Co-Opetition's Impact on Retailer and National Brand Manufacturer Relationships

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At the same time that brand marketers have been investing to make their retail relationships more strategic and collaborative, retailers have been investing in Private Brands which directly compete with National Brands and realizing tremendous success with them. At least for some marketers, this situation is cause for concern, and is confusing and frustrating. Successful resolution to this situation will depend in part on changing attitudes and behaviors among both branded suppliers and retailers:

- Some Consumer Package Goods marketers (CPGs) view retailer brands as competition. However, they may be willing to support programs that promote retailer brands in categories in which the CPG does not directly compete. More importantly, CPGs want to drive volume through display support without having to heavily discount their products.

- Many retailers, on the other hand, are concerned about potential loss or diversion of trade funds ("supplier resources") from their local programs. They want the CPGs to fund incremental programs with dollars from national marketing budgets.

Clearly, there are many issues to air; but what is also clear, after speaking with our panel, is that there are opportunities that can result in mutual benefits as long as both retailers and manufacturers are willing to explore new approaches to working together including joint, related-item merchandising.

This white paper will explore the issues and opportunities associated with these complex relationships, and seek to identify ways to generate mutual gains. To help shed light on the subject, we gathered a distinguished panel of senior retailers and manufacturers via webinar on 9/29/09; the panelists included:

- Andy Abraham, VP Our Own Brands, SUPERVALU. Andy is a classically trained senior international marketing executive. Prior to SUPERVALU, Andy was with P&G, Radio Shack, Roundy's, and Playtex.

- Tom Ewing, Director of National Accounts, Private Label, and International, T. Marzetti Company. Tom's career began at P&G and continued to Frito-Lay, Borden, Inc., and now T. Marzetti.

Tom has also served on the Private Label Manufacturer's Association board.

- Dan Glei, SVP of Grocery, Giant Food Stores. Dan is currently responsible for the Non-Perishable departments. He has experience in working for both CPGs and retailers which brings a well-rounded view of the shopper.

- Nick Hahn, Retired Director, Corporate Brands, The Kroger Co. Nick is a 40-year veteran of the food industry. Prior to his retirement, Nick was responsible for the total Kroger Corporate Brands Program. Nick served as a member of the PLMA Retail Advisory Council and the Kroger Supplier Diversity Leadership Council.

- Anthea Jones, SVP of Store Operations, BI-LO, LLC. Anthea has over 25 years of experience in the supermarket industry. Anthea started his career at Food Lion where he held essential roles important to his success today. Anthea serves as Vice Chairman of the Global Market Development Center.

- Joe Landfair, VP Sales, Barilla America, Inc. Joe has a broad set of experiences including DSD, customer marketing, category management, and functional team leadership. Prior to joining Barilla America, Joe was at P&G, E&J Gallo, Mott's Inc., and Cadbury Schweppes.

- Bill Sever, VP, Chief Marketing Officer, Sunstar Americas. Bill has more than 25 years experience in the consumer goods industry. Prior to joining Sunstar Americas, Bill was at Pharmacia & Upjohn, P&G, Kellogg's, and Spectra Marketing and Homescan.

This white paper draws upon that session and Willard Bishop experience to reach its conclusions. Here are the headlines from the webinar we held:

- The tension that the growth of Private Brands produces can be real, and is felt most strongly by the number three or four share brands in a category, or brands without a distinct "reason why" they fill consumer needs better than Private Brands can.

- Alignment around best satisfying consumer needs is the key to long-term successful collaboration between retailers and manufacturers; National Brand marketers should accept that Private Brands likely play a significant role satisfying such needs.

- Collaborative merchandising joining complementary National and Private Brands is a low-risk, high-return approach to quickly generating mutual benefits and reducing tensions between trading partners.

To fully absorb these conclusions, let's first review the historical context:

- Brand marketers have been investing in retail relationships for a decade or more. Their investments include financial resources, personnel such as customer teams, and intellectual property whether in the form of proprietary software and models, or consulting services. These investments have made customers more successful and more competitive, and the investing suppliers have been rewarded with disproportionate growth in sales and profits. Willard Bishop research suggests such "strategic" relationships can grow sales 20% faster than "transactional" relationships, and tend to be more stable, organized around long-term planning horizons.

