The Unstoppable Rise of Aldi and Lidl

from the magazine

The two German supermarket chains are taking their global rivalry to America. So far, they've always triumphed.

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The new kid on the block. Source: Imago

When Alicia Baxter heads to her Aldi supermarket in Chicago's North Side, she doesn't expect convenience. She has to deposit a coin to get a shopping cart, the groceries are still in their cardboard shipping boxes and there's no one to pack her bags. Compared to a full-service supermarket, the selection is slim. But with three growing boys to feed, it's Aldi's prices she's after. A gallon of milk, for example, is $1.99, versus $3.49 at her regular store. "I find I spend a lot less," Baxter says.

Move over, Costco and Walmart. The struggle for global retail supremacy has entered its newest phase, and the battleground is America. Two of Europe's most successful supermarket chains have their sights set on conquering the world's biggest food-retailing market, worth $700 billion a year. Aldi, which has already carpeted Europe and Australia with its no-frills stores, in June announced a $5 billion expansion that will add 900 new U.S. stores to the 1,600 the company already operates. Right on Aldi's heels is Lidl, a second German company that is already the world's third-largest food retailer, after America's Walmart and France's Carrefour. Over the coming year, Lidl plans to open 100 stores along the East Coast, with another 500 to follow nationwide.

But what may be good news for thrifty shoppers such as Baxter could spell trouble for America's struggling established retailers. The Germans have a fearsome record of changing the buying habits of local consumers in every country they have entered, with customers eager to embrace the discounters' distinctive budget-minded offerings. In recent years, the Germans' main international rivals have tried to go overseas, but met a costly defeat: Walmart has closed hundreds of stores worldwide since 2016, while France's Carrefour has abandoned 19 foreign markets, including China. But whenever Aldi and Lidl have launched a simultaneous assault on a foreign market, the Germans have usually triumphed.

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What matters most, however, is not just the identity of the victors; it's the message their success sends about the future of food retailing. A decade after the financial crisis of 2007–2008, many of today's consumers still feel the pinch, which could signal a permanent shift toward the thrifty ideas underlying the discounters' success. Then again, what if most consumers still prefer the older model of shopping, which emphasizes service and variety on the shelves? What does it mean for either model when grocery shopping increasingly shifts online? In the country that first invented the supermarket, the battle lines are drawn for a contest that could determine the entire future of food retailing.

The Germans' aggressive cost-slashing tactics are certain to win them a healthy market share. Bain, the management consultancy, expects the U.S. discount grocery market to grow by 8 percent to 10 percent each year until at least 2020. That's five times the predicted growth rate of traditional supermarkets. Within two years, it's likely to propel Aldi's international revenues past domestic German sales for the first time in the company's history. Aldi makes no secret of its big ambitions, talking openly of becoming America's third-largest grocery chain after Kroger and Albertsons, the owner of Safeway.

For the Americans, the timing of the latest German offensive could hardly be worse. A fierce domestic price war is already underway, with 17 consecutive months of price drops — the longest food-price deflation in more than 60 years. In part, the price-slashing is a reflection of Aldi's prior incursions into the market. And for good measure, just days after Aldi's announcement, Amazon unveiled plans to acquire high-end Whole Foods, introducing another superrich and combative player to a fiercely competitive market.

Walmart, once the great disruptor of U.S. retail, is clearly rattled. So far, the company's books show few signs of serious damage, its latest figures buoyed by the growth of online sales. But earlier this year, Walmart launched a full-on challenge to the Teutonic invaders, slashing prices at 1,200 stores in 11 states in the Midwest and Southeast, regions where Aldi has been strong. That followed surveys suggesting that prices at Aldi were typically 20 percent or more below those at its market-leading rival.

Not that Aldi's rise to the status of major contender has been a breeze. A presence in the U.S. since the late 1970s, its distinctive pared-down style at first failed to impress American shoppers. "The original Aldi stores were very plain, very hard-discount, very European," says Bill Bishop of the retail consultancy Brick Meets Click. Obedient to the company's formula — still widely in evidence from Berlin to Melbourne — stores followed the standard formula of stack 'em high and sell 'em low. The staff is the bare minimum — a few cashiers plus a forklift operator to bring in new pallets. No one helps bag groceries or collects the shopping carts. Americans, leery of a cheapskate image, largely stayed away. "The kids were embarrassed if their friends came in and saw Aldi packaging in the kitchen," says Bishop. "It was that bad."

