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WHITEPAPER

WINNING SHELF SPACE
Private Labels or FMCG Brands?

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Consumer preference for Fast Moving Consumer Goods (FMCG), based on quality and affordability, in the high inflationary markets led to the emergence of private labels across geographies such as Europe, China, India, and the Americas. Higher margins provided by the private labels in comparison to established FMCG brands have resulted in higher sales push by the retailers and hence, has augured well for the growth of private labels.

This whitepaper is an effort to delineate the emergence of private labels and its impact on branded products in the FMCG sector. Through this whitepaper, we aim to delve in the current state of development of private labels globally, identify the headwinds and tailwinds for private labels, gauge the impact of these brands on established FMCG players, and evaluate the steps taken by established FMCG brands to arrest their eroding market share.

What are Private Labels and What Do They Offer?

Private labels, also called store brands, are created by retailers and suppliers after the products are procured from manufacturers or contract manufacturers. Sometimes, a retailer is a part of the wholesale group that owns the brands available to only its members. The economies of scale and brand equity of large grocery retailers make them ideal for the development and distribution of private labels. Hence, markets with high penetration of supermarkets/hypermarkets have witnessed robust growth in private labels across FMCG categories such as food and beverage, household care, and personal care. The products sold under the private-label category include fresh, canned, frozen, and dry foods; snacks, ethnic specialties, pet foods, health and beauty products, over-the-counter (OTC) drugs, cosmetics, household and laundry products, hardware, and auto aftercare.

Types of Private Labels

Private labels have expanded extensively in product categories that involve low brand equity, low innovation rate, price sensitivity, and high purchase frequency. The custom approach for each market has turned out to be their unique selling proposition (USP). The approach banks on the concept of “act local and think global”.

Private-label Categories

Source: Integreon - Leveraging the Recession for Growth

Over the years, private labels have evolved to be categorized into three broad types: value, mainstream, and premium. The products offered by the value category are sold at heavy discounts, but have satisfactory quality. Mainstream offers generic products at affordable prices compared with products from national FMCG brands. The premium category, however, offers products to match the quality of the national brands. The development of these categories was supported by various market segments and price-conscious consumers. By 2025, mainstream private labels are expected to become the largest market segment, accounting for about a third of the global market. Premium private labels will likely register a rapid rate of growth and in due course would challenge the prospect of the category leaders.

The Emergence of Private Labels – Capitalizing on Recession

The share of private-label products in FMCG retail has grown significantly since 2007. As of 2014, it garnered around 16.5%[1] (on average) of the global FMCG market. The global economic recession, which hurt consumer spending prowess, was one of the major reasons for the emergence of private labels across the globe. Low income levels and high unemployment rates paved way for cost-centric consumers, who resorted to private labels as means to economize their spending without compromising on quality.

The main drivers that changed the consumer's consumption pattern across the globe and consequently helped the emergence of private labels are as follows:

- Rise in urbanization, which increased the number of modern retail formats such as supermarkets, hypermarkets, convenience and discount stores.
- Growth in the population of youth, as well as rise in the number of working women.
- Increase in the disposable income of the middle class drove consumers toward packaged products for hygiene and better quality.
- Ability of private labels to offer affordable products compared with the FMCG brands.
- Sales push by retailers, as private labels offer higher margins (on average,10%[7] higher than the FMCG brands).

Together, these factors have shifted consumer preference toward private labels as an economical alternative. Additionally, there are not many established FMCG players in the grocery segment specifically pulses, grains, and spices and this presented an ideal opportunity to the retailers to tap the inherent gap in the market.

Typically, private labels offer competitive-quality products at rates that are 5–10%[7] lower than the FMCG brands, as retailers take into account the benefits of eliminating middlemen. In the US, private labels were reported to cost 29%[5] lesser than FMCG brands in 2012. Apart from providing cheaper alternatives, private labels provide consumers with a wide array of products to choose from. Generally, margins are quite high in staple food categories such as sugar and grocery.

