CORPORATE TRANSFORMATION SERVICES

GOING IT ALONE: THE RISE OF PRIVATE LABELS IN THE POST-PANDEMIC ERA

Introduction

Three years after riding out the pandemic storm, grocery retailers are facing unprecedented pressure on their margins due to soaring inflation and the worst cost-of-living crisis in a generation. The squeeze is coming from all fronts, with cash-strapped consumers looking to obtain higher value from their purchases and suppliers requesting price increases because of rising commodity prices.

This changing dynamic provides an opportunity for businesses to set themselves apart through their private label strategies. The tactic is gaining prominence in the current economic environment as shoppers rapidly switch to private label products to avoid national brands' steep price hikes.

With private labels gaining an increasing market share across Europe, A&M has been helping companies capitalise on the moment.

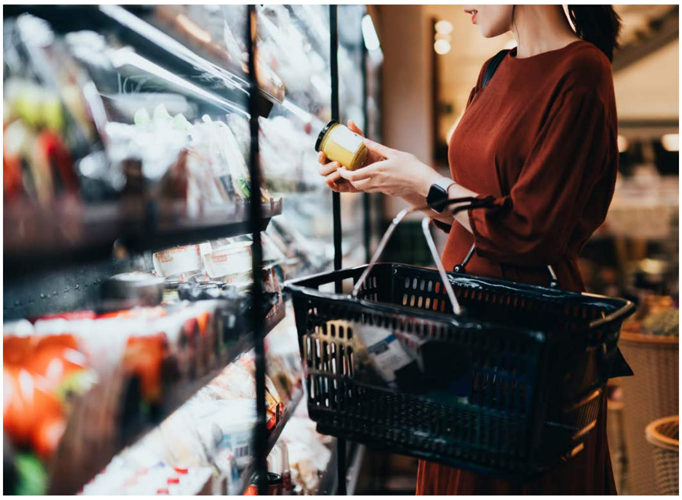
Private label goods now combine better value with elevated quality

Household spend on private labels globally increased by more than double the rate of branded goods last year, a recent report by Kantar[1] showed. In Europe, these products now make up 38% of total fast moving consumer goods (FMCG) value sales, worth an estimated €229 billion, and in many categories their popularity has outpaced that of national brands[2].

Private label has historically covered only basic ranges and focused on offering generic products of trusted brands. But the strategy has matured over the years to reflect fast-changing shopping habits and new market dynamics. Today, retailers with successful private brand propositions have become innovators in their own right, continually launching and refreshing their portfolio of products, including offerings in organic, free-from and premium categories.

Buyers increasingly expect national brand-quality – or superior – when buying a private label item, while still tapping into the all-crucial value equation. To respond to that, best-practice retailers have strengthened their quality standards around sourcing, packaging and marketing. In fact, recent research revealed that 60% of shoppers in Europe now perceive private labels as equalling national brand quality.

In addition, with many customers more concerned with eating healthier and limiting their carbon footprint, ingredient quality and traceability as well as sustainability in packaging have become key to maintain and expand customer base within retailers' private label strategies.



1 https://cdne.kantar.com/inspiration/fmcg/private-labels-buying-less-and-discounters-consumers-global-coping-strategies

2 https://www.circana.com/press-releases/2023/private-labels-capitalise-on-the-cost-of-living-crisis-to-make-up-38-of-total-fmcg-value-sales-in-europe-e229-bn/

Four benefits of increased private label penetration

Increasing private label penetration can produce wide-ranging benefits for retailers, including higher levels of customer loyalty and satisfaction, as well as improved working capital position and profitability.

1. Increased Profitability and Working Capital to Fund the Future

Gross margins for private label grocery products across categories averages around 35% compared with just 20% for branded products. Grocers can generate additional profits by making private label growth a strategic priority, and benefit from the lower acquisition cost of private label products, which can improve cash flow and reduce working capital, something critical in times of higher rates and more expensive capital.

This gives grocers the freedom to fund the near future by tracking evolving consumer trends and reinvesting in own-brand promotions and pricing. It also allows businesses to compete with leading national chains by making investments in value-added services, technology, e-commerce, and product and packaging innovation.

