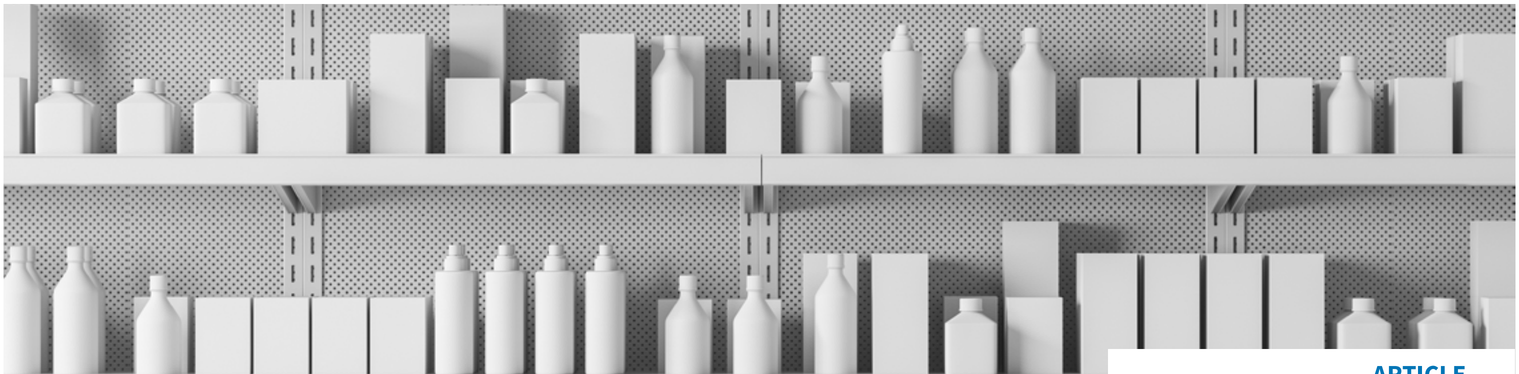


ARTICLE

Is Your Private Label Brand Underperforming?

Consider These Solutions

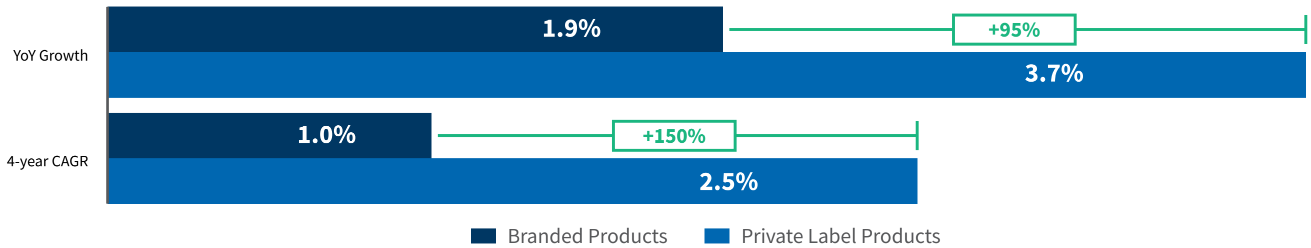
Private label sales growth outpaced branded products in recent years. This disparity will widen further with the downturn in the economy. FTI Consulting has observed that companies often manage private brands sub-optimally, leading to increased costs and an inefficient process. Given the economic impacts of COVID-19, this must change. A recent survey[1] found that 75% of consumers had tried new brands from new places, or otherwise changed how they shopped since the pandemic. Retailers and CPG companies must improve their response to changing consumer needs, as 97% of manufacturers believe that the retailer/CPG – manufacturer relationship should be more agile adjusting to product demands. We believe the following:

1. **Private label is growing, with companies investing in the category to drive sales and margin**
2. **Companies often setup an inefficient private label organization, which increases costs and inefficiencies**
3. **Cost savings are real, anywhere from 10% to 60% depending on the product component**
4. **Savings realization will be fast, if you manage vendor relationships and internal expectations**

The sharp rise of private label has been well documented through past research and articles. Consumers, drawn to cost savings of private label products, have also been swayed by the continued improvements in product quality. Private label sales[2] grew 3.7 percent YoY in 2019, compared to 1.9 percent growth for branded products. Private label also compares favorably over the longer term, with a 2.5 percent, four-year CAGR versus 1.0 percent for branded. We expect this trend to continue, given the current economic downturn. A recent FTI Consulting consumer survey[3] revealed price as a primary driver for shoppers, both during and after COVID-19. With price being a critical consumer consideration, private label will benefit.

