RESPONDING TO PRIVATE LABEL

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CORIOLISRESEARCH

Coriolis Research Ltd. is a strategic market research firm founded in 1997 and based in Auckland, New Zealand. Coriolis primarily works with clients in the food and fast moving consumer goods supply chain, from primary producers to retailers. In addition to working with clients, Coriolis regularly produces reports on current industry topics. Recent reports have included an analysis of the impact of the arrival of the German supermarket chain Aldi in Australia, and answering the question: "Will selling groceries over the internet ever work?"

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The lead researcher on this report was Tim Morris, one of the founding partners of Coriolis Research. Tim graduated from Cornell University in New York with a degree in Agricultural Economics, with a specialisation in Food Industry Management. Tim has worked for a number of international retailers and manufacturers, including Nestlé, Dreyer's Ice Cream, Kraft/General Foods, Safeway and Woolworths New Zealand. Before helping to found Coriolis Research, Tim was a consultant for Swander Pace and Company in San Francisco, where he worked on management consulting and acquisition projects for clients including Danone, Heinz, Bestfoods and ConAgra.

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The coriolis force, named for French physicist Gaspard Coriolis (1792-1843), may be seen on a large scale in the movement of winds and ocean currents on the rotating earth. It dominates weather patterns, producing the counterclockwise flow observed around low-pressure zones in the Northern Hemisphere and the clockwise flow around such zones in the Southern Hemisphere. It is the result of a centripetal force on a mass moving with a velocity radially outward in a rotating plane. *In market research it means understanding the big picture before you get into the details.*

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CORIOLISRESEARCH
PO BOX 10 202, Dominion Road, Auckland, New Zealand
Tel: +64 9 623 1848; Fax: +64 9 353 1515; email: info@coriolisresearch.com
www.coriolisresearch.com

The growth of Private Label in New Zealand presents a real challenge to FMCG manufacturers

THEORY: **The experience of other countries suggests that the key driver of private label growth is retail consolidation**

PRACTICE: **While New Zealand retailers are consolidating, they are still in the early stages of developing successful private label programs**

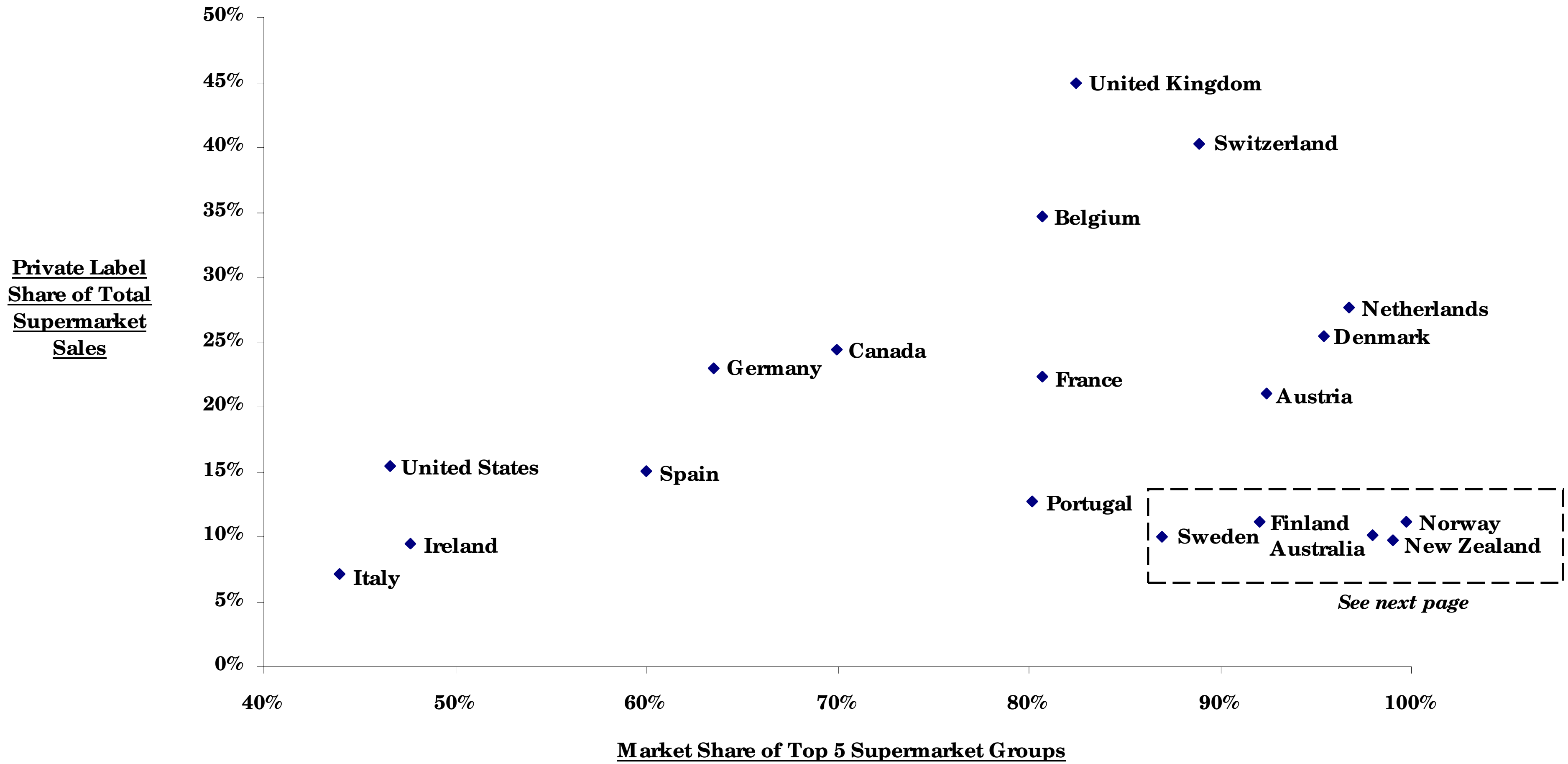
RESPONSE: **Successful FMCG Manufacturers will act now to choose their own private label destiny**

