EXECUTIVE INSIGHTS

Retail Private Label Feeds a Hunger for Growth

As the possibility of a recession looms and Americans adjust to the new normal following COVID-19, demand for retail private-label products is expected to rebound. The future for private label may be bright, but the road to profitable growth is by no means easy for producers.

Before the pandemic, retail private label was gaining share over branded products due to retailer investment and growing consumer preference. Then the trend reverted as consumers fled back to brands amid outsized supply chain issues for private-label products.

Now private label is once again on a positive trajectory, amplified by recession fears and indicators that Americans are trading down on food and beverage spend. The next five years are projected to show private-label penetration continuing to outpace branded products. So, what does it take to win in this new environment? Let's find out.

A strong track record of share gain

The earliest private-label programs were lower-priced copycats of national brands. Although some still are, the approach has evolved. Today, many retailers have sophisticated tiered private-label strategies aimed at meeting consumer needs across several pricing dimensions. On certain occasions, they even drive innovation. For example, Target's Good & Gather private-label brand features more unique flavors than the retailer's traditional Market Pantry private-label brand.

U.S. private-label sales, which historically have grown faster than national brands, stumbled during the pandemic (see Figure 1). Retail food and beverage sales skyrocketed as consumers stocked up and stayed home. The result was that private-label sales grew at an annual rate of 11.6% in 2020. But national brands grew even faster at 11.8%.

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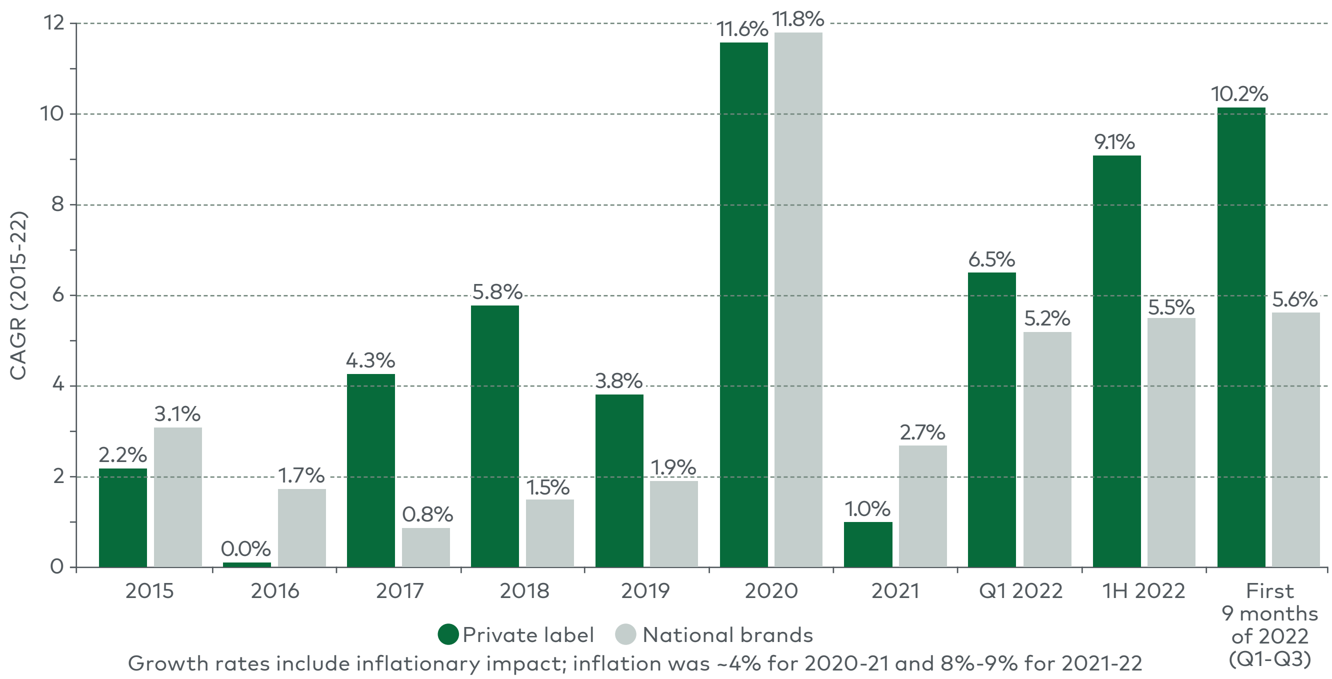
Figure 1

Year-on-year sales growth rates — private label vs. national brands



Note: CAGR=Compound Annual Growth Rate; CPG=Consumer Packaged Goods; MULOC=Multi Outlet with Convenience Stores; PLMA=Private Label Manufacturers Association
Source: IRI Market Advantage, MULOC (CPG categories included: Food & Beverage, Health, Home Care, General Merchandise, etc.)

