Can a relaunched Netto take on Aldi and Lidl?

Sainsbury's sent shockwaves through the grocery sector last week when it revealed plans to tie up with Danish discounter Netto. By George MacDonald

Four years after selling its 193 UK stores to Asda for £778m, Danish discounter Netto is back for a second bite at the market – this time in partnership with Sainsbury's.

Netto, owned by Dansk Supermarked, will make its reappearance by the end of this year and by the end of 2015 the plan is for 15 UK stores.

The tie-up came as a bolt from the blue to a grocery retail industry in the midst of seismic change, precipitated in part by the success in the UK of Netto's hard discounting counterparts Aldi and Lidl, which have been growing apace.

And it's that change which has convinced Netto and Sainsbury's chiefs there is an opportunity for them in a disrupted market.

Discounter market growth

Each sees the chance to take share in a growing market. The UK discount sector is expected to double in value over the next five years to £20bn.

Sainsbury's finance director John Rogers said he could envisage the market share of the discounters to reach 15% over the next five years compared with about 8% now.

To claim their share of the growth, Sainsbury's and Netto bosses are putting their money – £12.5m apiece – into a format and approach they think will give them a distinct and appealing proposition.

"No-one knows British customers

Netto boss Per Bank (left) and incoming Sainsbury's chief Mike Coupe ink the tie-up deal

Simon Burke defends the Co-op's ethical heritage **Retailer, p25**

AT A GLANCE

Netto

Its trademark black Scottie dog logo will be making a return to the UK

- Netto launched in Copenhagen in 1981. It is the largest retail chain in Denmark, with more than 450 stores.
- **The Danish translation of Netto means 'net price'. Netto said its prices will be "transparent with a focus on everyday low prices, with a refreshing lack of multibuy offers".**
- Netto is the third-biggest brand in Denmark, behind Ikea and electronics retailer Elgiganten.
- **It is owned by Dansk Supermarked, which also owns three other Danish retail brands: department store Salling, supermarket Føtex and hypermarket Bilka.**
- Dansk Supermarked is the largest retail company in Denmark and has a 34.9% market share. It operates more than 1,300 stores in four countries.
- **More than two million customers visit Dansk Supermarked's stores every day.**
- Netto launched in the UK in 1990, with its UK headquarters based in South Elmsall, West Yorkshire. It operated a total of 194 stores in the UK.
- **The partnership marks a return to UK soil for the Danish supermarket. It departed the country in 2010 when it sold its stores to Asda for £778m.**
- The joint venture with Sainsbury's will see the opening of 15 Netto stores by the end of 2015. The first store is expected to open later this year.
- **Both Netto's and Sainsbury's initial investment in the joint venture will be £12.5m. Each partner expects to incur a post-tax loss of around £5m to £10m up to March 31, 2015.**

SUZANNE BEARNE

The business reported revenues of 56.9bn kroner

£6.1bn

in 2013, up from 54.4bn kroner (£5.8bn) the year before

Profit

before tax increased to 1.77bn kroner

£189m

in 2013, up from 1.31bn kroner (£141m) the year before.

Dansk Supermarked employs 42,500 people and is run by chief executive Per Bank

It operates

1,255

stores across four countries: Denmark (453), Germany (346), Poland (301) and Sweden (155)

WHAT THE ANALYSTS SAY

Dave McCarthy, HSBC

The discounters have real momentum in the UK, with lots of column inches and airtime given to their improving offer. That Sainsbury's is capitulating to this format rather than competing effectively will only add to that momentum, in our view.

We find this move by Sainsbury's perplexing, and it will help further highlight how expensive the supermarkets are relative to the discounters.

This was a problem in France for many years and it is only recently that the hypermarkets there have realised that the way to win is not by imitating the discounters with their own chains but by being more price-competitive.

Clive Black, Shore Capital

We see this combination as a potentially astute one because it possibly solves a particular problem for Sainsbury's.

Accordingly, we believe that Mike Coupe, Sainsbury's soon-to-be chief executive, has shown a good appreciation of the limitations and virtues of Sainsbury's brand, and yet engineered a potential mechanism to gain access to the discount channel.

We see the trial as being potentially complementary to Sainsbury's core business.

James Anstead, Barclays

The growth of the discount segment has prompted questions as to whether existing players might set up their own discount chains.

This would not necessarily be difficult from a practical perspective, but it could potentially confuse customers or muddy the main brand – especially if the existing brand is in some ways transplanted into a discount store.

Sainsbury's and Netto seem to be cognizant of those risks, with no apparent intention to feature the Sainsbury's brand in the new Netto concept.