Amid all other reasons, perhaps the most significant one was the change in the perception of consumers about private labels. These products are no longer viewed as cheaper alternatives, but have risen to the status of being the preferred choice.

> According to a leading retailer in the US, *"With improvement in the economy customers are looking for value offerings. The cut rate premium offerings of private labels and improved quality have fostered the emergence of private labels across FMCG categories."*

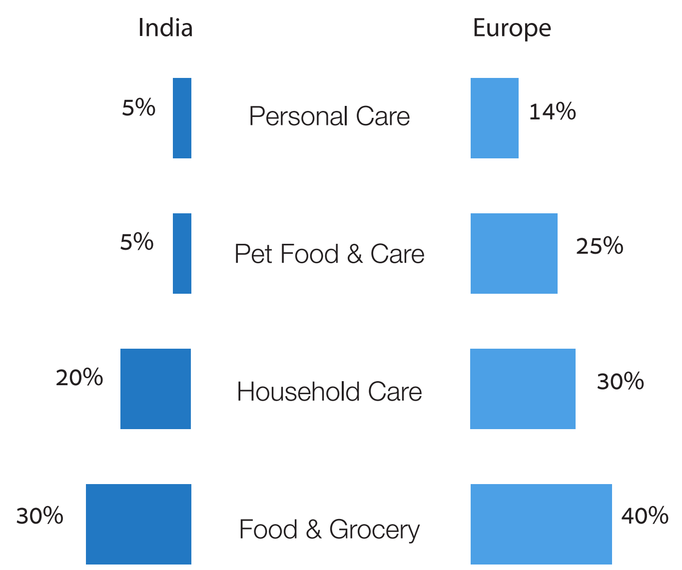
1 Report on global private labels–Neilson survey 2014
7 Primary research and Aranca analysis
5 Foodnavigator.com-http://www.foodnavigator.com/market-trends/private-labels-borrow-brand tactics-to-grow-market-share

Packaged Food and Grocery Dominate the Private-label Product Category Globally

Private labels were quick to respond to the global slowdown, capitalizing on the low growth in FMCG sales in 2014. These brands focused on innovative packaging and product categories, which are of primary importance to consumers and demand low involvement. Private labels are typically favored in generic non-packaged categories, such as rice, flour, and pulses, and this trend is more prevalent in the emerging markets compared with the developed ones. Globally, private labels have prospered mostly in the retail tissue and hygiene, packaged food, and pet foods segments. Furthermore, it was observed that the premium segment generated higher demand.

The level of private-label penetration across categories varies widely with geographies (Chart 1). In developed nations, the acceptance of private labels is quite high due to the presence of numerous modern retail outlets and discounters. Developing nations, on the other hand, have low penetration in these categories, as consumer confidence is yet to improve. In India, the food and grocery segment is a key driver for private labels, accounting for 30% of the sales. Meanwhile, the demand for household care products, such as tissue and toilet cleaners, has been rising in the private-label category and accounts for around 20% of the sales. In Europe, private-label products in the frozen food and grocery, and household segments garner over 30% of the market share in their respective FMCG categories, while personal care has around 14% market share.

