost Leadership
- Small Variety
- Cross-trained Employees
- Low Operation Costs
- Low Advertisement
- High Customer Involvement
- Small but growing market share (U.S.)
- Growing Revenue (U.S.)

Aldi Case Study: The Dark Horse Discount

Group A2: X. Li, T. Tseng, H. Xu, X.Y. Yang, X.C. Yang

30.10.2017
Aldi in the U.S.
No. of Stores and Geographical Coverage in US

Market Share (Grocery, May 2017)
Aldi: 1.5 %
Walmart: 22 %

Sales Growth (Grocery, May 2017)
Aldi: 15 %
Walmart: 2 %

Ranking (Global retailers, 2012)
Aldi: 8th
Walmart: 1st

Competitive Advantage
Aldi: Cost leadership
Walmart: Always low prices

*Data extracted from Aldi study case
Aldi SWOT Analysis

STRENGTHS (+)
- High quality products
- Majorly private-labeled goods: 95% of portfolio
- Low prices: 20% cheaper than Walmart, 2013
- Value for money: 80% of price is purchase price

WEAKNESSES (-)
- Limited product portfolio: 1,400 SKUs per 17,000 square foot store
- Low brand recognition
- Low level of customer service

OPPORTUNITIES (+)
- Geographical expansion: 80 to 130 stores per year
- Organic food: 82% of households will buy
- Online shopping

THREATS (-)
- Intense competition: price war
- Substitutes: supercenters, warehouse clubs
- New entrants: Lidl
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**Recommendation**

Avoid Department Store Segment, Focus on Groceries

**No Department Stores !**
- Differentiation through exclusive brands goes against Aldi culture and competitive strategy
- High service level and costly operations against Aldi culture
- High product overlap with online retailers
- High investment

**Department Stores**
- Profitability +
- Growth --

**Strengthen Grocery Stores**
- Aldi has know-how and experience in grocery store and loyal suppliers
- REAL cost leader in grocery market
- Online retailers lesser threat to grocery stores
- Many growth options: e.g. organic food

**Grocery Stores**
- Profitability +
- Growth +

**Why Not Supercenters?**
- Extremely high investment, no experience
- Vulnerable to e-tailers
- Can only be supported by high demands
- Aldi’s target: low budget, price sensitive customers

**Supercenters**
- Profitability ++
- Growth ++
Recommendation

Dynamics

Supercenters
- Profitability ++
- Growth ++

Department Stores
- Profitability +
- Growth --

Grocery Stores
- Profitability +
- Growth +

"Convenient" customers

Price sensitive customers

Remain Here!
Recommendation
Location of Stores

"Poor, rural areas will be most affected by Walmart closing stores"

Lessons to Learn

- Walmart could not compete with dollar stores (low income)
- Supercenters were too big (low density)


Consumer trends

Low income / price sensitive consumers shop **locally** (high gas prices) and **often rather than big**.
Recommendation

Location of Stores

Crack Well-guarded Markets

Crack Well-guarded Markets: Attack Weak Spots, than Strongholds

1. **Leverage assets**
2. **Reconfigure value chain**
3. **Undersupplied niche market**

Solution

1. **Aldi is cheaper than dollar stores** (Dollar General)
2. **Tackle low income, both high and low density areas** as long as demand is sufficient

Gradually target mainstream markets: **Walmart neighborhood stores** (urban areas, high density)

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Recommendation
Seek opportunity of online-retail in the long-term

In the short run
No fully online shopping:
- Less vulnerable to e-tailers:
  online sales = 4.6% of total grocery sales (2014).
- E-commerce is not well suited:
  low price-to-weight ratio, hard to keep fresh.
- Cooperate with 3rd party delivery
  Test 1 hour food delivery in three city as the 1st step.

Current digital solution: mobile coupons, mobile shopping list.

In the long run
Online shopping:
- Big profitability and high growth potential in the market
- Future trend: Millennials has affinity to use E-commerce

Future digital solution: search feasible online operation model.
  e.g. home delivery, in-store pickup, drive-through pickup.

The Kroger Co.: From Corner Store to Supermarket Giant Available at http://marketrealist.com/2015/10/online-grocery-retail-a-future-sales-driver-for-kroger/
Recommendation
Extend organic products line

Preference towards organic food in the U.S.

- 82% households purchase organic products
- 5.3% of food sale is organic, grow at a rate of 7.9%.
- 25% of American population is millennials, who have strong affinity for organic food.

Aldi’s position in organic product line

- 25% cheaper and high quality organic food since 2013.
- >72 USDA certificated organic food items at Aldi.
- On the way to go full organic.