THEORY: The experience of other countries suggests that the key driver of private label growth is retail consolidation

- **WHAT?**
  - **Generally, retail concentration leads to greater private label penetration**
  - **The countries that are the exception to this rule, other than Australia, have very strong wholesale and independent sectors**
  - **However, as the United Kingdom demonstrates, this is a gradual, long-term process with private label penetration trailing consolidation**
- **WHY?**
  - **Analysis shows that a strong private label program can double profits**
  - **Increasing value-added private label is one of the few means of achieving sales and profit growth in a highly concentrated market**
  - **The chains with strong private label programs have been able to buy out their poorer performing competitors, thereby increasing consolidation**

Generally, retail concentration leads to greater private label penetration

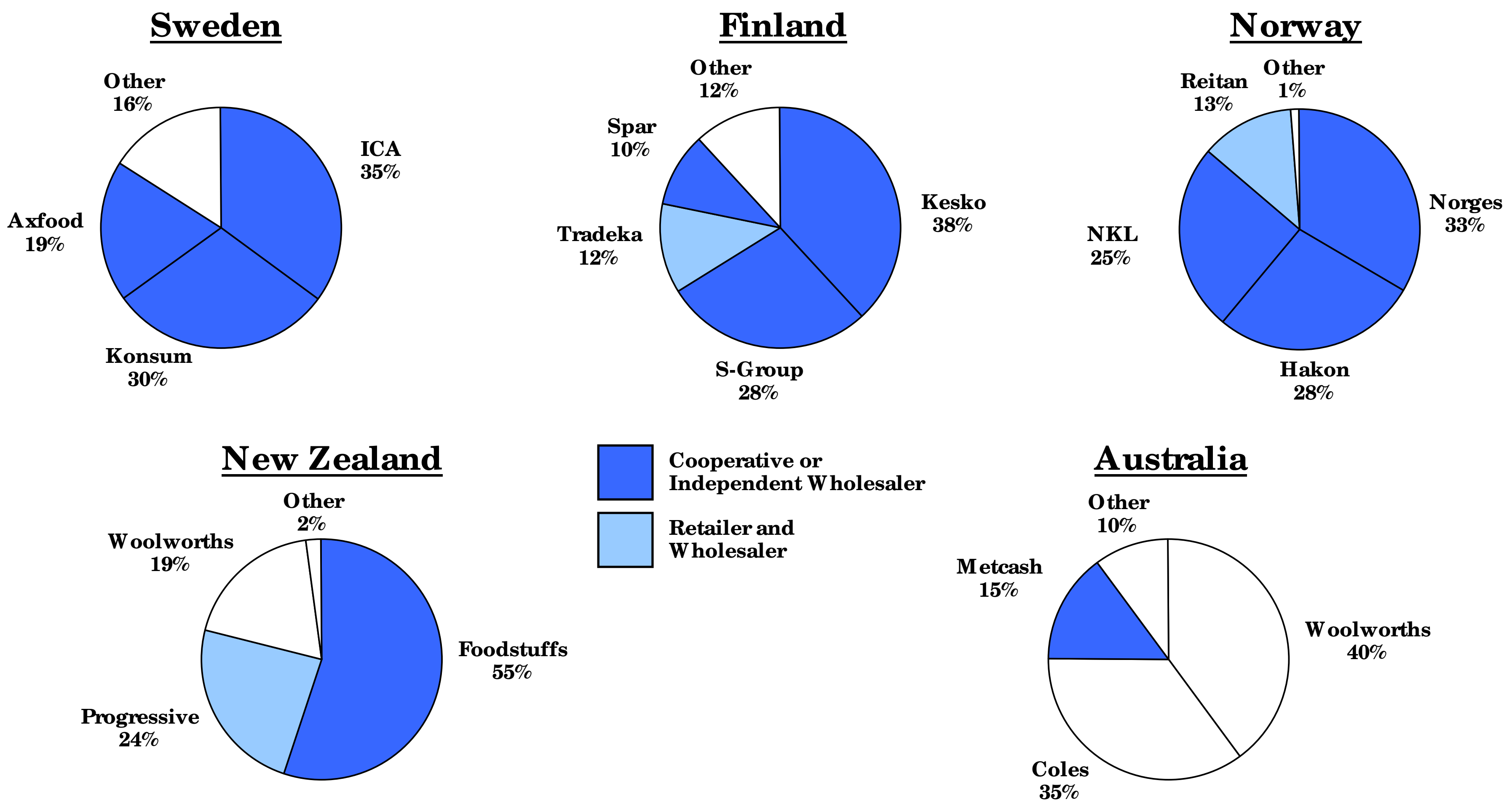
RETAIL CONCENTRATION VS. PRIVATE LABEL PENETRATION
(Percent of supermarket sales; 2000[1])



