What's in Store for Store Brands

Store brands, also known as private labels, are mainstream in many markets and becoming more so, particularly in developing markets. As such they constitute legitimate threats to established brands. As retailers update store brand packaging and roll out premium lines of private labels, shoppers seem increasingly willing to try these products. How can the makers of major consumer packaged goods brands defend their market share in the face of this phenomenon?

In a trend that transcends categories, countries and retail environments, brands are under attack from private label products. According to Nielsen, private label penetration is estimated to be growing on a global basis by 5 percent per year, while the growth rate for manufacturers' brands is just 2 percent. Is it the value proposition alone that powers the growth of private labels, or are there other factors underlying the trend?

A private label — also known as a store brand, or a shop's "own brand" in the United Kingdom — is one carried exclusively by a single retailer. For the purposes of this POV, I am referring specifically to store brands that compete with manufacturers' brands on retail shelves, as opposed to brands sold in stores that feature retailer brands exclusively (such as Gap, Victoria's Secret, Aldi, and IKEA).

Store brands may carry the store's name (e.g., Kroger or Sainsbury's) or a name unique to the retailer (e.g., Kirkland at Costco, or No7 at Boots). But even in one individual store, the situation on the shelf can be quite complex. A shopper may face multiple tiers of private labels: generics offered at substantially lower prices than brands; "imitation" brands designed to emulate the quality of brands at a reduced price; and premium offerings at price parity or slightly above brand pricing. At retailers such as Tesco or Royal Ahold in Europe and the United States, there are organic and fair trade lines of products as well.

Private label products generate anything from 1 percent of All Commodity Volume (ACV) in Mexico to close to 50 percent in Switzerland (AC Nielsen, 2005). In Germany and the United Kingdom, private labels account for almost one-third of the value of goods sold. The United States has more room to grow, with private labels accounting for about 17 percent of goods sold and a strong growth rate of 7 percent. In emerging markets, sales of private label products are growing at about 10 percent per year, which is twice the overall global rate.

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What Drives Private Label Penetration?

Why are private label products enjoying sustained growth while branded products tend to be languishing? It is a complex situation, with contributions coming from brand manufacturers, retailers, and shoppers, accelerated by changes in economic conditions and the media environment.

The manufacturer

For many years, manufacturers have focused their marketing activities on the "consumer" to the detriment of the "shopper." By using continual price promotion and reduced advertising, marketers undermined loyalty to their brands. Meanwhile, the retailer focused on people's shopping behavior and found ways to improve the experience of people visiting their stores. Only recently have manufacturers teamed up with retailers to create programs that focus on the consumer in a shopping role.

The retailer

Retailers have a great deal to gain from growth in private labels. Not only do they gain margin from their own brands, but they can also differentiate themselves from the competition with unique offerings. (And given the greater margin they have to play with, it is not hard to understand why the quality of private label products has improved considerably.) Brand marketers no longer have immediate and exclusive access to innovation. Retailers — particularly Wal-Mart — have been instrumental in building supply chains and sourcing, and their access to shoppers has helped them develop new ideas and products.

Our internal data shows an erosion of loyalty to brands that benefits retailers. As trust for the banner over the door increases at the expense of trust for brands on the shelf, retailers have more opportunity to successfully launch brands under their own banners with minimal marketing investment.

Retailers also benefit from the trend toward "disintermediation." As media have fragmented, it has become harder to generate mass communication on the scale that is typically used to launch brands. Wal-Mart actually generates more traffic on a weekly basis than the TV networks. This loss of mass-marketing opportunity favors the emergence of more narrowly targeted products. Retailers, because of their close relationships with shoppers, can take advantage of this and target specific lines to match local needs.

The shopper

The people doing the purchasing, as well as those consuming the products, have been quite happy to try private label offers. There are numerous reasons for this, with the most obvious one related to economics. Generally, during a recession or a period of escalating prices (like the one we are currently experiencing), consumers are more willing to try private label products. While many will return to traditionally branded products when the economy turns around, some will stay with private labels, thus driving up the baseline level for those products.

Sometimes ignorance plays a role in the adoption of store brands. In many instances, shoppers are not even aware that the product they purchased is a private label. This is true in apparel and durables and in many cases in grocery and personal care as well. Retailers typically emulate the packaging of the leading brand to signal (or confuse?) the shopper. Drug chains

signal the parity of their over-the-counter (OTC) drug offerings by calling out on the package that the active ingredient is the same as the one in the name brand.