CHART 1: PRIVATE-LABEL PRODUCT SHARE, BY CATEGORY – EUROPE AND INDIA, 2014



Source: Aranca Research

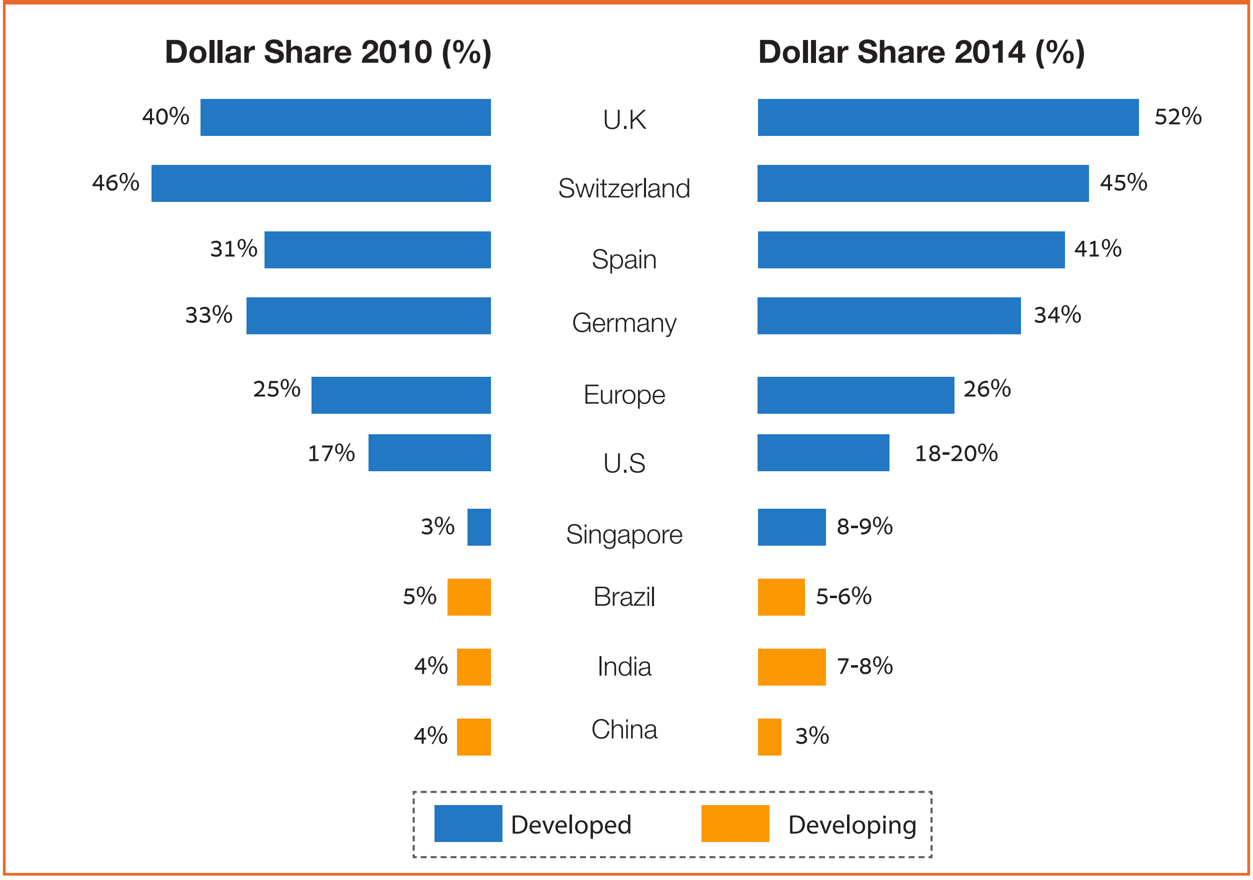
To summarize, it is evident from the trends that on a global basis, the food and grocery, and household care categories have been subject to high private-label penetration due to low customer engagement and less consumer stress on quality. Also, the absence of organized retail in the food and grocery segment supported the growth of private labels in this category.

The Rise of Private Labels Across Geographies

The perception about private-label brands is changing toward positive with the value shares in dollar terms being unevenly distributed across geographies. Developed regions, such as Europe, North America, and Australia, generate higher demand than developing regions, such as Asia, where brand loyalty for national brands reigns supreme.

In terms of private-label FMCG penetration, the UK leads the race among developed nations with 52% (Chart 2), as of 2014. This can be ascribed to the dominance of store brands of large retailers such as Sainsbury, Tesco, and Co-op Mart. Switzerland, Spain, and Germany are among other nations that have high private-label penetration of over 40%. The higher penetration rates can be attributed to the high concentration of grocery retail sales through modern retail formats, such as supermarkets and convenience stores, and the existence of numerous discounters. In the US, private-label penetration was 18–20%[7] in both dollar and unit share, with food being the most favored category accounting for around 70%[6] of the private-label sales ($115.3 billion[3], as of 2014).