1. Norway, Belgium and Switzerland use 1999 private label data
Source: PLMA; Nielsen; Euromonitor; FAS; Coriolis analysis

The countries that are the exception to this rule, other than Australia, have very strong wholesale and independent sectors*

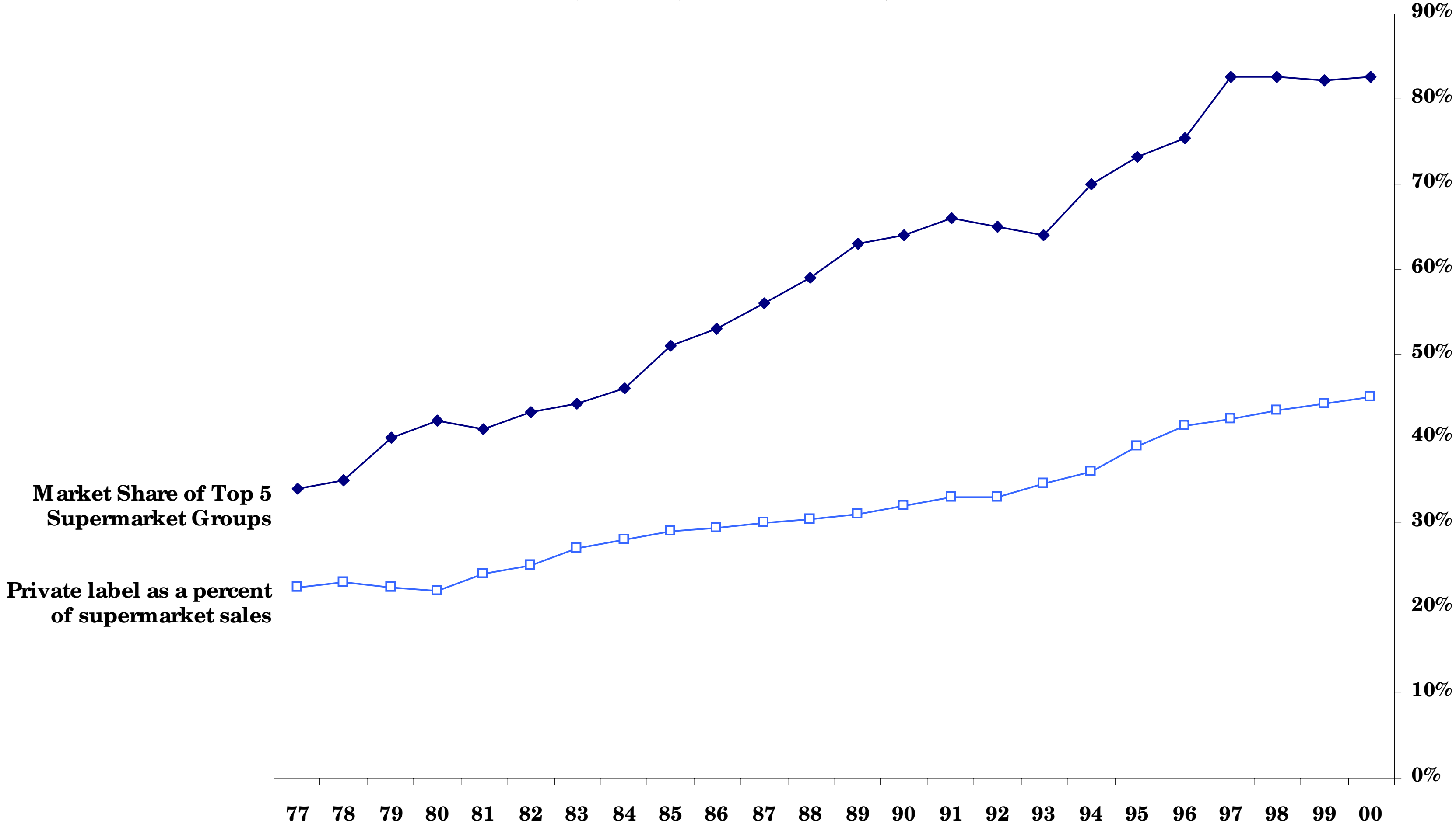
SUPERMARKET MARKET SHARE BY SELECT COUNTRY
(% supermarket sales; 2000)