Solution

- Advertise on social media: promote Aldi organic brands.
- Cooperate with local farms: improve organic food line.
- Noticeable organic labeling and layout
- Keep low price competitive advantage

Source: News:
Recommendation
Adapt to U.S. customer behavior

- Extend Opening Hours
- Expand Product Portfolio (eg. by 5%)
- Focus on Private Labels
- Make Carts Coin-free

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Summary

- **Department Store** Industry has stable positive profit and negative growth, with competition issues.
- **Grocery Store** Industry is mature and has stable profit.
- In general, grocery store industry is more attractive. However, some changes have to be made to achieve sustained growth.

+ Operations efficiency, cost leadership and high quality private-label goods
- Low technology inclination, lack of service dimension, relatively small player

Recommendations for Aldi in US

- Forget DS, focus on groceries
- Corporate & enhance organic food line
- Adapt to U.S. customer behavior
  - Open new stores & Tackle price sensitive customers
  - Test food delivery with 3rd party
  - Seek opportunity of fully online-retail
References

Thank you for your attention!

Strategic Management Course
Case Study: Aldi

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Tseng, Thomas
Xu, Hong
Yang, Xingyu
Yang, Xuechun

30th Oct 2017
Zurich, Switzerland
Appendix
Grocery Industry in the U.S.
Porter’s Five Forces

**Threats of New Entrants**
- Concentration
- Pre-existing relation
- Technology Change
- Life Cycle Stage (Mature)
- Regulation Policy
- Capital Requirement

Barrier to entry is relatively low, but have to face enormous competitors followed.

**Bargaining Power of Suppliers**
- Suppliers switching costs relative to firm switching costs is high due to loss of volume and profitability.
- Suppliers concentration to firms concentration ratio is high due to the emerging substitute inputs.
- Emerging new distribution channels make suppliers’ bargaining power higher.

**Intensity of Competitive Rivalry**
- Low market concentration.
- Low diversity of competitors.
  → Fierce competition

Homogeneous products.
- Low demand for advertisement.
- High information transparency.
  → Price war

**Threats of Substitutes**
- Internal Substitutes: Organic, Natural foods
- External Substitutes: Warehouse Clubs, Supercenters

Buyers’ propensity to substitute:
- Higher per capita disposable income, Stronger concern towards health issue, Lower Switching cost

- Specialized in organic or natural foods and one-stop-shop will become powerful competitors

**Bargaining Power of Buyers**
- Customers are loyal to Wal-Mart private label because of their great effort in product development, sourcing, technology and new talent.
- Food retail consolidation —lower bargaining power of buyers.
- Buyer switching costs mainly depend on the transportation fee and time.
Department Store Industry

Porter’s Five Forces

Threats of New Entrants

- high entrance barriers:
  - capital requirements: department stores need huge locations and infrastructure. Initial investment is very high
  - incumbent advantages (experience, positioning, brand)
  - product differentiation: entrants would have to match differentiation of incumbents to be competitive

- many players are leaving, power of suppliers increases, making deals with fair prices harder

Threats of Substitutes

- online shopping (low switching costs, attractive price-performance trade-off)
- Supercenters include all departments of department stores with additional advantage of groceries

- buyers have low switching costs to online shopping or supercenters
- trend: become more price sensitive due to crisis (groceries represent bigger slice of income)

Bargaining Power of Suppliers

Intensity of Competitive Rivalry
e.g. Walmart, Sears, JC Penney
price pressure since:
- high fixed costs
- low switching costs
- rivals are big players

Bargaining Power of Buyers
### Grocery Industry

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<td>✤ Mature industry ←→ Economies of Scale ←→ M&amp;A activities</td>
<td>✤ Specialized in organic and natural foods ←→ higher premium</td>
<td>✤ Intensifying competition from alternative competitors: warehouse, supercenters</td>
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<td>✤ $600 B market ←→ Steady growth around 1%</td>
<td>✤ Investment in promoting private labels ←→ consumers loyalty</td>
<td>✤ Increasing of a variety of retailers: price wars result in stagnating profitability</td>
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<td>✤ Low profit margin ←→ Stable around 1.5%</td>
<td>✤ Investment in online service ←→ changing purchasing method</td>
<td>✤ Harder to negotiate with suppliers due to increase of stores</td>
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<td>✤ Pre-existing trust and loyalty between suppliers and stores</td>
<td>✤ Investment in R&amp;D ←→ technology reduces fixed cost and waiting time</td>
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<td>Intensity of competitive rivalry</td>
<td>High → price war</td>
<td>High</td>
</tr>
<tr>
<td>Threats of new entrants</td>
<td>High → but with low competition power</td>
<td>Low</td>
</tr>
<tr>
<td>Threats of substitute</td>
<td>High → Specialized stores, one-stop-shop, local farmers</td>
<td>High → online stores, specialized retail</td>
</tr>
<tr>
<td>Bargaining power of supplier</td>
<td>Low → high switching cost and concentration</td>
<td></td>
</tr>
<tr>
<td>Bargaining power of buyers</td>
<td>Low → customer loyalty and food retail consolidation</td>
<td>Low switching costs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Price sensitive</td>
</tr>
<tr>
<td>Market opportunity</td>
<td>Many: organic food, private label, online store</td>
<td></td>
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</tbody>
</table>
Aldi SWOT Analysis