- Retailers have accelerated their investment in Private Brand growth. Industry sources such as Private Label Manufacturers Association (PLMA), IRI, and Mintel USA have tracked Private Brands' share growth since the early 1990s. These long-term trends accelerated beginning in 2007 with the re-introduction of food inflation, then became turbocharged by 2008's economic downturn which continues today. Finally, Private Brands became a competitive necessity when Walmart announced Great Value upgrades as part of Project Impact and guaranteed quality equal to or better than National Brands' quality. Net, retailers large and small are seeking to dramatically enhance the contributions their Private Brand programs make.

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Over the past decade, environmental characteristics have clearly led to enhanced cooperation:

- The industry's investment in Category Management beginning in the mid-1990s began an era of collaboration, based in large part on direct and indirect benefits which suppliers realized. In a direct way, the category growth which resulted from better, fact-based decision-making benefited many manufacturers as "rising tides floated all boats. " More indirectly, the more disciplined approach to making fact-based decisions clarified "what counted" for suppliers… and helped create advantages for larger, better-resourced manufacturers with information and tools.

- Major retailers and suppliers built upon category management momentum to develop longer-term and broader relationships which we at Willard Bishop call strategic; they are really based on manufacturers' abilities and willingness to add value at retail "beyond product, promotion and price."

- The goal of such relationships stated by each trading partner is often stated as "better satisfying our mutual consumer." Such sentiment remains today, as Anthea Jones of BI-LO stated during the webinar "It all begins and ends with the consumer and whoever offers the consumer the best value in these times is going to win in the end of the day."

Today, however, some disruptive dynamics cut across the collaborative landscape, as National Brand manufacturers' needs for returns on their investments in innovation are challenging them:

- Historically, new products have driven 60% of year-on-year growth for National Brand manufacturers and retailers alike, so being great at new-item introductions was a shared value. Over the years, National Brand manufacturers have driven new item innovation, devoting a significant proportion of sales to research and development. Then, they created awareness and demand for new products through advertising, and generated returns for them and their retail partners.

- Once new items were established, retailers "knocked off" leading items and took a sliver of market share, but that really didn't challenge National Brand Marketers as long as Private Brand unit shares remained "below threshold noise levels."

- Now, retailers are building innovation and marketing capabilities that build from and rival National Brand Marketers'. Tom Ewing observed, "Something has happened in the last five to eight years and it has been a transformation… on how we're going to move forward. Folks like SUPERVALU (are hiring) Steve Michaelson with National Brand backgrounds. They're going to want to market their Private Brands the same way National Brands were marketed in the past. They're going to want to use their Private Brand as their tool to be relevant to the consumer."

- There may be repercussions as these capabilities gain breadth and traction. Bill Sever warned, "The incentives for brand companies to continue to innovate is very high, but the ability to do so without some type of protection—intellectual property protection—is a disincentive to invest. I think, over time, we'll find a situation with less real innovation."

Another disruptive dynamic is the emergence of extreme-value retailers like supercenters, clubs, and limited assortment stores. Today's mass retailers need to differentiate themselves, enhance their price images especially against extreme-value retailers, and generate profits to re-invest for growth.

For example, traditional supermarkets are "generalists" beset with competitors which are sharply differentiated. Many if not all of these specialists have business models with limited assortments which enable low-cost operations and support very low prices. It's not possible for most retailers to meet price competition with broad price cuts on National Brands; Private Brands offer a way for them to create exclusive and preferred products, maintain overall margins and offer broad assortment. Nick Hahn said "Kroger and other retailers have used their Private Brands business as a point of differentiation to make themselves more attractive to the consumer. And I think more retailers going forward will do the same thing."

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So with that backdrop, what happens when the customer you've been investing in becomes your competitor? Here's some insight from the session:

- There is real tension between retailers and suppliers over the issue, but also significant room for collaboration, especially in the context of satisfying real consumer needs. Common "friction points" include:
  - For CPGs, "unfair" merchandising and de-listings of smaller items and brands in favor of Private Brands. Andy Abraham identified who may be at risk, "brands that are value-tier brands trying to compete with the retailer's value-tier equivalent…we ask, does it have a differentiable position on the shelf, or is it simply going to be redundant? I think today in the world of brand rationalization the store brand will win out over a redundant value tier brand." Other areas of contention include shelf position, numbers of facings and "guaranteed" promotion execution and support.
  - Deciding whether to co-pack Private Brands. Bill Sever said, "There doesn't seem to be an opportunity to link partnering on the store brand side with some longer-term relationship on the brand side… it's a great challenge when there is a capital intensive investment needed in order to have differentiated (Private Brand) products."
- For their part, retailers see little true innovation from CPGs. "As you look at brands #2 through whatever, they don't have much of a differentiated offer and you spend all of your time on a transaction level...how cheap will you sell it to me and how much money will you give me to promote it? And ultimately, it doesn't do anything to build our category because it just trades off some other secondary or tertiary brand," commented Abraham, while he observed, "there has been such great innovation in the world of pure Private Label manufacturers in a number of categories. I'm talking about fundamentally different delivery systems to consumers or taste profiles or types of items."