** The initial hypothesis here is that cooperative and wholesalers are generally less able to exercise the discipline needed to push private label*
Source: Nielsen; Euromonitor; FAS; Coriolis analysis

However, as the United Kingdom demonstrates, this is a gradual, long-term process with private label penetration trailing consolidation

GROWING RETAIL CONCENTRATION & THE GROWTH OF PRIVATE LABEL
(Percent; sales; UK market; 1977-2000)



Source: PLMA; AGB; Nielsen; IGD; Coriolis analysis

Analysis shows that a strong private label program can double profits

THE EFFECT OF PRIVATE LABEL ON PROFITABILITY: A SIMPLE MODEL
(Two hypothetical $30B supermarket groups)

	Weak Private Label		Strong Private Label	
	%	$B	%	$B
Sales	100%	$30.00	100%	$30.00
% of sales…				
- Private label	5%	$1.50	30%	$9.00
- Branded	95%	$28.50	70%	$21.00
Gross Margin on…				
- Private label	35%	$0.525	35%	$3.15
- Branded	25%	$7.125	25%	$5.25
		$7.650		$8.40
% of sales operating expenses	23%	($6.90)	23%	($6.90)
Operating profit	2.5%	$0.75	5.0%	$1.50

Increasing value-added private label is one of the few means of achieving sales and profit growth in a highly concentrated market

WHY CONSOLIDATION LEADS TO STRONG PRIVATE LABEL

	Explanation
Imitation	Retailers in Canada imitated the success of Loblaw's Retailers in the UK imitated the success of Sainsbury's Retailers in the US imitated the success of Safeway
Implicit collusion is easier	Squeeze out smaller manufacturers Squeeze out tertiary brands Squeeze out smaller retailers
Top-line growth is hard	Real sales growth is hard in a consolidated retail environment Private label boosts the bottom line without sales growth
Non-price competition	Fewer new stores being built - more non-price competition Private label can be used to create a point of difference Unique private label can attract and retain customers

The chains with strong private label programs have been able to buy out their poorer performing competitors, thereby increasing consolidation

WHY STRONG PRIVATE LABEL LEADS TO CONSOLIDATION

	Explanation
More Profitable	Gross Margins Private Label 35% Branded 25%
Add-value to acquisitions	Able to consolidate & add value to other chains [US examples] Kroger (25%) buys Fred Meyer (17%) Albertsons (27%) buys American Stores (17%) Safeway (30%) buys Vons (13%) Dominicks (11%) Randalls (13%)
Lower Prices	Able to offer lower per unit prices on branded & private label Offer the consumer a lower total basket price Offer lower prices versus competition

"Private brands separate the quick from the dead."