**STRENGTHS (+)**

- High quality products (14 of 21 products equal or better than national brands)
- Majorly private-labeled goods (95% of portfolio)
- Low prices (20% cheaper than Walmart, 2013)
- Customer ranking (4th best grocery store in the U.S.)
- Operations efficiency → value for money (80% of customer price is purchase price)

**WEAKNESSES (-)**

- Limited product portfolio (essentials) (about 1,400 SKUs per 17,000 square foot store)
- Low brand recognition
- Online presence
- Low IT investment (scanners installed 20 years after Walmart)
- Low level of customer service (a coin for shopping carts deposited and returned)

**EXTERNAL**

- Geographical expansion (80 to 130 stores per year, from coast to coast)
- Organic food (82% of households)
- Online market
  - New technology: self-checkout
  - Strengthening economy

**OPPORTUNITIES (+)**

- Intense competition → price war
- Substitutes → supercenters, warehouse clubs
- New entrants → e.g. Lidl

**THREATS (-)**

- Operations efficiency → value for money (80% of customer price is purchase price)
## Segments overview

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</thead>
<tbody>
<tr>
<td>Big-Box &amp; Department Store Retailers</td>
<td>$166.1</td>
<td>$4.8</td>
<td>- 4.1%</td>
<td>-1.4%</td>
<td>72</td>
<td>$19.5</td>
</tr>
<tr>
<td>Warehouse Club &amp; Supercenter Retailers</td>
<td>462</td>
<td>25.4</td>
<td>3.5%</td>
<td>2.1%</td>
<td>27</td>
<td>40</td>
</tr>
<tr>
<td>Supermarkets &amp; Grocery Stores</td>
<td>584.3</td>
<td>8.8</td>
<td>1.3%</td>
<td>0.8%</td>
<td>42,036</td>
<td>56.7</td>
</tr>
<tr>
<td>E-tailers</td>
<td>297.9</td>
<td>21.2</td>
<td>10.3%</td>
<td>5.9%</td>
<td>131,447</td>
<td>18.5</td>
</tr>
</tbody>
</table>
Segments overview

- **Maturity**: Company consolidations; level of economic importance stable
  - High growth in economic importance; weaker companies close down; developed technology and markets

- **Quality Growth**: Many new companies; minor growth in economic importance; substantial technology change
  - High growth in economic importance; weaker companies close down; developed technology and markets

- **Quantity Growth**: High growth in economic importance; weaker companies close down; developed technology and markets
  - Many new companies; minor growth in economic importance; substantial technology change

- **Decline**: Shrinking economic importance
  - High growth in economic importance; weaker companies close down; developed technology and markets
Segments overview

Products and Services Segmentation (2015)

- Children's clothing & footwear: 7.2%
- Men's clothing and footwear: 12.1%
- Drugs & cosmetics: 14.1%
- Fresh & frozen meat: 8.4%
- Other non-food items: 11.3%
- Frozen foods: 11.4%
- Dairy products: 12.1%
- Fruit & vegetables: 2.2%
- Other food items: 32.4%
- Beverages (including alcohol): 19.1%
- Toys & hobbies: 6.2%
- Non-grocery food items: 4.2%
- Women's clothing & footwear: 23.5%
- Home goods & appliances: 16.4%
- Other: 16.3%

Products and Services Segmentation (2015)

- Health & wellness: 10.8%
- Home & apparel products: 13%
- Fuel & other: 20.5%
- Technology & entertainment: 9.3%
- Food & beverages: 46.4%
- Computers & TV’s: 24.5%
- Office equipment & supplies: 5.5%
- Medication & cosmetics: 6.5%
- Furniture & home appliances: 7.2%
- Clothing, footwear, accessories & jewelry: 14.8%
- Sporting goods, toys, hobby items & games: 13.8%
- Other merchandise: 23.3%
Macro insights

**Per Capital Disposable Income**

![Per Capital Disposable Income Graph]

**Major Market Segmentation (2015)**

- Consumers aged 66 and over: 16.3%
- Consumers aged 31 to 44: 23.1%
- Consumers aged 18-30: 18.4%
- Consumers aged 45 to 54: 21.8%
- Consumers aged 55 to 65: 20.4%