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better than Sainsbury's and nobody knows discounting better than Netto," observes Per Bank, chief executive of Dansk Supermarked.

The new Netto shops, which will be run as part of a standalone business with its own headquarters and distribution system, will be very different from their predecessors, according to Bank and Sainsbury's chief executive designate Mike Coupe.

The layout will be new and the range will be transformed. The assortment will be much larger – 2,100 products compared with 1,200 – and there will be a focus on fresh food including meat and in-store Danish bakeries. "Self-evidently, it will be more compelling," says Coupe.

New grocery appeal

Despite Netto's limited impact in the UK previously, Bank and Coupe believe expectations of discount grocers have changed in the intervening years and their model should appeal.

Bank says: "We're coming back as a much better Netto this time. It will be great value for money and a great shopping experience. It will be easy to park, easy to shop and easy to pay."

Coupe insists that the Netto deal was not a sign of panic in the face of Aldi and Lidl's rise. Instead he sees discounting as a distinct growth channel in which at the moment Sainsbury's has no presence.

He maintains that its presence will complement, not conflict with, Sainsbury's operations in its three existing channels – supermarkets, convenience and online.

"It's as well as, not instead of," he says. "The bulk of supermarket shopping is still in big supermarkets.

"It [discounting] is ultimately a different sector. Dansk brings us experience we didn't have and gives us quick entry to the market.

"The Netto brand has resonance with customers. It's a great opportunity for us to develop."

Although Netto chose in 2010 to abandon Britain to rivals Aldi and Lidl, Bank claims the retailer is perfectly capable of competing with the pair.

He says that Netto already holds its own against Aldi in international markets, including the latter's German homeland, and that the UK is less mature than Germany from the discounters' perspective so there is plenty of scope to make up ground.

"DANSK BRINGS US EXPERIENCE WE DIDN'T HAVE AND GIVES US QUICK ENTRY TO THE MARKET"
Mike Coupe, Sainsbury's

He says: "If we did not profoundly believe we could deliver, then we would not be introducing Netto to the UK."

Northern launch

The first of the new generation of Netto stores, measuring about 11,000 sq ft, will open in the north of England.

That area was chosen because of population density, its logistics infrastructure and the fact that there are suitable property opportunities.

Sainsbury's-branded products will not be sold in the shops, which will carry a high proportion of own-label lines. "We thought long and hard but it's important it's positioned differently," Coupe says.

The venture's start-up costs are expected to result in each retailer bearing a pre-tax loss of between £5m and £10m in the year to March 15, 2015. Coupe was reluctant to reveal when he hoped it would become profitable.

He says: "We're not going in to that. At the moment it's a trial. We wouldn't be doing it if we didn't believe we could make money in the long term."

As Sainsbury's rivals such as beleaguered Morrisons and Tesco attempt to adapt to shifting conditions precipitated by the discounters, the competition has just been ratcheted up again.

WILL THE TIE-UP WORK?

Whether Netto and Sainsbury's will succeed is this week's hot question, says Kantar director of retail Ray Gaul

Financial

Financial success is easy to measure. Netto's track record in Denmark, Germany, Sweden and Poland is pretty good on this front. The UK start-up needs to contain the costs of property, supply chain, staff and energy to about 16% to 17% of revenues.

The fact that Sainsbury's already has a supply chain in place and efficient operations with suppliers is a bonus here.

The fact that Netto already has a profitable formula in four other countries is also a bonus. Testing 15 stores to get the model right on a limited investment is a good sign.

The fact that both companies have deep pockets and are looking long-term would also indicate this is a business that will grow over time.

Assessment It will work

Something shoppers need

UK shoppers have been voting with their feet. Discounters are growing and big out-of-town supermarkets are not.

In Denmark, 2012 Brandz data shows that Netto shoppers say they love the store – a 5% bonding score, which is rare in the world of grocery – more than any other supermarket or discount store including Lidl. Netto is more brand-friendly and better at fresh than most discounters.

Assessment It will work

Management discipline

On paper, this is a 50-50 relationship. However, given initial statements it appears Sainsbury's has more at risk here than Netto owner Dansk Supermarked.

Sainsbury's business needs will transform over time.

Today, the company is eager to find new ways to grow revenue. In the future, the focus may return to profit optimisation or portfolio synergy.

Over time, it is likely that Dansk's and Sainsbury's needs may transform in ways that can create disagreements on where the Netto UK initiative fits in the overall business portfolio.

A review of successful long-term joint ventures in grocery retail is difficult to create. Just have a look at the adulterous fall-out from the Waitrose-Ocado-Morrisons love affair and you can see some danger here.

Assessment Danger ahead