How to best compete as private labels gain ground? It depends on the nature of your category and your brand's position.

Deciding to fight or play in the private-label arena

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How to best compete as private labels gain ground? It depends on the nature of your category and your brand's position.

We've all seen the headlines about private labels: retailers all over the world are increasing their investment in owned brands, and consumers are routinely buying them. Even before the recent recession hit, private labels' mounting success in many regions provided evidence that the growth of these brands was no longer a cyclical reaction to economic downturns, but instead a structural change in the consumer products landscape (see sidebar, "How big are private labels getting?"). But even as the power shifts and competition gets tougher, the outcome is not as gloomy as many have predicted; branded players can have a significant impact on the trajectory of private labels. The first step is to make choices: how much to invest to defend against the onslaught and how and when to manufacture private-label products.

Tylenol®, a leader in pain relievers, chose the defensive strategy. Historically, the brand forestalled private labels in the US by launching new products roughly every two years in the 1980s and early 1990s, riding a wave of innovation that delivered double-digit revenue growth on the success of such product extensions as gelcaps, Children's Tylenol and Tylenol PM. Branded players in the yogurt category recently used the same strategy. In fact, their focus on innovation has made yogurt the only category among the top 30 we studied where private-label share declined over the past four years, while the category grew. Danone alone introduced nine new products to gain four points of share between 2006 and 2010, even while raising prices.

But successful as it can be, innovation requires relentless focus and consistent investment. Look at what happened with Tylenol. Once the brand's innovation cycle slowed to a point where it had no new innovations in six years, private labels gained ground; penetration increased from 14 percent in 1991 to 42 percent in 2010.

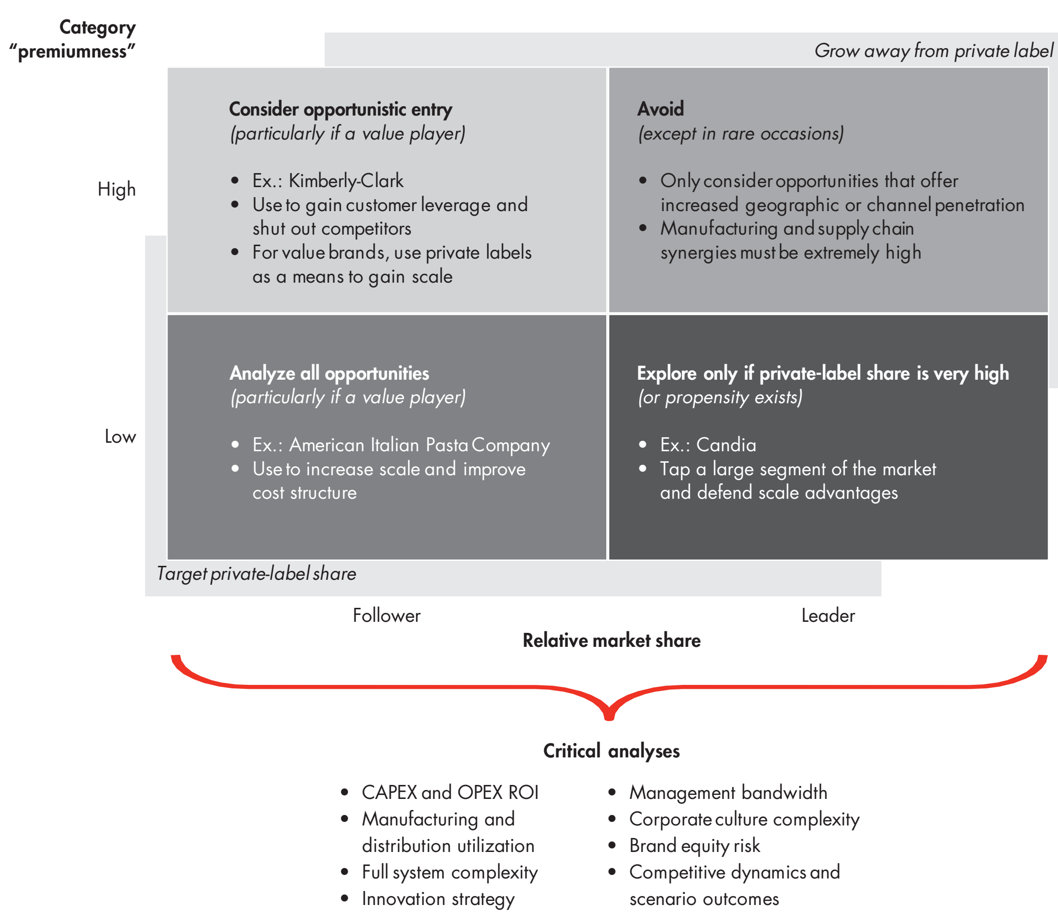
While some brands have won by fighting private labels, others have found success in joining the private-label pack. For example, Kimberly-Clark makes private-label products such as diapers to improve asset utilization, particularly with older technology. The company has also found the added benefit of securing exclusive shelf placement with important retailers like Costco, where it has been the exclusive brand in the diaper category for the past five years. It can accomplish that because some of its private-label and branded products are relatively similar, allowing it to take advantage of purchasing, distribution and manufacturing synergies. In Germany, some branded players have followed a similar strategy when hoping to list with Aldi, a retailer that carries few brands but garners nearly 15 percent of the grocery market. In the UK, a local player in the biscuits and cereal category has found that manufacturing private-label products helps build scale to compete against global players.