CHART 2: COMPARISON OF DOLLAR SHARE OF PRIVATE LABELS ACROSS GEOGRAPHIES (%)



Source: Aranca Research and Neilson Survey 2014

Note: Europe includes average penetration of major countries in Europe

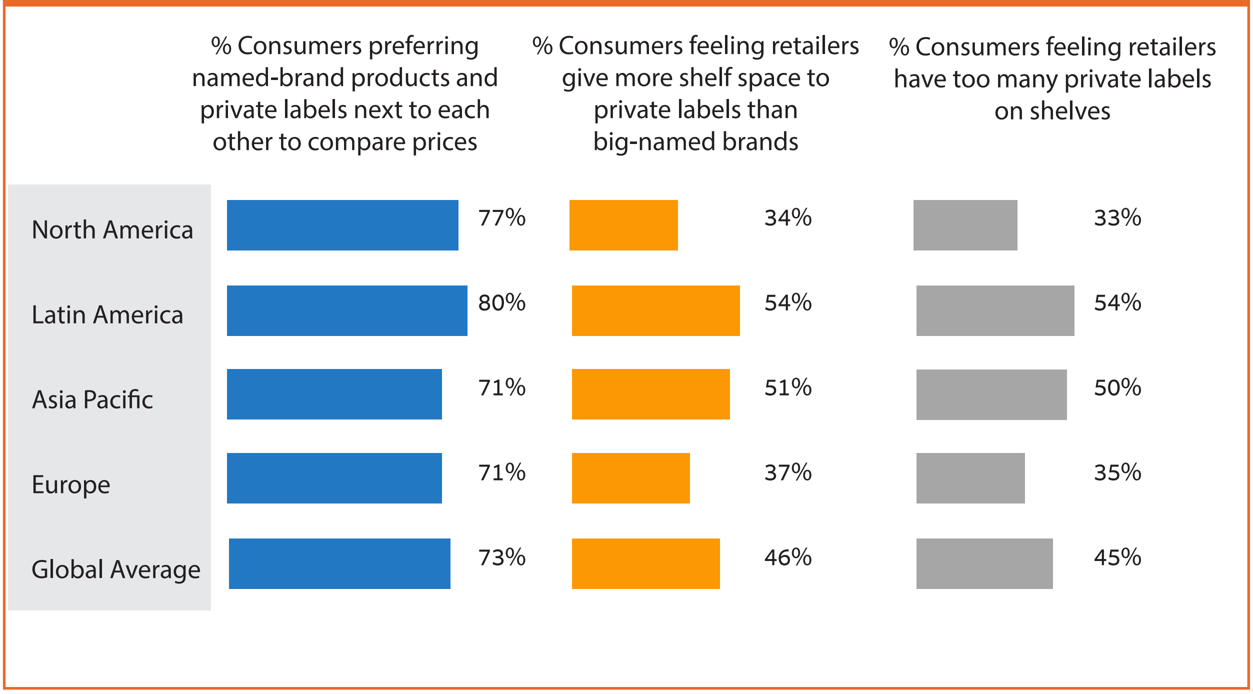
3 Private label year book, 2014–private label manufacturers association (U.S)
6 Prnewswire.com - http://www.prnewswire.com/news-releases/private-label-foods--beverages-in-the-us-8th-edition-300040777html/
7 Primary research and Aranca analysis

Kroger, Target, Wal-Mart, Safeway, and SuperValu are some of the major private labels in the US; accounting for about 17%[1] of the retail sales. The leading FMCG player in each category accounted for around 31%[1] of the sales, while the remaining 52%[1] is shared by other FMCG national players for the total FMCG sales in US. In the UK, private labels accounted for around 50%[1] of the FMCG sales, while the remaining was generated by leading national brands and other established FMCG brands.