2. Boost to Customer Loyalty and Category Leadership

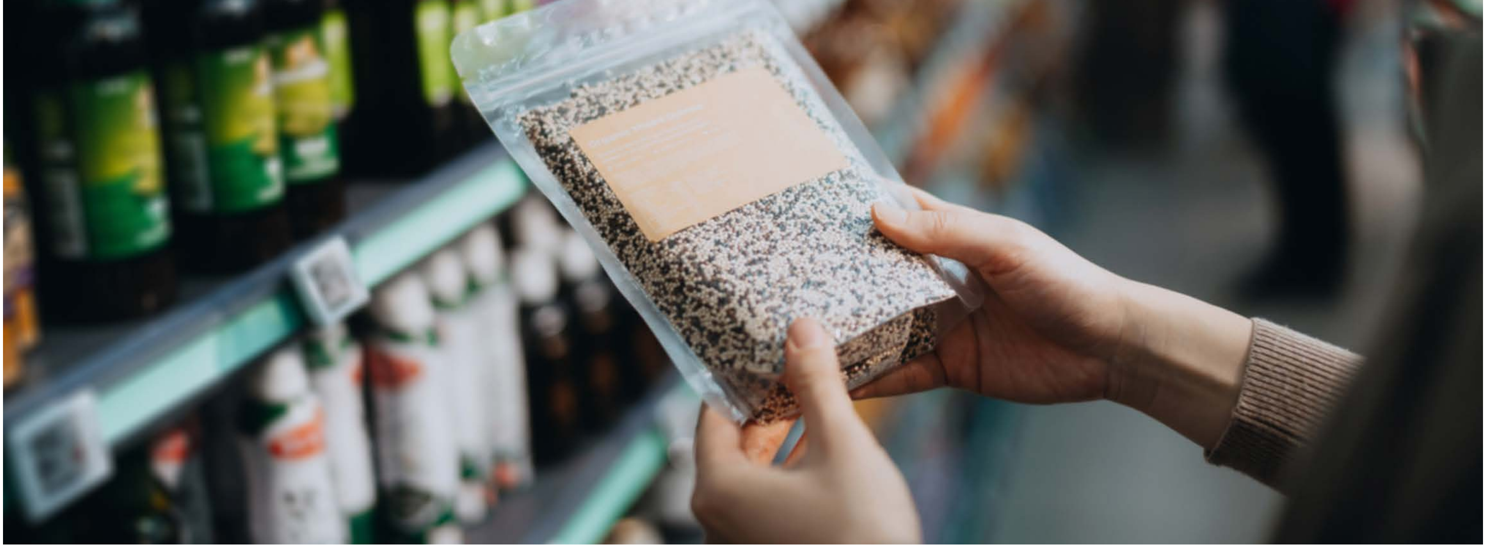
Growing own brands through improved penetration ultimately increases store traffic and consumer loyalty. The strength of a private label brand is often as important as the store itself. Capturing these customers' loyalty to store brands can help retailers expand beyond traditional categories and into those with higher margins.

3. Operational Excellence & Supply Chain Resilience

Growing private brands and strengthening supplier relationships can improve supply continuity, on-shelf rates, and boost supply chain efficiency. Private brands thrived during the pandemic, and as the pressure on supply chains induced in that period begins to ease, supply chain resilience will continue to be a focus for grocers needing to deliver on their customer promise.

4. Increased Leverage with Branded Manufacturers

Mature and robust private label programmes create the opportunity to improve leverage with branded manufacturers. As private label share of shelf increases, grocers negotiating power over manufacturers grow stronger. This can translate into better wholesale prices and terms, increased trade fund rates, and increased allowances in categories where private label is strong.



How grocery retailers can accelerate their private label strategies

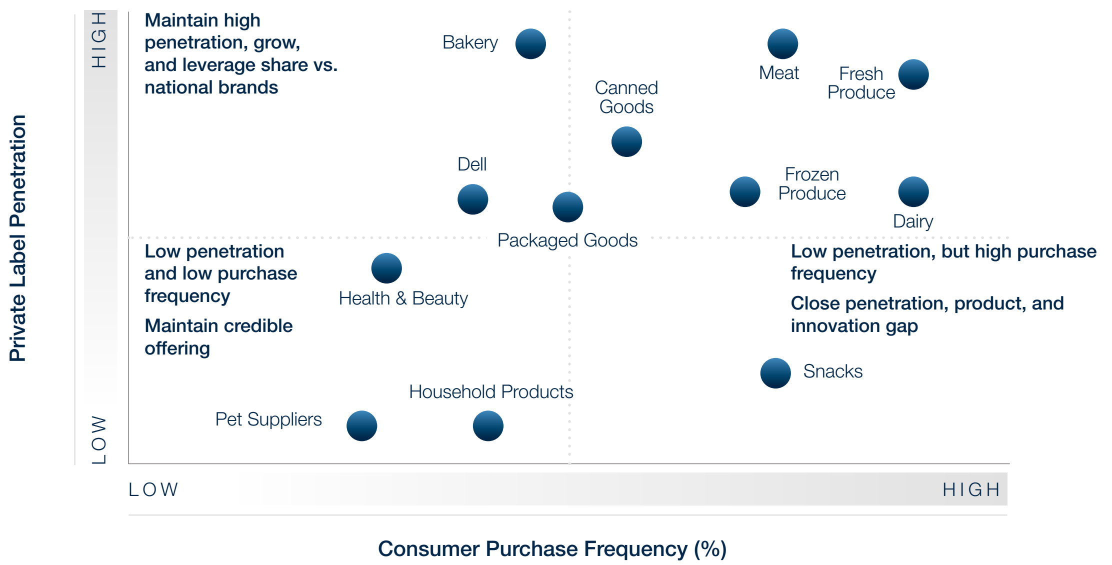
To significantly increase own label penetration A&M recommends retailers review their existing operating model, putting private label as the central offer. This can begin with developing a private label assortment from the ground up, and then adding national brands whenever they address a unique customer need.