Of course, building scale with private-label manufacturing also comes with risks, as not all scale is the same. By nature, private labels add short-run manufacturing complexity. Sales team demands increase as most retailers have separate buying teams for branded and private-label products, and retailers often demand innovation to flow into private-label products quickly—increasing innovation cycles and likely reducing margins. Also, companies must manage to a "cost culture," aiming for continuous improvements to stay competitive. That is no small task side by side with a branded culture. Those are reasons that contributed to Birds Eye's decision to exit the private-label business in 2006 and pursue opportunities to grow its branded products.

So how does one decide how much to invest and whether to join private labels? We've found that the High Road-Low Road framework we detail in [High Road-Low Road, revisited]() is a useful tool. A brand's reaction to private-label threats should take into account the nature of the category in which it plays and its position in that category.

For example, in premium categories, it rarely makes sense to enter the private-label arena (see Figure 1). Leaders should steward category innovation and build brand equity, while followers should focus on finding a consumer segment or usage occasion that the leader is

Figure 1: Category "premiumness" and market position guide private-label entrance strategy



How big are private labels getting?

In Western Europe and the US, private-label products accounted for nearly all of the growth in packaged food, beauty and personal-care, and home-care categories from 2000 to 2010. The global recession gave private labels an added boost, and in many categories the gains were sticky. Of 30 top US categories we analyzed recently, there was only one—yogurt—in which private labels lost share while brands grew in the years 2006 to 2010. Private label's share of new product introductions has steadily increased in every region of the world since 2005. Sainsbury's in the UK launched 1,300 new own-brand products and improved a further 3,500 in 2010. Carrefour innovated to introduce no fewer than 2,000 private-label products in 2009. Kroger's private-label products account for 35 percent of grocery units sold and 27 percent of dollar sales. Even in markets where private labels traditionally have had a lower profile, retailers are getting into the act—everyone from Korea's E Mart to Brazil's Pão de Açúcar. Many of these products are higher quality than the generics of yore, offer health, convenience or other benefits, and scan at low prices.

In retrospect, the rise of store brands is not surprising. Store brands help retailers differentiate themselves from competitors and often provide superior economics—an extra eight to 10 points of gross margin is typical in many categories. And retailers have grown big enough to invest in the insights and capabilities needed to build their own brands. There is a clear link between organized retail consolidation and private-label penetration: in Switzerland, the top five retailers have more than 70 percent share—and private labels have approximately 45 percent penetration. In France, top retailers account for more than 60 percent of sales; private labels have more than 30 percent penetration. By comparison, Russia's relatively low rate of consolidation—around 20 percent—translates to less than 5 percent private-label penetration. Bain analysis has found that for every 10 point increase in retailer consolidation, private-label penetration rises by approximately three points.