In developing markets, such as India, private labels account for 7–8%[7] of the food and grocery market, covering categories such as packaged food, refined oil, and breakfast cereals that are sold in over eight million traditional food retail outlets, along with a few thousand modern retailers. However, in geographies such as Asia, Africa, and the Middle East, consumers fathom private labels to be of inferior quality than the big-name brands. In India, approximately 68%[13] believe named brands offer better quality, while in China this figure is close to 60%[14]. This is the primary reason why the penetration rate of private labels in FMCG has been restricted across developing countries. As a result, it required significant attention from private-label participants.

Consumers in developed nations, such as the US and some countries in Europe, are more tolerant toward private-label products with only one-third of the population believing that there is abundance of private labels in the FMCG segment (Chart 3). In developing markets, the tolerance is low and so is the number of private labels. Over 50% consumers believe that there are numerous private labels on shelves. Consumers in developing nations also believe that retailers allocate greater shelf space to private labels at the expense of national brands, which prompted them to visit multiple stores in search of their favored named brands.

CHART 3: CONSUMER RESPONSE (%) ACROSS GEOGRAPHIES ON VARIOUS PARAMETERS



Source: Neilson Report 2014

1 Report on global private labels–Neilson survey 2014
7 Primary research and Aranca analysis
13 http://business.time.com/2012/11/01/brand-names-just-dont-mean-as-much-anymore/
14 http://www.chinainternetwatch.com/12013/retail-private-label/

Do Private Labels Pose Any Threat to FMCG Brands?

Private labels in the FMCG segment are well poised for growth and are challenging the prospects of national brands, as they now have to compete for limited shelf space with the retailer's private-label products. Given the better margins, retailers often prefer to give more shelf space to their own products instead of national brands. Additionally, private labels have incentivized retailers by enabling them to earn margins of up to 60%[8] more than the FMCG brands in certain geographies such as India. This positive impact on the bottom line prompted retailers to stock more of private label products alongside the national brands. This is an encouraging sign for private labels and would increase their visibility. The national brands would have to rely on brand image which they have created over the years through extensive advertising and promotional campaigns and hence, need to take steps to save their diminishing visibility.

Several other factors have worked in favor of private labels, making them a reckoning force against national brands. The threat is more observable in the developed countries vis-à-vis developing countries.

- Private-label products significantly improved their quality, reducing the quality gap with the national brands' offerings.
- Some major private labels have been successful in creating their own brands, which seems to be a major concern for national brands. The credit for building the sustainable brand goes to premium private-label offerings such as Loblaw's President choice line of 3,800 items[4a].
- New product categories by private labels have helped boost their business.

According to a private-label brand in the US, *"Improvement in quality is important to challenge the prospect of national brands. In an attempt to offer quality products at affordable prices, they manufacture 40% of the store-brand products and contract the rest to vendors."*

The various categories of private labels are undoubtedly expected to erode the share of national brands; however, the major stakeholders affected are the second- and third-ranked brands. The category leader enjoys brand loyalty, leaving the onus on the second- and third-ranked brands to improve their positioning and perception through promotional campaigns. The established national players are focusing on optimizing supply chain costs, expanding presence across rural markets, growing brand reputation, and increasing the number of product lines. They are also using a segmented approach to determine the best channel to sell a particular FMCG product. These steps are all part of the grand strategy adopted by national brands to overcome the challenges posed by private labels.

According to a major global industry player, "The challenge posted by private labels varies across categories and regions. The challenge posted by private labels is still not quite severe in the personal care category, mostly in developing nations; however, household care product sales have been affected across regions."

Most major private labels across the globe opined that "though national brands enjoy an efficient supply chain advantage, it is no longer the forte of national brands alone."

Private labels such as Kroger in the US, Mercadona in Spain, Future Retail, and Reliance Retail in India have significantly improved their supply chain management leading to lower product costs. This dented the bottom line of major FMCG brands, as they have to scale down prices to meet this challenge. However, in the premium segment categories, national brands continue to enjoy considerable advantage.