Mark Husson, Analyst, JP Morgan

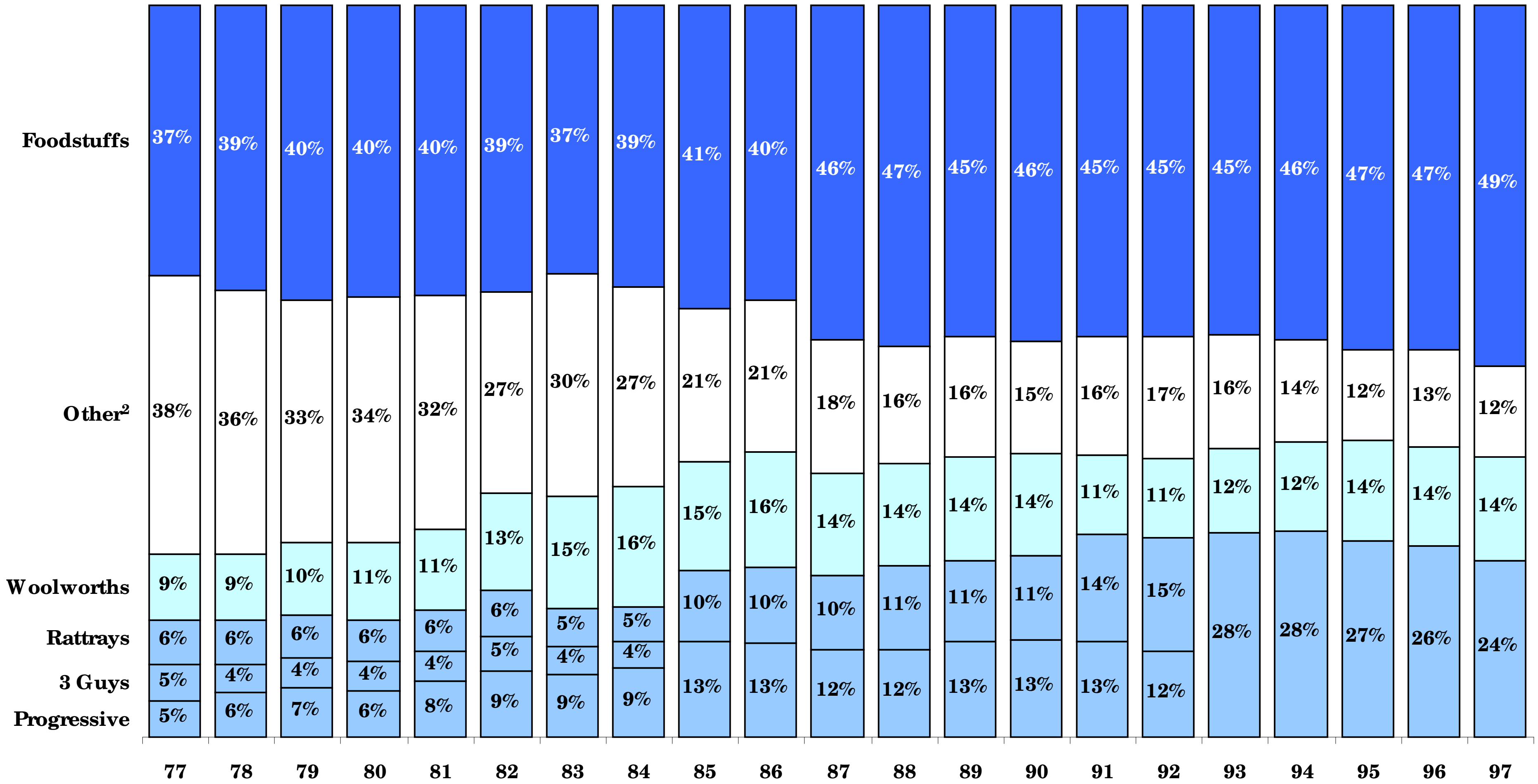
PRACTICE: While New Zealand retailers are consolidating, they are still in the early stages of developing successful private label programs