Critical to this is understanding the different penetration levels depending on the product category, owing to different strategies adopted by retailers in recent years.

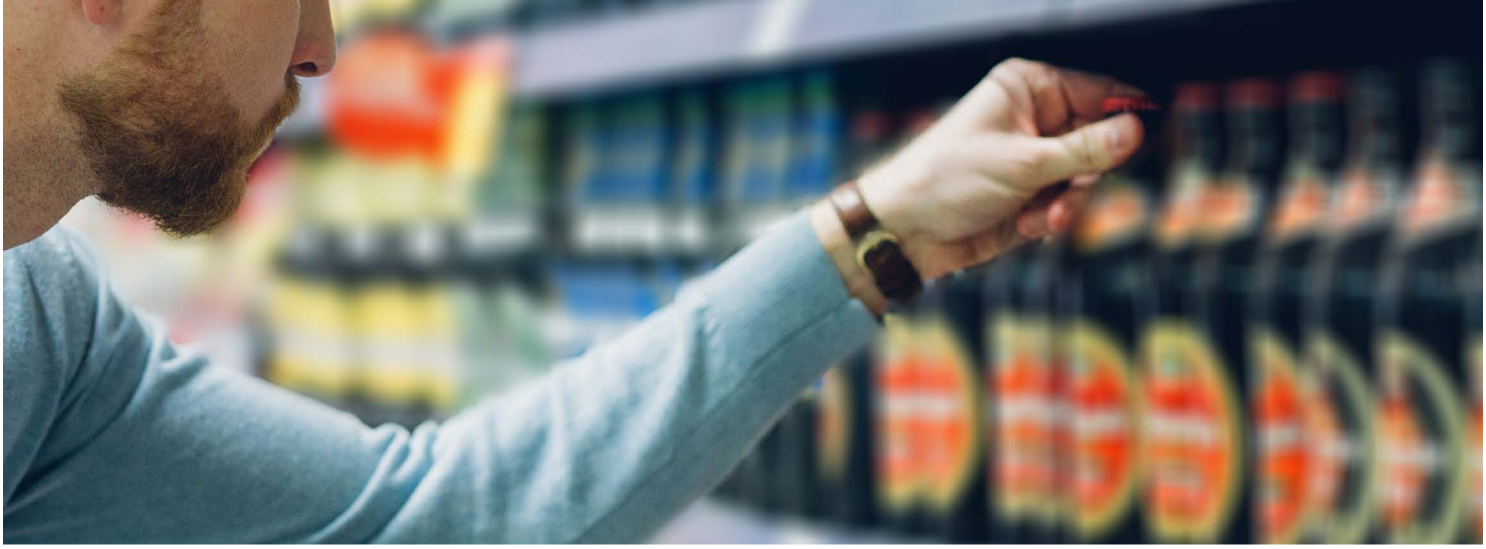
From its own analysis of syndicated and consumer survey data, A&M has found a varying approach to select categories.

For example, packaged goods such as cereal and oatmeal have become key target categories. Consumers directly compare private labels with brands such as Kellogg's when evaluating value and quality. With frozen and refrigerated products, a proliferation of own label goods has also been observed in recent years.

Figure 1: *Select Categories, Private Label Penetration vs. Purchase Frequency*



Source: *A&M analysis, FMI, Consumer Insights, Company websites*



Greater difficulty has been found in Health and Beauty and Pet Supplies for example, which tend to offer high margins but are hard to execute due to packaging requirements, brand recognition, and consumer affinity. That said, some hard-to-execute categories, such as bakery, deli and fresh produce items, may present tremendous opportunity given their role as traffic drivers.

Many retailers have seized the initiative and found a niche. Alcohol is one sector where brand loyalty continues to stand strong, but that didn't deter discount retailer Aldi partnering with craft beer company Brewdog to create a limited-edition drink last year. These collaborations can enable retailers to leverage the weight of premium brands to offer a greater choice.