4a. Loblaw-company website
8 Zenith research- http://www.zenithresearch.org.in/images/stories/pdf/2011/dec/zijmr/27_vol%201_issue8_zen.pdf

In the developing countries, national brands such as Hindustan Unilever (HUL) still enjoy considerable market share owing to their robust distribution network and rural market penetration. The FMCG brands' ability to associate themselves with a national cause gives them visibility and acceptance. In India, HUL initiated Project Shakti in rural areas to empower rural women with an ability to earn a livelihood. National brands still symbolize quality and the abundance of private labels may turn away consumers who may go to another retailer in search of the national-branded product. Thus, national brands still carry value for retailers. The journey to the top is still long and private labels have to achieve several milestones before reaching the top. It is their ability to offer niche products and identify gap in offerings of national brands that would help them challenge or surpass the national brands.

Stemming the Tide – What Can FMCG Brands Do?

The challenge posed by private labels for national brands may not be eminent, but their growth rate and rising penetration cannot be overlooked for long. In developed nations, such as UK, where private-label penetration reached over 50% (Chart 2) as of 2014, the threat is quite evident. In developing nations, such as India and South Africa, the robust growth rate of private labels in the last five years is a matter of concern. At this juncture, national brands should take steps to save their eroding market share and restrict consumer sentiment and preference from shifting towards private labels. The national brands should focus on the following:

Product Innovation
National brands, with their deep pockets, can invest in new product development and reduce the product life cycle to deem the private-label brands obsolete.

Line Extension
These brands need to identify customer needs and undergo line extension accordingly by launching new products in the existing product categories without creating clutter.

Cost Optimization
They should reduce product costs by working with suppliers and packaging companies.

Market Pull
National brands should improve their share of the customer's wallet through rigorous brand recall and aggressive positioning of the quality proposition of the brand.

Sales Push
These big-name brands should build trade relationships with retailers and embark on effective sales promotion strategies. The national brands should adopt different strategies for different product categories. For products with high private-label penetration, such as grocery and food, the focus should be on reducing price, while for low-penetration categories, such as personal care and baby care, the intent should be on maintaining high entry barriers.

Brand Extension
National labels could launch new products apart from their existing brands targeting specifically the private labels in that category.

Launch Effective Value Brands
National brands could introduce 'value' brands as a new private label to compete with the existing private labels and arrest their eroding market share. The new label should aim to acquire new customers in categories where the national brand is non-existent and should not cannibalize on the market share of the company's products.

CASE STUDY

The rise of organized retail paved way for the growth of private labels as observed across geographies. Private-label penetration varies across geographies, with the developed countries showing more tolerance than their developing counterparts.

United States (US)

In the US, the value of the food and beverages market was $530 billion[10] in 2013, of which private-label sales accounted for about $102[6] billion, up approximately 2% year-on-year. With a penetration rate of around 18%[7], many private-label brands have grown to be big enough to challenge the prospect of national brands in FMCG retail.

