

# Private Brands

## LOW PRICE ALTERNATIVE OR STRATEGIC ASSET?

Private brands are evolving beyond the traditional role of acting as generic entry-price options, and are becoming major assets for retailers. In European markets, private brands have been used by food retailers to connect with consumers while improving profit and revenue. Though private brands have risen in popularity in the US in recent years, a significant opportunity exists for further market penetration. There are a number of lessons American retailers can learn from their European counterparts. When building out a private brand strategy, retailers should consider the following themes:

- **Rising consumerism** has led to wider demand for innovation
- Private brands can serve as a mechanism for **differentiation**, by allowing retailers to connect with consumers faster and better
- Through a clear focus on **brand building**, retailers can define themselves more clearly and control what they are “famous” for
- The **economics** of private brands can be game changing

There are many winning approaches for private brands. Once retailers have assessed their strategic priorities and the opportunities in their markets, they can harness the full potential of private brands as an asset.

## PRIVATE BRANDS: A NEW TERMINOLOGY

This report uses the term “private brands” throughout to refer to products sold under the banner of a food retailer. Other commonly used terms include generics, own brands, private label, and store brands. Successful private brands, however, go beyond generic items, beyond a label, and often beyond the confines of a given store. To emphasize this expanded vision of private brands and to encourage a brand ownership mentality among food retailers, we use the term “private brands.”

To “win” with private brands, food retailers must adopt a broader strategic outlook. There are four themes to consider when crafting a private brands strategy: **rising consumerism**, **differentiation**, **brand building**, and **economics**. In the following sections, we’ll describe each of these ideas and consider some examples of success, primarily among European retailers.

## 1. RISING CONSUMERISM

In response to rising consumer demand for innovation, private brands in the US have begun to evolve. But while some have shifted away from basic generic items, most private brands do not yet embody the ideal of well-regarded, high-quality products. Retailers have an opportunity to further refine their strategy to deliver to consumers.

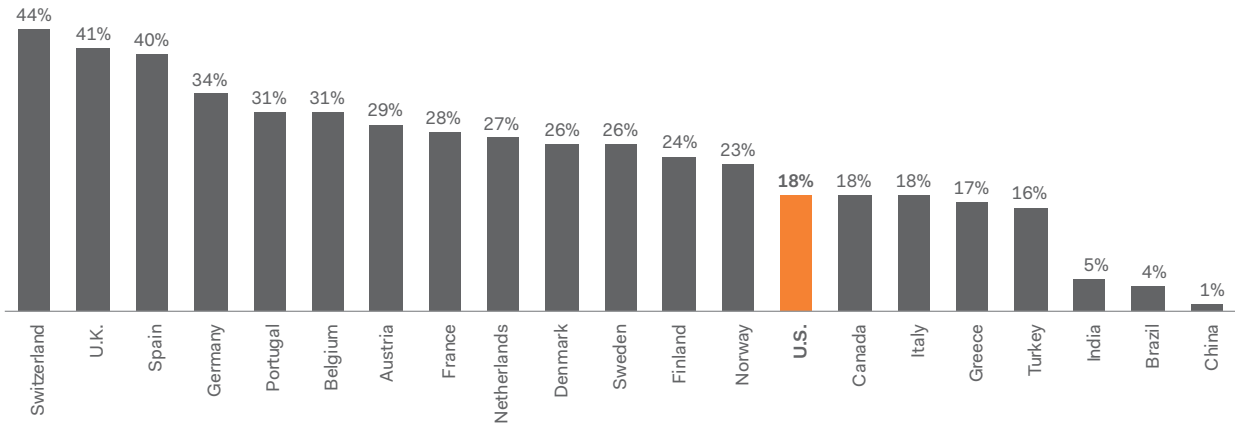
### Current penetration of private brands

In comparison to many European countries, the US exhibits somewhat low levels of private brand penetration. (See Exhibit 1.)

The penetration of private brands in the US in 2014 was roughly 18 percent, less than half of the level seen in Switzerland, the UK, and Spain. Even leaving room for differences between American consumers and their counterparts around the world, there still appears to be quite a bit of headroom for growth in private brands in the US.