Private-label gains have been most acute in premium categories. (We define "premiumness" as the percentage of a category sold at a premium to value or private-label offerings.) Bain analysis shows premium categories, such as refrigerated grape juice and graham crackers, experienced more dramatic private-label growth during the recession than value categories, such as canned beans and condensed soup. After the recession, brands in premium categories have clawed back share more successfully than brands in value categories. But in nearly two-thirds of the premium categories we examined, private-label products sustained or continued to gain share.

Even in markets where private-label penetration is currently low, consumers are increasingly willing to incorporate private-label products into their shopping repertoire. In Singapore, while only 56 percent of households tried private labels in 2004, more than 90 percent did four years later.

The signals are clear: no geography or category is immune to the increasing—and enduring—competition of private labels.

under-serving, and use differentiated innovation and brand building to target that subsegment. Strengthening the value tier dilutes management focus and fortifies the base of the category pyramid. There are situations—Kimberly-Clark is an example—where the opportunity to access a new channel or create purchasing, distribution and manufacturing synergies presents a compelling economic rationale. But these are rare. The best defense is to play offense: innovate and reinforce consumers' emotional connections to brands.

In value categories, the game is completely different. Defending against private labels requires a focus on cost position, managing price gaps and plowing excess returns into communication and innovation around benefits. Runaway leaders have little incentive to manufacture private labels because they already have scale advantage. But close rivals or follower brands can use private labels to tip the balance in their favor, particularly if private label has high share or if the category has a propensity for private-label growth (see sidebar, "What makes a category prone to higher private-label penetration?"). The French dairy Candia entered private-label milk and generated scale cost savings that were invested to develop high-margin, value-added milk products. That strategy allowed the company to remain the branded market leader in milk. American Italian Pasta Company (acquired by Ralcorp Holdings last year), whose brands include Heartland and Mueller's, manufactures private-label products for most major US grocers and club stores as a major source of growth in the dry pasta category. Today, it is North America's largest producer of dry pasta. Yet even for these brands, joining private labels requires caution—and the need to carefully monitor such metrics as return on invested capital as well as manufacturing and distribution utilization.

Before deciding which way to go, consumer products executives need to fully understand category characteristics, the options for defending against private-label growth and the economic scenarios of private-label participation by any of the leading players in a particular category. Only then can they make the right moves in a game that has undeniably changed—and has become too big to ignore.

What makes a category prone to higher private-label penetration?

For branded players in markets or categories with low rates of private-label penetration, understanding the threat of private labels starts by analyzing the characteristics that make it more likely for those products to gain a foothold. Bain analysis found 10 characteristics that explain the differences in private-label penetration across categories. Some of these characteristics reflect the nature of the product. For example, perishable goods more often attract private-label competitors than non-perishable goods. But many of the characteristics are within a brand's control. The higher the levels of innovation or media spend in a category, the lower the private-label penetration. Such considerations are invaluable in determining private-label strategies: where to play and how to win.

10 category characteristics are related to private-label penetration

Higher private-label penetration		Characteristic		Lower private-label penetration
28%	Highly fragmented	**Category consolidation**	Highly consolidated	6%
35%	Low	**Barriers to entry**	High	14%
30%	Infrequent	**Innovation**	Frequent	8%
30%	Low	**Media spend**	High	11%
19%	Warehouse	**Distribution approach**	Direct store delivery (DSD)	12%
32%	Narrow	**Product line breadth**	Broad	5%
28%	Low	**Perceived consumer risk**	High	6%
24%	Frequent	**Purchase frequency**	Infrequent	16%
31%	Single/standardized	**Active ingredients**	Multiple/complex	6%
32%	Perishable	**Perishable**	Non-perishable	18%

Source: Bain analysis, based on FDMx (Food, Drug, Mass excluding Wal-Mart) markets

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