- **Long term consolidation of grocery retailing is clearly a trend in New Zealand**
- **However, New Zealand retailers currently underperform their British and North American peer group in private label performance**
- **Like in the UK, the growth of private label in New Zealand has been, and will continue to be, a long and gradual process**
- **All three of New Zealand's major retail groups have a private label architecture in place**
  - **These programs are all broadly similar, each offering both a Tier I and a Tier II private label, but with different depths of range and performance**
  - **All of these strategies have both strengths and weaknesses**
  - **Foodstuffs currently has the best program overall**
- **All three New Zealand retail groups are firmly committed to growing their private label programs**
- **The experience of the UK market suggests that private label has the capability to dramatically re-divide the available industry profit pool**

Long term consolidation of grocery retailing is clearly a trend in New Zealand

CORE GROCERY MARKET SHARE[1]

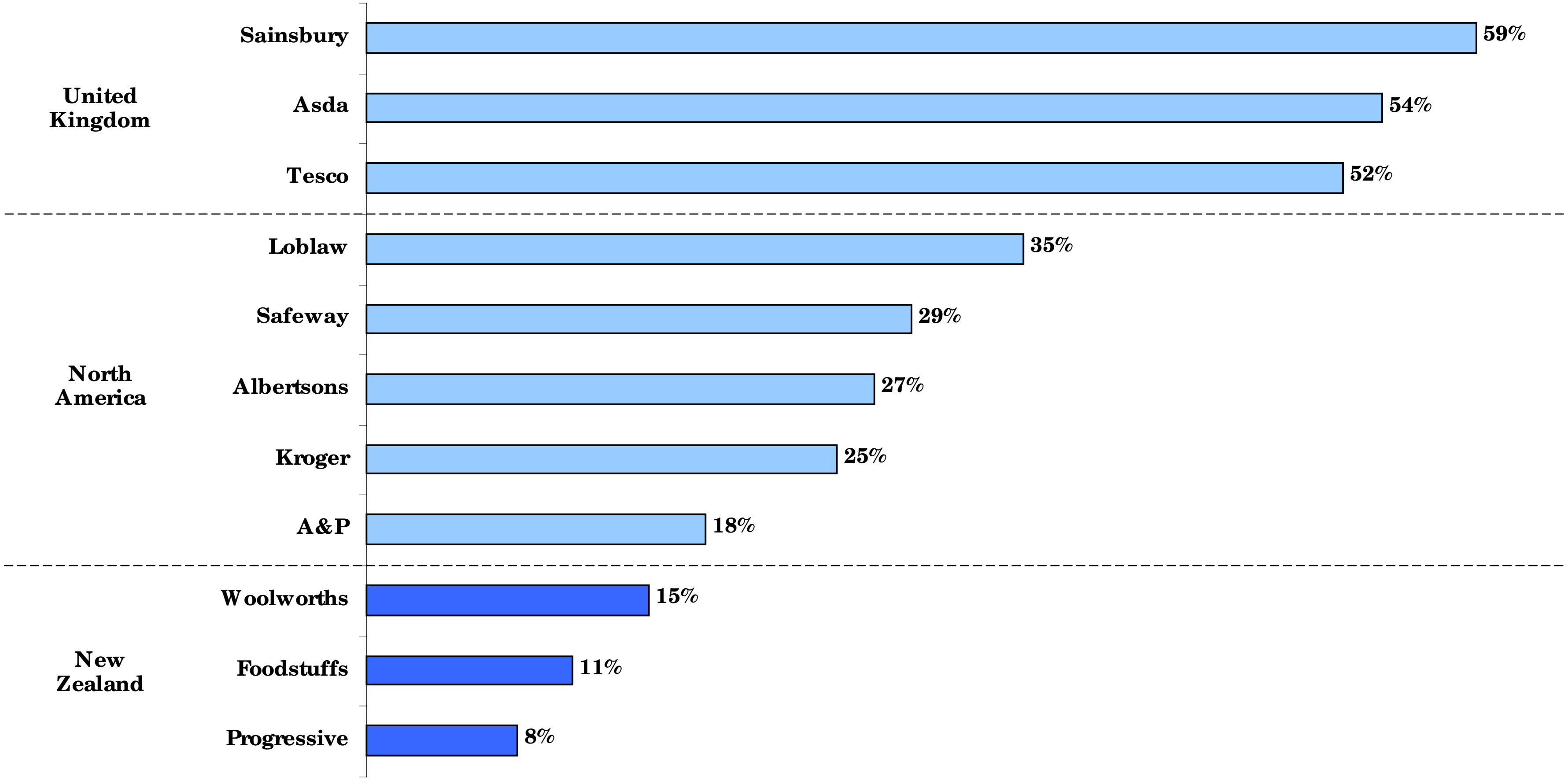
(% of purchases; sample of GMA member companies; 77-97)