Other key areas that need to be addressed to build an effective strategy includes:

Strategy & Organisation

Using group synergies in purchasing, quality process, supply chain and others to efficiently support private label growth. Changes in organisational structure, such as the reconfiguration of central and country teams, may also be required.

Promotions

Reassess private label promotional activities to support the penetration ambitions. Business leaders must also consider how much funding must be secured to cover the margin loss and cost of promotions.

Impact on national brands

A private label strategy will impact on national brand price and volume negotiations, including shelf space allocation. Retailers must assess the impact of such negotiations on the longer-term supplier relationship.

Data

Customer and sales data can be leveraged to identify the "must have" national brands. Updates in reporting and performance monitoring should also be implemented to support the private label-focused operating model.

CASE STUDY

Increasing private label penetration at a global grocery distributor

In one recent engagement, A&M worked with a global wholesale grocery distributer with a revenue of over $10 billion and over 3,000 stores. The company had multiple private label brands from opening price point through to premium, although with an ambiguous and overlapping brand value proposition.

The overall private label brand programme was significantly underdeveloped, with PL penetration of around 12% to 15%, with some divisions significantly below this average. Its organic and premium offerings were at early stages of development.

What did A&M do?

Conducted primary market research in key markets to understand private brand purchase decisions and retailer brand awareness, perception, and opportunities across the architecture

Identified value opportunities across category penetration and white space, promotion spending effectiveness, assortment, and price pack architecture

Conducted executive level workshops to review, refine, and align on brand value proposition, opportunities, and required areas of strategic investment

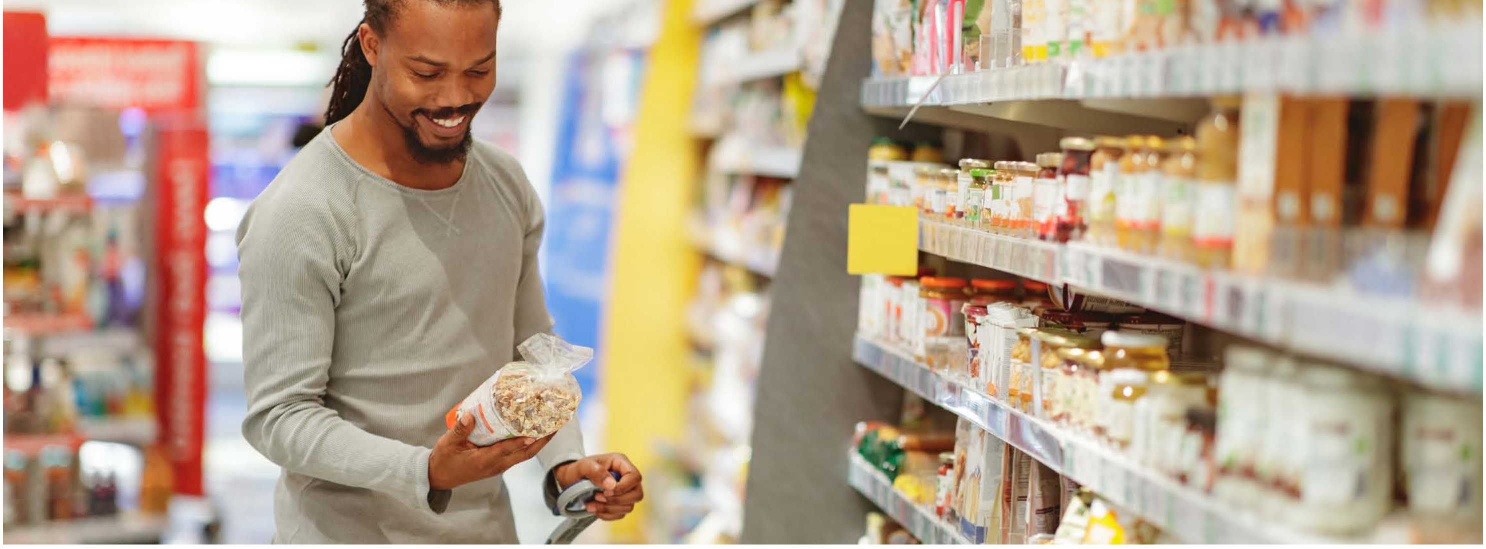
While developing the overall strategy plan, **initiated an aggressive sourcing programme to realise in-year benefits**

Designed a **comprehensive private label strategy plan**

Results

Sourcing programme **delivered with an identified** 2% to 4% **cost reduction** for categories sourced

Strategy implemented with a glidepath to **increase sales by** 35% to 50%



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KEY CONTACTS

David Benichou
Managing Director

dbenichou@alvarezandmarsal.com

Anthony Gibbons
Director

agibbons@alvarezandmarsal.com

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