Exhibit 1: Penetration of private brands by country

Percentage value penetration



Source: Nielsen 2014

### Attitudes of American consumers

Consumer surveys have demonstrated that US consumers perceive many aspects of private brands in a positive light. (See Exhibit 2.) Summary responses indicate US consumers are often more likely than their European counterparts to view private brands as smart purchases.

In Oliver Wyman's annual consumer survey, the customer perception map (CPM), several retailers were identified as "winners," indicating consumers found their combination of offer and value appealing. (See Exhibit 3.) Attractive retailers are positioned on the CPM to the right of the dashed line. We have called out a few of the successful US grocers that also have strong private brand offerings, suggesting a wide range of consumer interest.

From Whole Foods Market with its more expensive offerings, to Aldi with its affordable products, retailers that have focused on private brands have seen a payoff in consumer perceptions.

The CPM survey results also indicate that private brands are appealing to consumers of varying demographic backgrounds. Even among those shopping at the discount retailer Aldi, 34 percent of households had average annual incomes greater than \$75,000. Shoppers at Aldi broadly fit the same demographic profile as shoppers at major national and regional retailers.

There is a clear demand among American consumers for private brands. While penetration in the US has not yet reached European levels, consumer attitudes toward private brands are positive, and American consumers tend to hold retailers with well-

developed private brands in high regard. With the arrival of Lidl in the US, American consumers will have access to another set of strong private brands. As a result of Lidl's entry into the US market, we are likely to see an increase in the level of competition in the private brands space. But at the same time, this could hasten a tipping point in the US, after which private brands become a mainstream choice for American shoppers.

Given that consumer tastes and demands have grown to encompass a wider array of products in recent years, retailers can capitalize on growing interest in private brands, while providing their consumers with an innovative assortment.

Exhibit 2: Consumer perceptions of private brands (Europe vs. US)

CONSUMER SURVEY	EUROPE	US
Private brands are usually extremely good value for money	69%	74%
Private brands are a good alternative to name brand products	70%	75%
I am a smart shopper when I buy private brand products	63%	71%

Source: Nielsen 2014 (n=30,000, 60 countries)

Exhibit 3: Customer perception map



## 2. DIFFERENTIATION

An effective private-brand strategy enables retailers to differentiate themselves and connect with consumers more quickly and effectively. Whether through assortment, services, formats, or other forms of engagement, retailers can use their private brands to define and differentiate themselves to shoppers. The following case studies demonstrate potential options for engaging consumers through private brands.

### CASE STUDIES

#### MERCADONA

Mercadona, a market leader in Spain, has had enormous success over the past 10 to 15 years because of its popular private brand offering. In order to set its stores apart and respond to consumer needs, Mercadona has focused on providing an extensive offering of specialized products. For instance, Mercadona's private brand contains over 1,000 gluten-free products, accounting for roughly 16 percent of its product range. Beyond that, Mercadona strives for a wide variety of products that meet other consumer preferences.

#### MARKS & SPENCER

UK retailer Marks & Spencer has differentiated itself by expanding into a variety of services and products, ranging from luxury cakes to fast food options.

Marks & Spencer has expanded its market beyond that of a traditional grocer, so that it competes for consumers with fast-food outlets, takeaway restaurants, caterers, and more. The Marks & Spencer brand has become widely known and associated with a far-reaching expanse of products and services.