What Works Against Private Label Penetration?

For all the circumstances that seem to favor the continued growth of private labels, other conditions exist that may limit the upside of these brands, at least in some categories. While the BrandZ™ database shows that for categories like diapers and mineral water in the United States, more than half of category users would include a store brand in their competitive set, private label baby foods or body washes are considered by, at most, just 10 percent of category users. Nielsen global data shows private label value shares ranging from 25 to 32 percent for products such as refrigerated food and plastic wrap to 2 percent for cosmetics and baby food.

Two factors seem to drive this situation: relative cost and risk. In the case of baby food and cosmetics, the relative risk seems high even if the price differential is large. It is critical for shoppers to trust these products, and brands have invested a great deal in developing high levels of trust. On the other hand, the risk for purchasing and using diapers and mineral water is low. As long as a store brand diaper delivers acceptable performance compared to a manufacturer's brand, the volumes consumed can make these products seem like bargains even at a small price differential.

The degree of commoditization of the product is also an important factor. The closer an item is to a commodity, the greater the opportunity it has to be matched or preempted by private labels. In large part this is why refrigerated foods (e.g., dairy products and meat) have large private label shares, while highly sophisticated electronics products have virtually none (though Wal-Mart does offer its own TV brand).

Economies of scale also play an important role. A category needs to be relatively large in order to support a private label offering. Economics generally favor manufacturers who can amortize fixed and developmental costs across the volume distributed through dozens of doors, while grocery chains (even

national ones) might not generate sufficient sales to justify adding a store brand. In markets such as the United Kingdom, where just four chains dominate the grocery business, manufacturer brands face greater risk than they do in less concentrated markets such as the United States, or in developing markets such as India.

Marketers must embrace retailers as partners and collaborate on building shopper programs that benefit all parties.

What Does This Mean for Marketers?

Those responsible for maintaining the health and viability of brands can do several things to protect those brands.

First, they can work to increase consumers' perceived risk of switching. This means changing the competitive equation from price paid to value delivered. If brands persist in excessive price promotion, consumer loyalty to brands will continue to erode. Brands need to innovate, differentiate and clearly communicate why they are worth their price. In some cases they can also provide reasons to question the quality of private label. For instance, manufacturers of OTC and personal care

products can advertise that they are not suppliers of private label goods (as the U.S. brand Tylenol has done), thus casting doubt on private label quality while reinforcing their superiority. By contrast, in categories that are highly proliferated with brands and line extensions, shoppers may perceive many sources of private label manufacturing, and thus feel confident about considering an alternative to a brand. Furthermore, excessive clutter in these categories may encourage shoppers to shortcut the selection process by simply seeking the best deal.

Next, manufacturers should strive to "move up the food chain." That is, they should process, refine, and generally get as far as possible from the generic or commodity status of the category. The more value you add, the less likely you are to be emulated or undercut on price. In the United States, Arm & Hammer baking soda has successfully countered being a commodity by developing "fridge packs" and air filters, allowing its basic package to compete at pricing a little above that of store brands.

Additionally, marketers can take a lesson from their peers who have created exciting brand experiences in retail. Examples such as the Apple stores, NIKETOWN, and Hershey's Times Square in New York City show how brands can take control of the consumer experience and use it to enhance the way they are perceived. In this way the consumer and shopper experiences come together, both fully managed by the brand marketer.

Finally, marketers must embrace retailers as partners and collaborate on building shopper programs that benefit all parties by providing exciting offers for shoppers, increased revenue for retailers, and profitable growth for marketers.

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The Future of Brands and Private Labels

While the advance of private label brands is an important development that the manufacturers of brands cannot afford to ignore, it is not time to sound the death knell for traditional brands. The success of Lidl, Trader Joe's and IKEA notwithstanding, the vast majority of retailers still need brands to attract consumers. And even though chains like Costco and Carrefour have a sizable portion of their volume in private label, they depend on brands to attract customers and offer a viable range of choices. Finally, when it comes to product innovation, the edge remains with marketers: Can anyone envisage a world without Coca-Cola, Sony, Toyota or Colgate?

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