1. Purchasing relativity by sample of GMA members by retail grocery customer
2. Includes Wardell Brothers, Dingwall & Paulger, R.A. Wilkie, G.U.S. Wholesalers, Associated Wholesalers, and Shoprite; Source: GMA NZ; Coriolis analysis

However, New Zealand retailers currently underperform their British and North American peer group in private label performance

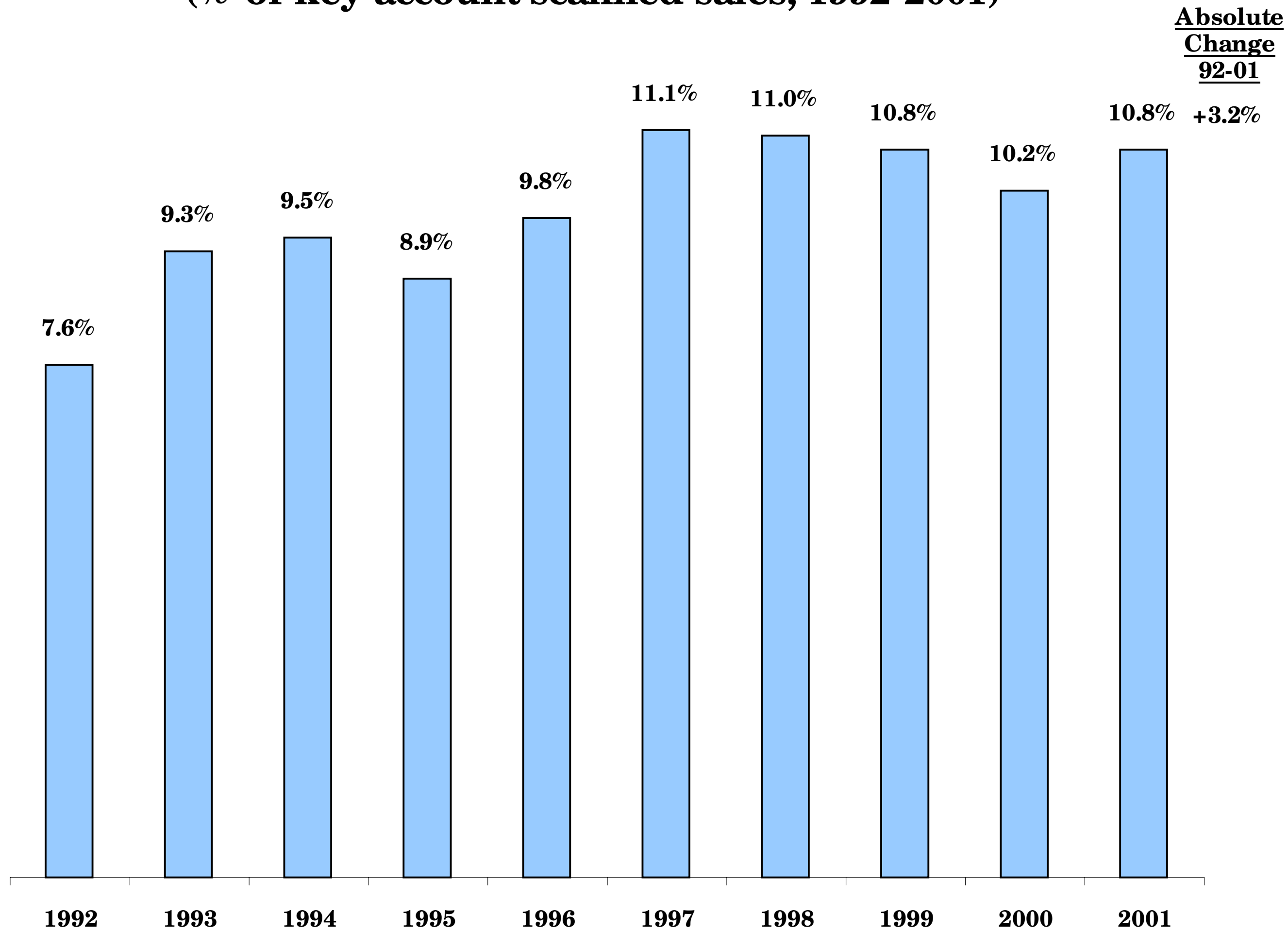
SELECT RETAILER PRIVATE LABEL PENETRATION
(% of supermarket sales through store brand; 2001)