Exhibit 4: Full scope of Marks & Spencer private brands offering



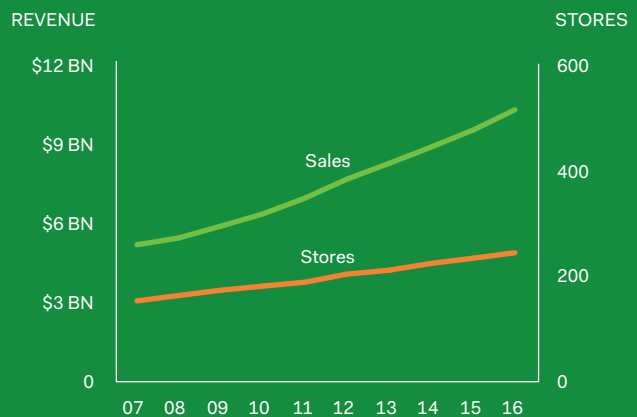
#### TRADER JOE'S

In the US, Trader Joe's has earned a reputation as a retailer with a strong private brand offering. Trader Joe's stores carry exclusively private brand products sold under the "Trader Joe's" banner. Consumers often identify as "fans" of the retail chain, because of their emotional attachment to its products. In addition, Trader Joe's prides itself on high employee engagement, which leads to better customer service and a well-regarded store culture.

The growth of Trader Joe's in recent years indicates consumer satisfaction with its private brand approach and suggests the growth potential for private brands in the US more broadly. (See Exhibit 5.)

Ultimately, there is more than one way to differentiate your stores through private brands. Several paths are available, from specialized assortment to an array of services and formats. No matter the mechanism, retailers can use their private brands to set themselves apart from their competitors and strengthen their connection to consumers.

Exhibit 5: Trader Joe's growth from 2007-2016





### 3. BRAND BUILDING

Given the demand among consumers for private brands, and the value of those brands as differentiators, retailers must ask themselves what they want to be known for and how private brands can play a role in helping them achieve that goal.

#### Beyond a store brand

Private brands come in all different shapes and sizes. At one extreme, they can become brands in their own right, extending beyond the banners who created them. As an example, the French retailer Monoprix's brand has achieved major success and is now sold by Amazon. Similarly, the President's Choice brand has taken on a life of its own, to such an extent that Loblaw's is touted as the home of President's Choice.

#### Private brand personalities

There are several dimensions that help determine a private brand's "personality," such as quality, price point, and other more specialized attributes. (See Exhibit 6.) Once a retailer has narrowed down the characteristics it would like to be famous for, the choices along these dimensions follow naturally.

Retailers often choose to develop multiple private brands to meet the various needs and interests of their customers. For retailers with a wide-reaching private brand offering, it can make sense to group products logically along a broad range of dimensions.

Mercadona's private brands tend to be defined by department. (See Exhibit 7.) So the food items across all price points make up the Mercadona private brand, while household products across all price points make up Bosque Verde.

Conversely the private brands for Coop in Switzerland tend to align with price points. (See Exhibit 8.) Fine Food serves as Coop's premium brand, while Prix Garantie fills the entry-price niche.

Once retailers assess their strategic needs and consider the role of private brands in fulfilling them, they must develop brand architecture to match. In other words, retailers must determine which categories, price points, and attributes to cover with their private brand(s), as well as the optimum configuration of brands to do so. The economics of private brands, covered in the next section, provide a useful balance against SKU proliferation.

Exhibit 6: Private brand assortment, by category, price point, and other attributes