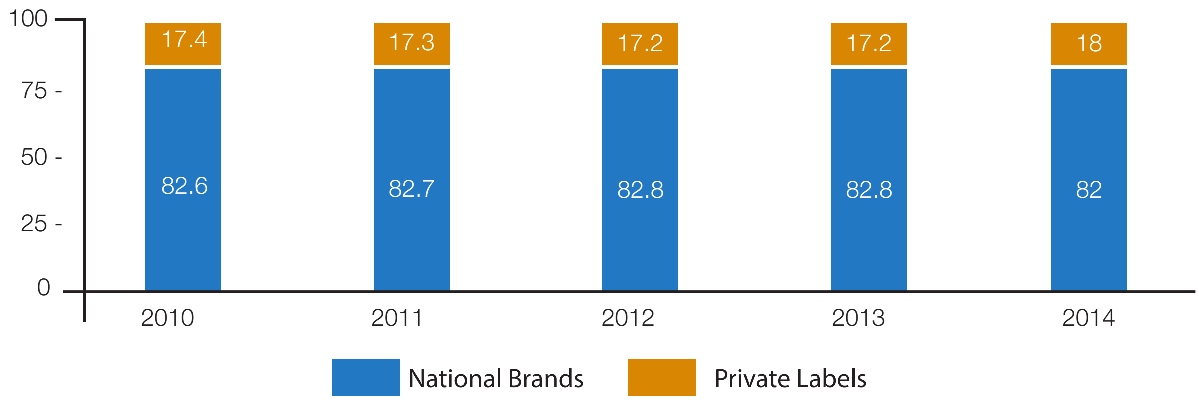
According to Rob Miller, CEO, Trailblazer, *"Consumers no longer view private labels as cheap alternatives, but as innovative and premium solutions to meet their needs. They have no reservation against paying premium for the same. Of late, private labels have extensively marketed their products as superior alternatives to FMCG brands."*

Safeway, Costco, Wal-Mart, Kroger, Walgreens, Carrefour and Tesco are some of the leading private labels that evolved over the years to reach their current status. Kroger, a leading retail chain in the US after Wal-Mart, hosts around two dozen private-label banners. In 2013, it generated about 27%[4b] retail sales through its store brands. Kroger main private labels include Ralphs, Fry's, King Soopers, Food 4 Less, Fred Meyer, QFC, Pay Less, Baker, and Smith's. In 2014, Kroger launched three brands, Psst, Check This One, and Heritage Farm, to target value-seeking customers.

Safeway[4c]

Safeway is the second-most selling private label in the US with 19 offerings ranging from frozen meat to personal care products. Safeways various store brands include Open Nature, the Snack Artist, In-Kind personal care brand, O Organics, eating Right, and Safeway Select. The company's revenue, which has been stable since 2011, was $36.1 billion in 2013. The key to success for Safeway has been its ability to place itself in the broad market category, thereby avoiding the challenge from discounters such as Wal-Mart and premium FMCG retailers such as Wegmans. Safeway emphasized on differentiation and offered various loyalty programs to earn customer loyalty. Meanwhile, it improved the supply chain efficiencies to gain cost advantage.

CHART 4: US – COMPARISON OF PRIVATE LABEL VS. FMCG BRANDS SHARE (%), 2010–14



Source: Aranca Research, IRI Market Advantage, 2013

4b. Kroger–company website
4c. Safeway–company website
7 Primary research and Aranca analysis
6, 10 Prnewswire.com-http://www.prnewswire.com/news-releases/private-label-foods--beverages-in-the us-8th-edition-300040777.html

India

In India, private labels garner around 7–8%[7] of the FMCG retail landscape, which was valued at around $45[11] billion in 2013, and is forecasted to reach $135[11] billion by end of 2020. Accordingly, private labels are estimated to be worth approximately $20[7] billion (considering penetration at around 15%) by 2020. Moreover, rise in the number of modern retail stores would help enhance the share of private labels to around 25%[8] by 2030. The ability of private labels to offer better quality, high food-safety standards, international look and feel, and customized packaging backed by retailer's credibility are the major factors fuelling the growth of private labels in India. The growth in supermarket house brands, especially in grocery retail in the FMCG category, is another encouraging sign for private labels. Grocery retail is expected to account for 40%[7] sales in the FMCG category.

The major retailers offering private labels include Bharti Retail, Aditya Birla Group's More, Nilgiris, Future Group, Reliance Retail, Godrej, and HyperCity.