Aldi and Lidl stores have raised their game to better compete in the US. Source: Getty

That image is changing fast. As elsewhere in the world, Aldi has adapted to local tastes and new expectations. These days it’s offering an altogether sleeker look. Gone are drab storefronts and gloomy warehouse-style interiors. For their latest generation of U.S. stores, the company has cribbed features from the top end of the retail market: wide aisles, soft lighting, larger displays of fresh produce and electronic displays on the walls.

But the reason for the aesthetic overhaul goes beyond a general wish to please the consumer. For the first time, Aldi must now face off with Lidl on U.S. soil — a rivalry once confined to Germany that has long gone global. For both companies, that means not just competing on price, but also upping their game. “They really don’t care about anybody else other than Lidl,“ Bishop says of Aldi.

Lidl, too, has gone upmarket where local circumstances demand. At two outlets in Verona, Italy, for example, it has built stores with huge glass facades, high ceilings and designer walls in warm brown tones. Wine and veggies are displayed in wooden crates, not trashy cardboard. The store smells of fresh bread. There are even such novelties as customer toilets and diaper-changing facilities, something unheard of even at upscale German supermarkets.

It’s the prospect of confronting such nimble competitors that should scare the U.S. giants. Britain, where Aldi and Lidl have grabbed 12 percent of the grocery market in just a few years, offers a lesson in the likely consequences. Caught off balance by the incomers, British retail giant Tesco racked up losses of £6.4 billion in 2014, the worst in its nearly 100-year history. Layoffs and cost cuts have since returned Tesco to modest growth, but the relentless rise of the discounters continues. Lidl is now the UK’s fastest-growing supermarket, with sales up 18 percent in a year. Over a three-month period this year, more than 60 percent of Britain’s population paid at least one visit to an Aldi or Lidl.

It’s no surprise, then, that the discounters’ market power is immense. Even powerful brands feel the pressure; in their German home market, a brand name pro-duct’s price plummets by 17 percent on average nationwide once the discounters start stocking it on their shelves. When Lidl introduced the popular energy drink Red Bull at €1.49 per 0.33-liter can, it set off competition that brought the price down to €0.95 just a short time later.

The two companies might be global now, but they have homegrown, humble roots. Both are privately held by German families and shy of revealing detailed financial results. Their rivalry is most often measured in relentlessly rising market share and the rapid surge in store openings wherever they set down stakes. Aldi's roots started just after the end of World War II, when the Albrecht brothers, Karl and Theo, returned from fighting in Russia and North Africa to run their mother's small grocery store in Essen. Amid the postwar hardships and food shortages in Germany's bombed-out cities, Karl and Theo added more branches of the Albrecht family store. In 1961, they founded the modern company, whose initials stand for Albrecht Diskont.

The brothers' vision was based on the assumption that lower-income consumers will always want to stretch their paychecks, while the middle class will turn to discounters in economic hard times or just for convenience. In 1962, the brothers split the family empire — as well as the German and global markets — into two divisions that work in tandem and do not compete. In the U.S., Trader Joe's — the company's ori-ginal U.S. venture — is owned by one division, while the other controls the Aldi-branded stores. Lidl copied the Aldi discount model in the 1970s and has edged ahead of its rival in revenues, generating €70 billion in sales in the most recent business year.

One cornerstone of the Aldi and Lidl model was simplifying the selection by, well, not having much of a selection. Each Lidl supermarket offers 2,500 products at most, compared with 20,000 or more at a typical German supermarket. Even today, more than 90 percent of the products on Aldi's shelves are labeled with own store brands.

Often, the packaging is a knockoff of the market leader. Aldi's Frosted Flakes breakfast cereal, for example, closely mimics the familiar logo and design of Kellogg's, but costs about $1 less. Hurried shoppers might fail to spot the difference between Aldi's Norpak butter and the Lurpak on offer at Tesco. But the Aldi brand comes at little more than half the price.

