WestRock

On-Site Insight

Retail Merchandising Trend Update

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The Germans Are Coming: Keep Your Retail Friends Close

Brands will need to solidify existing partnerships to keep private label discounters Aldi, Lidl at bay.

Aldi and Lidl are coming to the U.S. and they want your shoppers. If you haven't already considered the potential threat this presents to national brands, it's time you started worrying.

In the 2016 trends report from Shopper Marketing magazine, 73% of brand marketers said they weren't concerned about the Aldi "discount supermarket" model. That's a mistake, folks, especially in a volatile marketplace where:

- Private label already accounts for more than 20% of unit sales, according to IRI.
- 90 out of the top 100 national packaged goods brands lost category market share in 2015, according to Catalina.
- The mainstreaming of e-commerce has intensified competition for brands like never before. Online shoppers can now buy private-label products from any retailer in the country. Upstart manufacturers can get started with very little overhead. Oh, and Amazon.com is about to roll out its own line of packaged goods.

Aldi and Lidl could make all of that a whole lot worse. So forget that old expression about keeping your friends close and your enemies closer, because these emerging enemies don't fraternize with national brands very much. No, in this case, the right strategy more likely will be to keep your friends closer than ever before. Here's why.

Birds of a Feather

The similarities between Aldi and Lidl goes well beyond their German roots. Their comparable, extreme-discount business models have combined to spark major disruptions in the CPG marketplace throughout Europe, forcing more conventional operators to slash prices and reduce costs in response to the format's success.

Aldi's 1,500-plus U.S. stores range from 18,000 to 20,000 square feet in size and carry only about 1,500 SKUs. You don't find many competing products because the primary strategy is to offer only one or two of each product type.

More importantly, you don't find many national brand products in the stores either. More than 90% of the inventory is private label, and the retailer's primary marketing goal is proving to shoppers how much they can save by switching from national brands.

Aldi has been operating in the U.S. since 1976, of course. But after growing slowly and steadily for decades, the retailer started opening 100-plus stores per year in 2014 and recently announced plans to add 500 more by 2018, including an aggressive move into California. On the product side of the business, it rolled out a 50-SKU line of diapers, formula, snacks and other baby needs in June.

"Aldi has introduced some national brands in key categories, but for the most part it's an uphill battle for manufacturers to get on the shelf," says Doug Koontz, content manager at global consultant RetailNet Group. ("Shelf" here being figurative, since the vast majority of merchandising is handled by pallets.)

Lidl, on the other hand, hasn't actually arrived yet. While the company is keeping its plans close to the vest, industry watchers expect the retailer to hit the ground running by opening 100 to 150 stores in the Mid-Atlantic and Southeast regions by 2018.

Unlike Aldi, which has stayed faithful to its original model here in the U.S., Lidl might be changing its formula, more than doubling the typical store size from less than 15,000 square feet to more than 30,000. That kind of expansion would require a significant increase in its 1,700-SKU inventory, and some analysts think it might entail boosting a national-brand roster that traditionally has represented about 30% of the total.

"Lidl has been playing around with a store of the future model, and that includes more national brands," Koontz notes.

This Time, Forget History

It's understandable if some national brands are a little skeptical about the danger just yet. Experts also predicted that European supermarket giant Tesco would take over the U.S. grocery market when it crossed the pond from England in 2007 with the private label-heavy Fresh & Easy concept. But the concept failed to win over U.S. shoppers, and Tesco retreated in 2013.

Similarly, some analysts saw the rise of health food-focused chains Whole Foods and Wild Oats in the mid-2000s as handwriting on the wall for packaged national brands. But while natural and organic retailers (and the products they cart) have established a solid niche, they haven't exactly turned the traditional marketplace upside down.

The difference in those cases, however, is that natural and organic retailers have targeted a select segment of the U.S. population that had been underserved by traditional retailers. In fact, among Fresh & Easy's key mistakes was that it overestimated how much of mainstream America was really interested in drastically changing its eating habits.

Aldi and Lidl, in contrast, are capitalizing on (and maybe even exploiting) the value-driven behaviors and lifestyles of a much larger percentage of the U.S. population — a whole of lower-income consumers as well as the middle class. And they're making it even easier for these consumers to satisfy their value needs by simplifying the store environment, paring down the product choices and driving prices down even further.

Time to circle the wagons

Assuming there is an opportunity to work with Aldi or Lidl, consultant Kantar Retail recommends that national brands closely examine the role of their categories at the chains, determine what SKUs, pack sizes and prices would work best, and be very cautious about making long-term plans (because their assortment strategy can be mercurial).

But a much better strategy for national brands might be to double down on existing retail relationships rather than trying to work with a couple of new players whose relentless emphasis on price makes the discounters who've preceded them seem middle-market in comparison. Even if you do get your brands into the building, you won't be getting any kind of brand-building presence, and your profit margin will likely take a hit as well.

"Even Walmart will have trouble competing with Aldi and Lidl on price," suggests Koontz. "So it might be best to keep dancing with your current partners."

That means continuing with the collaborative marketing and merchandising strategies that have been strengthening your presence and improved your success at key retailers all along — and being prepared to up your game with any account that wants more help.

Once these two forces hit the market in full force, you might even find some retailers in greater need of assistance. When the competition gets even tougher, it'll be important to have as many friends as possible.

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