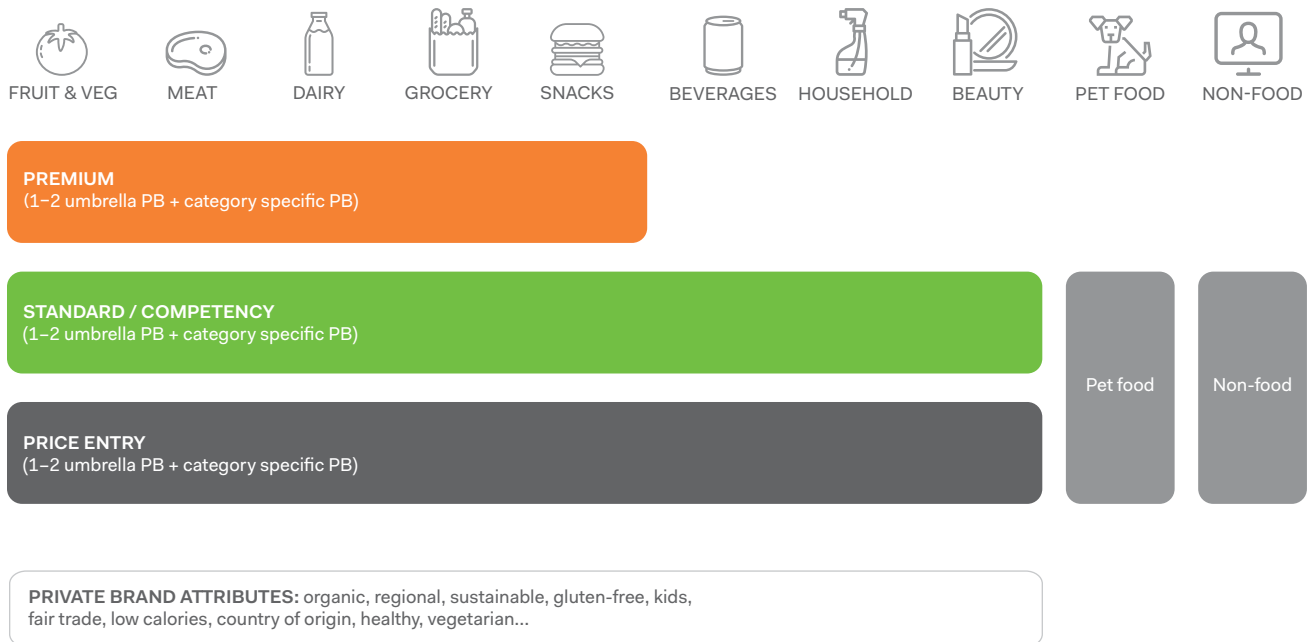


Exhibit 7: Mercadona private brands (organized by department)