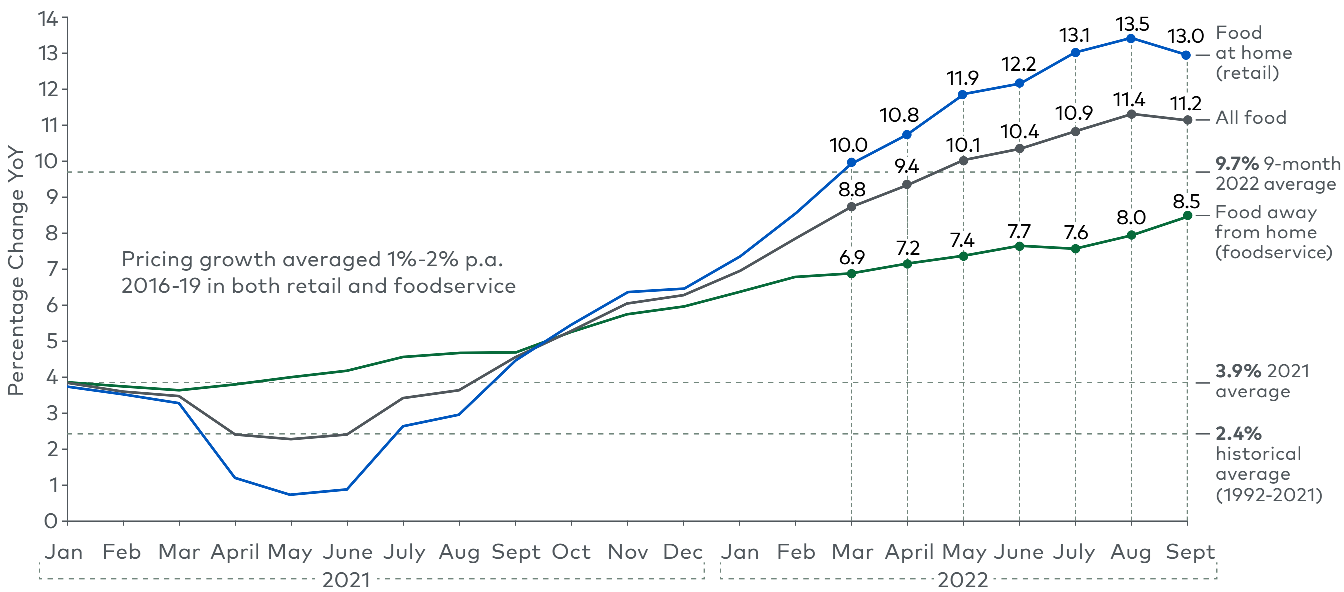
What happened? A desire for familiarity, paired with government stimulus spending, sent more consumers in search of national brands — particularly in comfort-food categories. At the same time, national brands that also produced private label made a conscious decision to prioritize fulfillment for their branded products so as not to damage brand equity. Private-label players lacked the scale and supply chain redundancy of national brands, so their issues with supply chain fulfillment were bigger. All these left retailers high and dry, with many private-label products missing from shelves into 2021. That year, the segment's annual growth again lagged that of branded sales (1% versus 2.7%).

However, this disruption was short-lived. The first three quarters of 2022 found store brand sales up 10.2%, compared to national brand growth of 5.6%. Store brand growth has accelerated significantly throughout the year, from 6.5% in Q1 2022, to 9.1% in 1H 2022, and 10.2% in the first nine months of the year (Q1-Q3). The third-quarter growth was driven by a particularly strong month of September, in which store brand sales increased 12% compared to national brand growth of 6.5%.[1] With U.S. economic indicators suggesting the possibility of a recession, consumers are beginning to tighten their wallets, positioning private label for further growth.

Stepping up the private-label game

Recession isn't the only time private label penetration goes up. Consumers also become more cost-conscious during inflationary periods. Data from the U.S. Bureau of Labor Statistics shows that food and beverage prices increased for 15 consecutive months, up 11.4% through August before finally slowing in September at 11.2% (see Figure 2). Inflation is affecting brand names the hardest. Over the past several months, the number of consumers who claim that price is more important than brand names has grown across all income levels.[2]

Figure 2
Monthly consumer price index for food (2021-22)

