Setting a strategy for private label

What began as a value offering has evolved to being an extension of a retailer's brand, and in some cases a unique selling proposition (USP). The increasing dominance of private label means that CPG brands need to respond strategically to the opportunities and risks.

With rising inflation fuelling cost of living pressures in Australia, the value proposition of private label products will undoubtedly continue to resonate with price conscious consumers. However, over the past decade, private label has evolved to encompass much more than a high value option. While private label is sometimes decried as a 'category killer' it has in fact spurred innovation by driving up competition.

In the beginning, private label was designed with the value shopper in mind. Its aim was to drive frequent consumption, potentially as a result of that value. There has since been a premiumisation of the private label proposition. It has become a point of differentiation for retailers and a reinforcement of its unique selling proposition (USP).

Private label introduces significant price competition, which is good from a consumer perspective. It also spurs innovation, which is a win for consumers and brands.

Private label effectively forces innovation on branded firms and provides some healthy competition. That doesn't mean it's always successful, but it forces even the big brands to ask themselves whether they have a clear value proposition versus the private label alternative.

For those on the front foot, 'private brand' is quickly becoming the equivalent of 'store brand.' Aldi is known for the success of its high quality, good value private label products, including award winning wines for a fraction of what rivals charge. Aldi's private label dominates its range – a branded alternative is offered only if it is the 'hero' brand in a category, such as Milo in flavoured milk. More than three-quarters of ALDI sales come from private-label products, compared with less than a quarter in Australia's biggest supermarkets, according to IRI research. Their success has prompted other retailers to match the offering to prevent losing basket share.

Indeed, retailers across the world have invested deeply in their private label ranges, as it represents the greatest potential for growth across multiple categories, most notably petrol and convenience and packaged grocery. Costco, for example, increased its private label Kirkland Signature brand by 10 percent to $US39 billion in 2018, and up from $35 billion the previous year.

In Australia, private label has an 18 percent market share of all FMCG retail dollar sales and it is growing at twice the rate of branded products, according to IRI research. The current market share in Australia is similar to the United States, but it is significantly lower than mature markets like the United Kingdom, where it is 47 percent. The UK has 'good, better, best' private label options in a diverse range of categories, including vitamins and other health and wellness products. Australia is expected to see a similar diversification trend, as conditions are favourable to the growth in private label. Consumers are increasingly cost conscious and no longer perceive private label as a quality compromise, while manufacturers face cost pressures that contribute to changes in basket size.

Local trends spell growth

There is significant room for growth in the local landscape. In Australia, private label is currently most prevalent in established ranges of product categories, however it can also serve to build smaller categories by introducing price-conscious shoppers to new products. And just because a category is well-established, it does not necessarily follow that private label will be well represented. Confectionary is one such outlier, as it is dominated by well-known, established players.

Private label rarely exists in a new category. The exception is when a retailer lacks a suitable equivalent at scale. For example, healthcare has been a particular area where Woolworths has used its Macro brand to lean into healthy product ranges because it was unable to find suppliers that could accommodate its vast supply chain.

With supply chain issues posing problems for manufacturers around the world as a result of the global COVID-19 pandemic, there has been a growth of private label in certain ranges where securing supply is difficult or unreliable.

Who wins?

There is no doubt that retailers benefit from the growth of private label. Retailers can realise 25-30 percent higher margins on private label goods than from branded products, according to CB Insights.

Consumers also value having lower cost options, and most are unaware that a product has been manufactured by a mainstream brand, even often using its recipe, but is packaged under the retailer's name. Just one-third of Australian shoppers feel brand names are important, and more and more Australians are seeing that store brands and private labels are of equal quality.

But is it beneficial for suppliers to enter a private label arrangement? Determining a private label strategy requires weighing up a complex range of factors. A private label arrangement is useful to cover a rising fixed cost base – insofar as it doesn't add extra manufacturing costs. While a private label arrangement will boost volumes, it can dilute margins. A supplier should carefully weigh up the overall impact on its bottom line and be well aware that these contracts are often only six months long. Once the contract ends, the retailer walks away with a high level of transparency into a product's cost base. Another consideration is this: can a brand afford to decline an offer from a retailer to enter a private label agreement? In some cases, it may be considered part of the 'pay-to-play' reality manufacturers face.

Today's bold moves

- **The current market share of private label in Australia is 18 percent, which is significantly lower than mature markets like the United Kingdom, where it is 47 percent.**
- **Private label can spur innovation. Ask yourself, before your competition forces you to; do we have a clear value proposition versus the private label alternative?**
- **Don't assume just because a category is well-established, private label is well represented. There are significant pockets of opportunity in Australia to outpace competitors by introducing price-conscious shoppers to new products, especially in categories such as Confectionary**
- **Suppliers need to be cognizant of the fact that a private label arrangement could boost volumes but dilute margins. Weigh up the overall impact on the bottom line.**

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