So, are retailers and CPGs likely to "drop the gloves" and fight it out? Probably not. Instead, they identified "ways out of the box" during our session. These included:

- Align around the consumer value equation—deliver both performance and price. Better satisfaction of consumers' needs creates roles for Private Brands and National Brands alike.

- Seek ways to collaborate for mutual benefit while minimizing risks. Three ways that make sense:

  1) Perform category planning with full National and Private Brand participation. As Abraham stated "we're expected, in Own Brands, to deliver the same margin enhancement or reason for being on the shelf as National Brands do…. Ultimately, this is still a category manager's total category to manage. But as we do promotional planning that group and our group are doing it at the same time in the same room using the same data." And, Ahold's Dan Glei added, "From a manufacturer standpoint, they get to sit with their competitor in the room and if transparency is achieved, there can be much mutual benefit. This is one of the few times that you get to sit with your competitor in the room and make a plan."

  2) Develop complementary National Brand/Private Brand joint promotions. Such promotions offer a low-risk, high-return opportunity for collaborative merchandising, and retailers and manufacturers alike see the opportunity:

     - Dan Glei said: "Collaborative cross-promotion can provide a little halo that can be generated both ways if it's done properly throughout the store between the branded good and cooperating retailer brand, be it a non-perishable or even a fresh brand to leverage in front of the consumer."

       And Joe Landfair added: "I'm aware of a number of examples where we collaborate with Private Brands to make a meal solution for the consumer. There are only so many merchandising opportunities throughout the year; to take a stance and say we won't do it because it will support Private Label would be not in our best interest as well. I think it's reasonable (to expect superior execution for National Brands) and we've found that to be the case," due to retailers' enhanced self-interest when co-promoting Private and National Brands.

- Nick Hahn pointed out the incremental sales opportunities: "At the end of the day, if you can get the consumer to pick up one extra thing, then you're ahead of the game."

- Tom Ewing identified additional benefits of such collaboration for retailers: "There are a number of ways in the past the retailer may have combined either national or regional brands across categories and across merchandising. But today, those opportunities exist with the retailer's own brand and it helps to promote the retailer to the consumer and try to create the image that the retailer is a full-service place to stop instead of just a place to shop."

- Co-promotion extends limited Private Brand support budgets by leveraging complementary National Brand funding, too. BI-LO's Anthea Jones described his experience when, "You're launching a (Private) Brand or seeking trial of your brand, if you can say 'buy this National Brand item and get this Private Brand item for free,' it drives some trial of the item you're trying to push and it also helps the National Brand manufacturer as well. We've worked with our National Brand partners, they're on board, and it was incremental to all other things we were doing. We set up the calendar timing and make sure everyone's aligned to category strategy so everyone meets their financial needs."

3) Evaluate mutual benefits from such executions to create a platform of trust to strengthen collaborative relationships. Barilla's Landfair: "It's in our interest to work with our customers to try to drive overall category sales. So that's what we try to do. We try to work with our customers to identify opportunities and insights in the ways our brands can work together with theirs. There's no retailer who can exist

on Private Brands alone. Likewise, there's no retailer who could succeed with only National Brands. It's a cooperative environment today and a competitive environment as well."

Our Conclusions

- Private Brands are part of the landscape now and in the future, based on their role in best meeting shopper needs.
- So, long-term collaboration is in CPGs' best interests—they will need to find ways not only to co-exist, but also to create value for themselves and their trading partners to truly succeed.
- Collaborative merchandising is a low-risk, high-return starting point for CPGs to identify productive responses to the growth of Private Brands.
- Retailers can expect National Brands to fund collaborative merchandising with incremental national marketing dollars if 1) the National Brand can achieve scale efficiencies (i.e., provide similar programs across all retailers during the same timeframe), and 2) retailers don't require National Brands to be unduly discounted as part of this collaborative promotion.

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