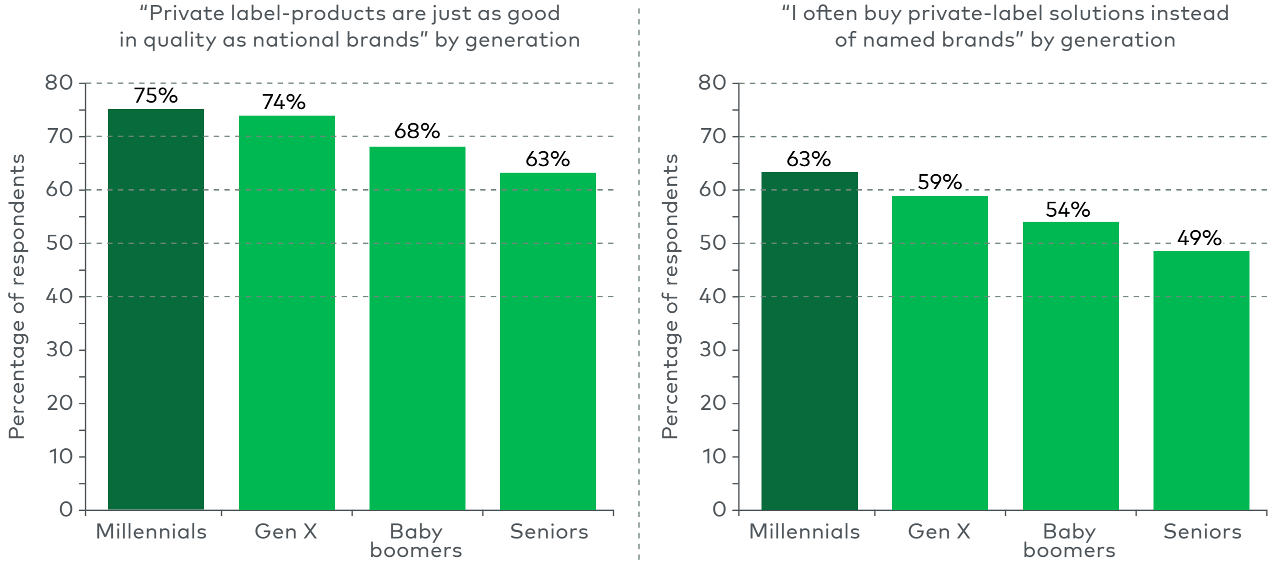


Source: BLS; L.E.K. research and analysis

Another reason for optimism is that consumers generally perceive private-label brands as equal to, if not better than, national brands.[3] This tendency is even more pronounced with millennials, the generation that will soon have the greatest spending power in the U.S. (see Figure 3).

If there were any doubts about the popularity of private-label brands, the success of private label-focused retailers like Aldi, Lidl and Trader Joe's should dispel them. In the second quarter of 2022, according to Numerator, Aldi was one of the fastest-growing private-label brands by household penetration.[4] Supermarket News reports that Aldi has more than 2,100 stores in the U.S., up from 1,700 five years earlier.[5] Lidl, another discount grocer centered on private-label products, opened its first U.S. store in 2017. It now operates in more than 175 locations.[6] For its part, Trader Joe's earned the No. 1 spot on the 2022 Axios Harris Poll 100 reputation rankings, beating out other grocers such as HEB and Wegmans.[7] Trader Joe's boasts 550-plus locations in the U.S. today.[8]

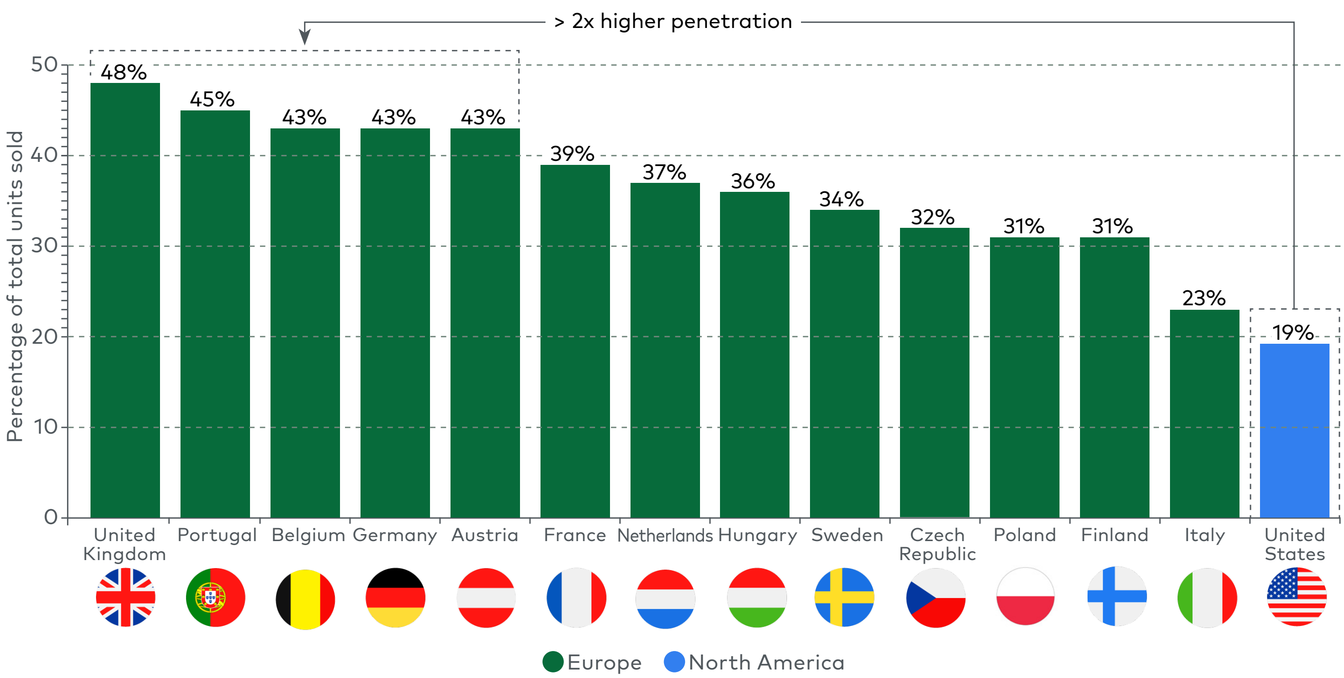
Figure 3
Consumer attitudes toward private-label products, by generation