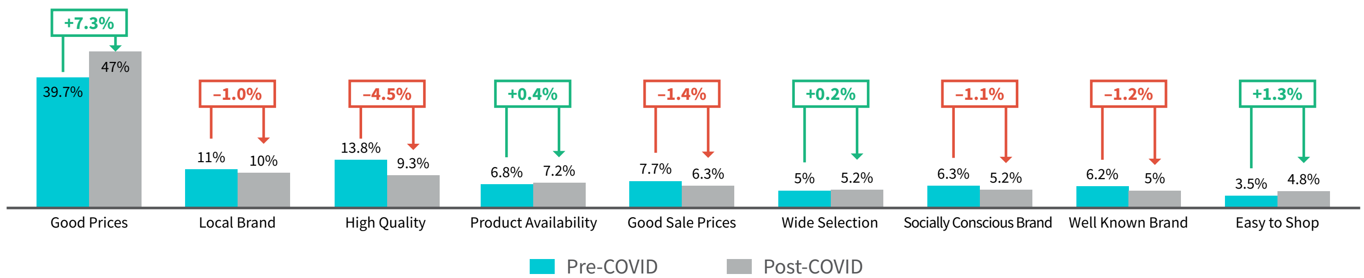
1. McKinsey & Company, *What Consumer-Goods Sales Leaders Must Do to Emerge Stronger from The Pandemic, 2020*
2. Nielsen, *Total Consumer Report 2019*
3. FTI Consulting, *Consumer Preferences During COVID-19, 2020*

Exhibit 1 - Growth of private label brands



Source: Nielsen Total Consumer Report 2019

Exhibit 2 - Top purchase drivers pre-COVID and post-COVID



Source: FTI Consulting

For retail and CPG companies, there's incentive to continue investing in the category. Companies enjoy more control over the brand and realize improved margin when selling private label. The more sales an organization can drive from national brands to private brands, the better.

But for all the benefits of private label, the category does not come without challenges: more control over product development places a heavier burden on internal teams. When a company isn't prepared to manage this process, we see three common missteps:

1. **Undefined organization structure and responsibilities:** Companies invest in private label without creating an internal team to manage the process
2. **Limited visibility to cost drivers:** The component pricing of products is unknown
3. **Misunderstood product purpose:** Teams lose sight of the private label vision and make unnecessary product decisions to compete with branded items, which drives costs higher and erodes margin

1. Undefined organization structure & responsibilities

The governance structure for the private label brand should be established before launch, with a focus on creating roles to achieve revenue and margin targets. The brand team will typically have overall responsibilities for the product and will work closely with their merchandising and planning counterparts. Brand is supported by product development, which handles the design, development and commercialization, as well as by sourcing, which acquires the raw materials. To achieve the revenue and margin targets, these teams must have clear roles and responsibilities and defined decision criteria to inform each step in the process.

Unfortunately, many companies do not take time to fully design and implement the optimal team. Rather, they move quickly to realize the benefits of private label, without ensuring that they put the right resources in place to manage the brand over the long term. Subsequently, when growth occurs, the company ends up scaling a broken internal structure that is not positioned to run the business.

When the organization isn't well established, companies tend to rely on the manufacturer(s) of the private brand to manage the end-to-end product creation process in a "turnkey" operation, where the manufacturer sources raw materials and components for each item. In this scenario, brand ownership and cost control are forfeited to the manufacturer, who takes on most of this responsibility. For the retail or CPG company, this causes a culture of contract renewal without questioning and acceptance of cost increases without visibility, and fosters a mindset that they are "stuck" with the manufacturer.

2. Limited visibility to cost drivers

In these instances, companies lack insight into the cost drivers of the products they are producing. Specifically, they tend to have little sense of what component pricing (e.g., ingredients, packaging, etc.) comprises the all-in "unit cost." An organization can build its own cost model, tracking component prices at the SKU level. The process may involve asking the manufacturer for the information (depending upon contract constraints), or be as detailed as reviewing product creation forms where such costs are typically listed (and promptly forgotten). Regardless, this type of undertaking requires a dedicated resource, and without one in place, the manufacturer will dictate the process. Because manufacturers are not responsible for controlling costs, there is little oversight and they are not incentivized to keep component costs low.