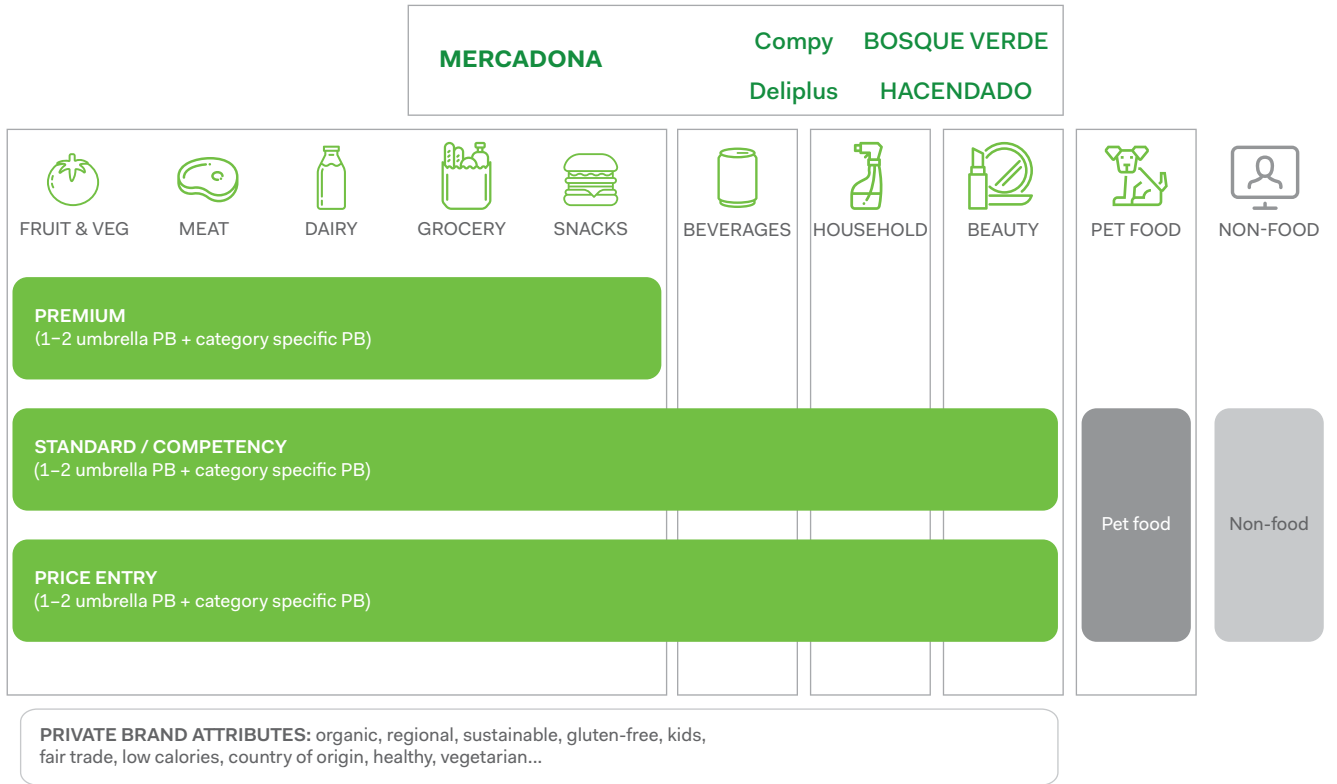


Exhibit 8: Coop private brands (organized by price points and attributes)



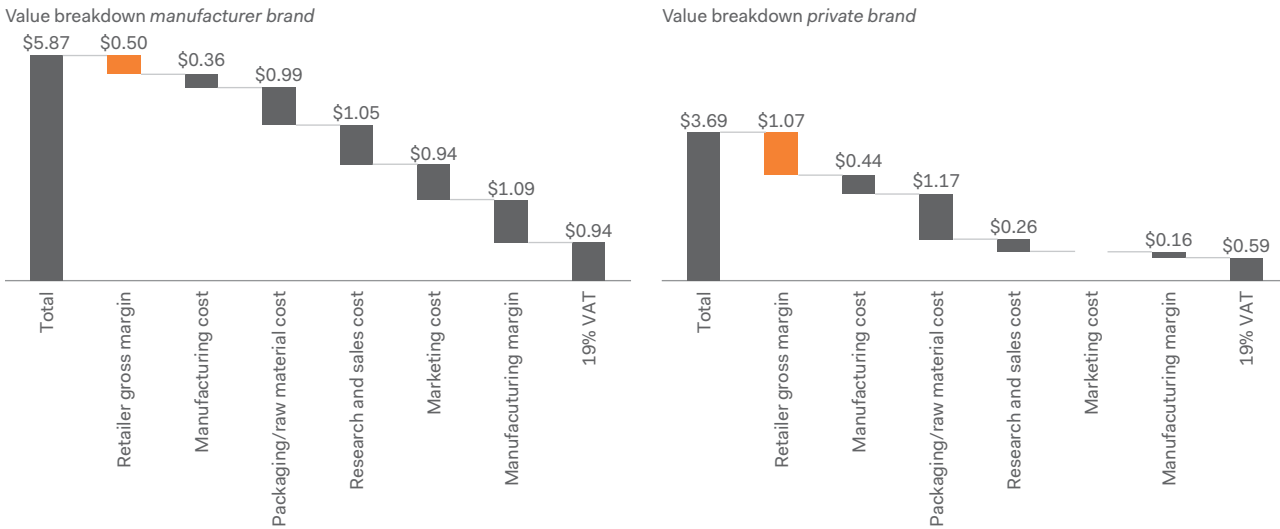
## 4. ECONOMICS

If executed properly, private brands entail economics that are extremely favorable to retailers. Among the key points retailers should consider: The products hold the potential for attractive margins; there may be a halo effect when margins are lower; and private-brand products hold the potential for benefits of scale.