Source: Insider Intelligence; L.E.K. research and analysis

And the segment still has room to run. On average, private-label penetration in the U.S. is still just 15%-20% across food and beverage categories. This is significantly below the norm in European countries, where the average is around 40% (see Figure 4). Private-label suppliers have an easier time scaling in Europe because the region's retail industry is more consolidated.

Figure 4
Private-label unit share by country (2021)



Greater retailer consolidation in some European countries relative to the U.S. allows for greater efficiency and scalability of private-label offerings

Source: Private Label Manufacturers Association; L.E.K. research and analysis

Opportunities for retailers and suppliers

As the market evolves and private label continues to grow, there's a multibillion-dollar opportunity for retailers and private-label suppliers. But taking advantage of the opportunity will require effort, resources and a sound strategy. Here are some steps to consider.

Retailers

Amp up your strategic sourcing. Look for suppliers that innovate in step with consumer trends (think product transparency or supply chain traceability). While you're doing that, continue to consolidate volume among scale providers who can, in return, deliver lower prices.

Take a tiered approach to offerings. Aldi and Kroger, to name two, have created premium, all-natural private-label brands that are a tier above commodity knockoffs. Best-in-class private label can meet or exceed national brands at the premium tier while also offering a value tier that's well below national-brand prices.

Expand your web presence. That's what Whole Foods did following its 2017 acquisition by Amazon. Now the grocer's 365 Everyday Value is available on the ecommerce giant's website. Focus private-label ecommerce efforts on click-and-collect service instead of delivery. This can help keep store footprints relevant and keep the cost of last-mile delivery with the consumer.

Fine-tune experience to improve customer stickiness. Best-in-class private label is a basket driver that lets grocers build loyalty and differentiate themselves by offering something not found anywhere else. So invest in the in-store shopping experience and service levels. Consumers increasingly expect personalized solutions and value-add capabilities.

Suppliers

Focus on value and premium. No-frills commodity knockoffs have been played off. The next wave of conversion is in the hourglass economy. Focus on insights and the consumer experience to deliver more premium and fresh-to-go offerings, with innovation to meet evolving consumer needs. At the same time, hit the value end of the spectrum with low-cost production and no trade or marketing to keep costs low for consumers.

Simplify to grow. Breadth brings complexity, making it harder to turn a strong profit. A key reason is that salespeople need to be intimately familiar with operations to give customers either a quick "no" or appropriate pricing for complexity (special flavor, count, size, etc.). Private-label producers that span too many categories lose this link between sales and operations. The most profitable private-label companies tend to focus on one to three categories only.

Sync up commercial and operations teams. A common pitfall in the industry is a disconnect between sales and operations teams. Sales teams tend to be motivated by customer asks and may not fully understand the complexities of the plant and the implications on cost. Many private-label players can improve efficiency and synergy within manufacturing plants by having all teams work toward the same operations-first goal.

Be selective with customers and contracts. Instead of agreeing to everything just to win the account, reward the sales team based on deal profitability. Sales teams must ensure they're getting the right price for requests like changeovers or formulations that are complex or customized. Prioritize customers who view you as a partner and co-develop a private-label program focused on innovation. Ensure you have appropriate pricing mechanisms in contracts that appropriately pass on additional incurred costs in a timely manner (especially in this inflationary environment).

Between a strong track record and favorable market conditions, private label is positioned for continued growth — especially for retailers and suppliers willing to up their game. The math speaks for itself: A modest 5% increase in private-label penetration would yield more than $60 billion in market growth. That alone should give market participants something to chew on.

For more information, please contact consumerproducts@lek.com.

Endnotes

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