Future Retail[4d]

Future Retail is the modern retail chain of Future Group. It has already set foot in 121 cities across India. It comprises outlets such as Big Bazaar (hypermarket), Food Bazaar (supermarket), Foodhall, and KB's Fairprice (convenience store). Future Retail has grown both organically and inorganically through acquisitions, joint ventures, and store expansions. In 2014, Future Group acquired Nilgiris, adding another 140 retail outlets to its portfolio of over 300 stores, to expand presence in South India and provide exposure to its private-label products. The key to the success of Future Retail has been its ability to improve on the supply chain, especially the cold chain, and introduce the concept of festive discount offerings and everyday low pricing to Indian consumers. The loyalty program offered helped Future Group build customer loyalty. In 2014, Big Bazaar won the most admired "Food & Grocery Retailer of the Year" award due to its ability to offer quality and fresh products at discounted prices.

South Africa

In the case of South Africa (SA), private-label penetration in grocery was around 18%[2] in 2014, rising from a mere 8%[12] in 2011. The increase in penetration is in accordance with the rise of modern retail and growing consumer preference toward private labels. Private-label retailers in SA, such as Pick n Pay and Shoprite, have gradually shifted attention from offering affordable products to premium offerings to earning long-term consumer loyalty with superior quality. Private-label players in SA have improved their supply chain efficiency, built brand identity, maintained supplier relationship, and developed new products and customer loyalty programs to challenge the prospects of leading FMCG brands. Some of the leading private-label brands in SA are Pick n Pay, Shoprite, Woolworths, and Spar Group Ltd.

Pick n Pay[4e]

Established in 1967, Pick n Pay is one of the leading supermarket chains in SA and offers a wide range of products including food and grocery, general household merchandise, pharmaceuticals, health and beauty, clothing and footwear. Since 2009, the company has focused actively on improving private labels. It offers products under two brands: Pick n Pay and Boxer. As a result of the improvement efforts, private-label sales jumped over 12% year-over-year from 2009. Grocery and food items such as meat, dairy, fruits, and vegetables contributed majorly toward private-label sales, accounting for 15% and 12% of the sales in 2014, respectively. The company has over 1076 stores in SA covering formats such as supermarkets, hypermarkets, franchise, and pharmacy stores, and has undergone major expansion to increase its reach in SA and other geographies such as Zimbabwe and Nigeria.

The company has embarked upon a growth strategy by following a good-better-best approach and offering customers a wide product range to choose from. It plans to target the burgeoning middle class of SA who often depict purchasing best products in each category (cherry pick attitude). In an attempt to efficiently manage its supply chain network, the company centralized its distribution facilities in 2011. Several social initiatives, such as collection of recycling materials from customers, have been undertaken to build brand identity and awareness.

2 http://www.retail-fmcg.co.za/old_news.htm
7 Primary research and Aranca analysis
8 Zenith research - http://www.zenithresearch.org.in/images/stories/pdf/2011/dec/zijmr/27_vol%201_issue8_zen.pdf
12 http://www.supermarket.co.za/news_articles.asp?id=3063
4d Future retail –company website
4e Pick n pay–company website
11 The Netherlands India chamber of commerce & trade-http://www.nicct.nl/indian-consumer-durables-and-fmcg-industry-analysis/

OUTLOOK

FMCG Brands Might Get Restricted to Product Categories with High Entry Barriers

Private labels have evolved as a reckoning force, capitalizing on the after-effects of the recession, and have emerged to challenge the prospect of established brands. The ability of private labels to offer good-quality offerings at affordable prices and create new packaged product categories helped the growth of private labels. Private labels have done well to understand the inherent needs of organized food retail, and hence, have targeted market gaps that were either not generally catered by FMCG brands or they had limited presence. Some private-label brands have emerged as strong brands and command market pull and customer loyalty, which are generally associated with the FMCG brands. Food and grocery categories would be dominated by private labels in the future due to the low entry barriers. After undermining the threat from private labels for some time, FMCG brands have finally stood up to the challenge and are investing in product development and promotion, and are initiating flanking marketing strategies to face the challenge. FMCG brands need to focus on high entry barrier segments, such as personal care, which until now have been not fully targeted by private labels. To sum it up, it is yet to be discovered as who shall win this battle; however, the competition guarantees that consumers would be at the vantage point in this fight for shelf space.

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