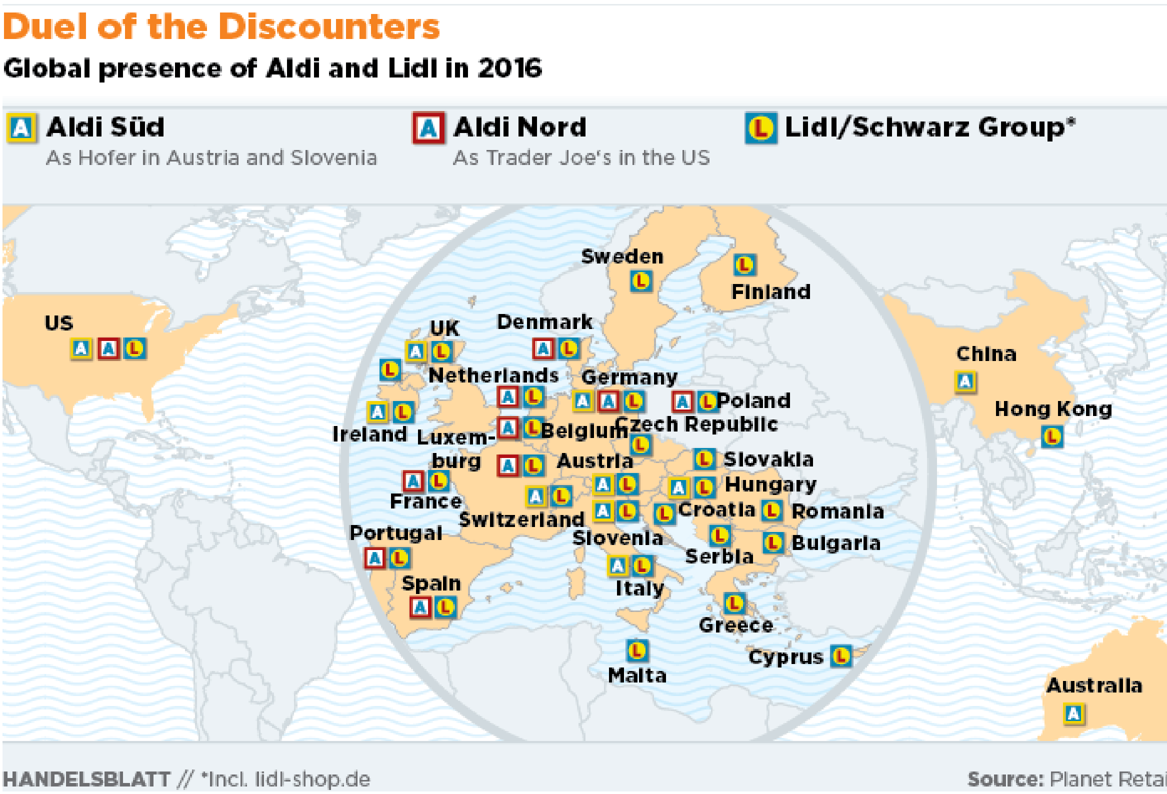
Aldi's strategy goes beyond mere copycat behavior. Supermarket strategists say that by mimicking the major brands in such exacting detail, the company undermines the very idea of a brand. According to the Hartman Group, a retail consultancy, "Aldi has perfected [this strategy] like no other." In a recent shift, Aldi and Lidl have added a smattering of top brands such as Coca-Cola. Keeping pace with local tastes, Aldi has repeatedly adapted to shopping habits wherever it goes, and it's winning devoted shoppers from across the income spectrum. "I know people who will travel half an hour by metro to get to an Aldi," says London-based artist Christabel Forbes. "And you find everyone there — just look at the Range Rovers in the parking lot."

Another major change has been the addition of organic food to the product range. The discounters have also scored surprisingly high on quality. In Germany and Britain, their deals on, say, French champagne or extra-virgin olive oil are legendary among upmarket urbanites for their price and quality. A €10 bottle of Lidl's sparkling Cremant de Bourgogne Blanc picked up a "silver outstanding" award at this year's International Wine and Spirits competition, ranking alongside champagne sold for €55 at rival Sainsbury's. All these steps are part of a move to attract more upmarket customers.

The German discounters will have to show they can go the distance in the U.S. supermarket landscape. Small regional retailers will likely be the first to feel the pinch. "Weaker retailers there will be the first to lose market share," says Mike Watkins, a retail specialist at Nielsen. "They will steal sales, and they are in this for the long haul."

To be sure, the U.S. has bloodied foreign invaders before. Britain's Tesco chain, still the world's No. 3 after Walmart and Carrefour, began its assault on the U.S. market in 2007 with 200 stores under its Fresh & Easy label. The venture ended in failure and a $1.6 billion loss six years later. Analysts blamed Tesco's failure to understand how Americans shop for food. Tesco was also unlucky in its timing, launching just ahead of America's subprime mortgage crisis and an economic recession. By contrast, the U.S. economic downturn worked in Aldi's favor as households looked to pinch pennies.

Lidl might be a latecomer in the U.S., but its expansion elsewhere around the globe has been just as relentless. The company is investing in modernizing and enlarging its stores in France. Lidl also plans to spend €1 billion by 2020 to expand in Italy, following rival Aldi's plans to expand south of the Alps. Each company has about 10,000 stores worldwide, and both consistently rank in the world's top 10 supermarket chains by sales. If Aldi and Lidl's experience in all those other markets is anything to go by, the two German discount giants could soon change America's supermarket landscape forever.



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