### Better margins for premium products

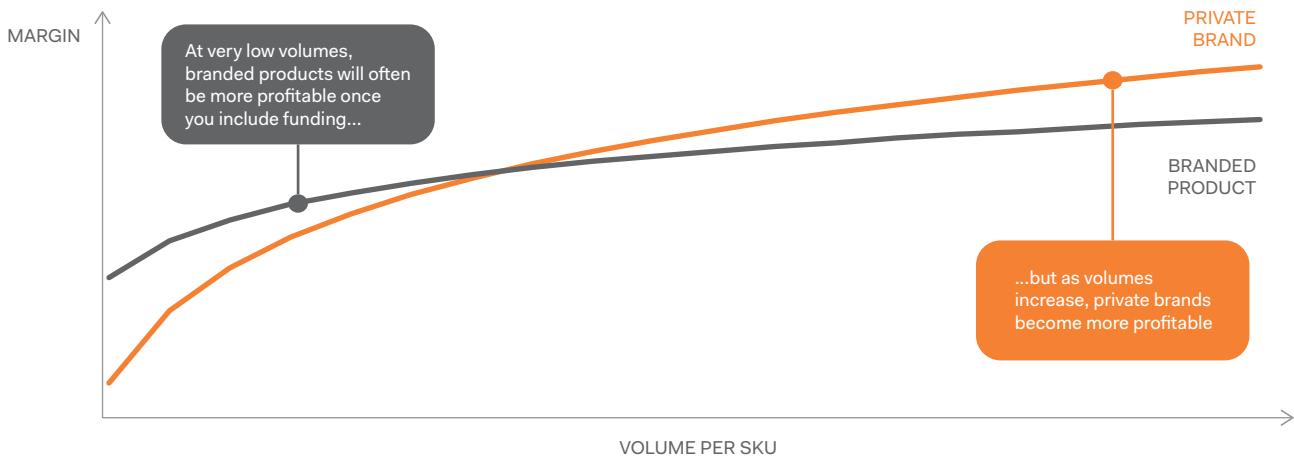
For premium private-brand products, retailers can generate a very attractive margin relative to manufacturer brands. (See Exhibit 9.) Premium private brands do not require the same degree of marketing and sales, which can account for 15 to 20 percent of product costs for manufacturer brands. Retailers can effectively return these cost savings to consumers in the form of lower-cost products. By providing high quality products at a lower cost, retailers build up consumer trust and loyalty, thus strengthening their brand and business more generally.

Exhibit 9: P&L for premium product (manufacturer brand vs. private brand)



Source: IPLC

Exhibit 10: Relationship between volume and profitability: Typical relationships between volume per SKU and margin rate



### A case for entry price point products

Entry price point private brands can also benefit retailers, in spite of less appealing margins. On average, private brand products at an entry price point have a gross margin of 20 percent, as compared to the rest of the private brands range, which has an average gross margin of 33 percent.

However, more affordable private brand offerings drive strong halo and basket economies. Oliver Wyman analysis has found that even in a basket with six entry-price private brands products, these products only made up roughly 20 percent of items in that basket. In other words, consumers buying the less expensive private brand products tend to have large baskets that include other more premium products. Plus, retailers with affordable private brand options can benefit from reputations as carriers of high-quality, low-cost items.

## Benefits of scale

Beyond the margins of premium private brands and the halo effect and basket implications of entry price point products, private brands become more profitable across all price points when volumes increase. (See Exhibit 10.)

Private brands demonstrate the traditional relationship between volume per SKU and margins: While entry price point private brands may be less attractive than branded products at very low volumes, at a certain point the benefits of scale allow private brands to achieve better margins.

In summary, there are three key economic benefits of private brands. First, premium private brands have significantly higher margins than manufacturer brands. Second, even for entry price point products with less appealing margins, there are significant benefits from halo and basket economics. Lastly, once volumes reach a certain level, private brands across all price points look more attractive than national brands. By harnessing the benefits of private brands, retailers can unlock game-changing economics.

## CONCLUSION

Private brands have already grown in popularity in the US and that trend is likely to continue going forward. With Lidl moving into the US market and Amazon acquiring Whole Foods and its well-regarded private brand, pressures are mounting for traditional grocers to revamp and prioritize their private-brand strategies. Given that consumer demand for private brands is high, and that these brands allow retailers to differentiate themselves and build consumer loyalty, the real questions for retailers are on how to build their brand strategy and make the economics work.

In developing their private brands playbook, retailers must first determine their strategic priorities, identify growth opportunities and obstacles in their respective markets, and then assess opportunities at the SKU level in one or two pilot categories. From there, retailers can build out their private-brands portfolio, creating an enticing proposition for their consumers.