A retailer or CPG company can take back control by dictating to the manufacturer which supplier they should source their component (raw material and packaging) goods from. By combining the company's volume across the product set around a finite group of component suppliers, pricing can improve through volume discounts. When identifying their own suppliers, the organization will also control which costs are worth investing in. This strategy will change the supply chain, as the company will have more influence over the product development process and visibility into the costs that drive their private label. Our experience with identifying suppliers to source component goods for a client yielded the following savings opportunities:

- **Bulk & Fill** – cost savings opportunity between 10 percent and 20 percent
- **Caps** – cost savings opportunity between 10 percent and 20 percent
- **Bottles** – cost savings opportunity between 20 percent and 30 percent
- **Labels** – cost savings opportunity between 40 percent and 60 percent

3. Misunderstood product purpose

Lack of internal ownership also causes the organization to lose sight of the original private label premise of maintaining strong margins. When developing their own brand, the organization will often select pricier raw materials and expensive packaging to compete with the branded products. While a balance between these variables will always exist, an internal team that owns the brand will be more likely to control these costs than will a disjointed group of decision-makers.

In one example, we worked with a retailer that used a unique color combination of bottle and cap along with a screen-printed label for their private label product. We engaged the manufacturer to understand how we could change the packaging to cut costs without sacrificing brand integrity. In one option, the manufacturer proposed a scenario which cut annual packaging costs in half and increased gross margin between 2 percent and 5 percent.

MAKE COST SAVINGS A REALITY

For an organization, identifying savings opportunities and executing on a proposed packaging implementation are two separate problems. Any transition will offer a unique set of challenges, and these are some obvious hurdles to be mindful of:

1. **Component testing:** Qualifying new suppliers with product manufacturer(s)
2. **Ordering process:** Managing minimum order quantities across product manufacturers
3. **Internal expectations:** Preventing teams from losing sight of the mission

1. Component testing

All product manufacturers will require a thorough testing process of newly recommended components. While this may sound simple, it will take time. Prepare for delays, given the iterative nature of suppliers perfecting specifications and manufacturers testing each item.

2. Ordering process

While the testing process will work itself out in time, a company may have more difficulty encouraging product manufacturers to adhere to component supplier minimum order quantities. When bifurcating the supply chain, the company takes a more integral role in the process and forces their product manufacturer(s) to order from an identified components supplier at a set, negotiated cost. The contract manufacturer is likely unaccustomed to being held to a specific order quantity from a specified supplier. In the beginning of the transition, frequent communication between the company and suppliers is critical; outline expected orders and volume, and set clear expectations between suppliers. Additionally, introducing a regular forecast that is issued to all parties will assist in the planning and ordering process.

3. Internal expectations

Even in a well-defined organization, there will be natural tension between product development and sourcing, as the groups manage the revenue and cost elements of the business. Changes to a supplier, or to other elements of the product, may be challenged by members of the product development team. In these instances, the organization must be mindful of the original private label premise. Ideally, a strong internal organization will have created a brand that considered costs during initial product development. After all, it is easier for a company to "flex up" and spend more as the brand takes off, rather than scale back costs once they realize margin is below targets. The company should also maintain a thorough understanding of what is important to the consumer. Use customer data, consumer surveys and market research to derive insight into what product changes might influence demand. This information will inform all product decisions. With that said, never forget the end goal: hitting revenue and margin targets without compromising product integrity.

Moving forward, we expect consumers will continue to gravitate towards private label. For a retailer or CPG company, this should be viewed as an opportunity to develop and maintain a brand that resonates with consumers, delivers high-quality products at an affordable price and creates loyalty with shoppers. To maximize success, however, organizations must also stay focused on the cost drivers in order to effectively capitalize on the promise of improved margin. Internal ownership, product decisions, product manufacturers and component suppliers all play a role in impacting costs. If you've let the process get away from you, there is money to be recouped by regaining control. Challenges may arise during the transition, but once completed, your bottom line will tell a story of success.

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