 Source: Taylor Nelson; CIES; JP Morgan; Canadian Grocer; Industry Sources; Coriolis analysis

Like in the UK, the growth of private label in New Zealand has been, and will continue to be, a long and gradual process

NEW ZEALAND PRIVATE LABEL PENETRATION
(% of key account scanned sales; 1992-2001)



Source: ACNielsen NZ; Coriolis analysis

All three of New Zealand's major retail group have a private label architecture in place

NEW ZEALAND RETAILERS PRIVATE LABEL OVERVIEW

	Store Fascias	Private Label Brands
Foodstuffs Group	New World Pak'N Save Write Price Four Square Wholesale	Budget Pam's Fresh Express +Others
FAL/Progressive	Foodtown Countdown Three Guys Supervalue Wholesale +Australia	Basics Signature +Others
Dairy Farm/Woolworths	Woolworths Big Fresh Price Chopper +Asia	No Frills First Choice

These programs are all broadly similar, each offering both a Tier I and a Tier II private label, but with different depths of range and performance

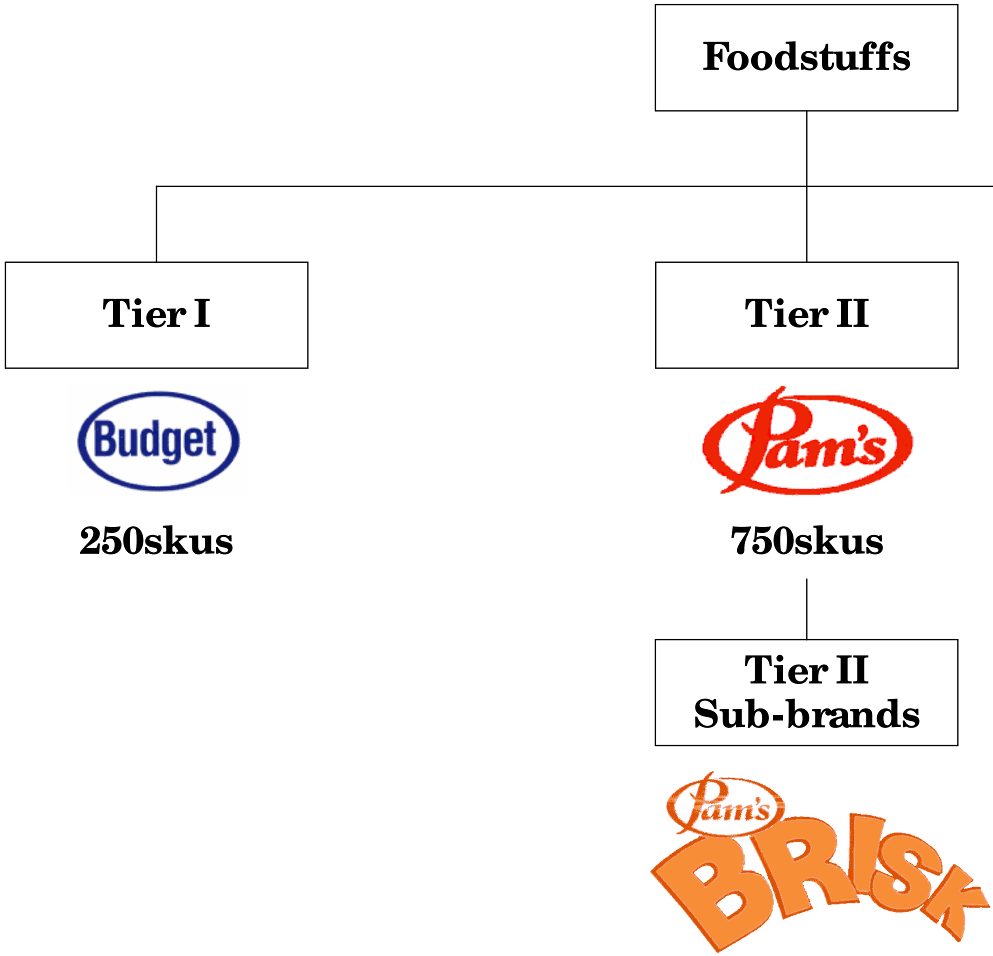
NEW ZEALAND RETAILERS PRIVATE LABEL OVERVIEW

	Tier I		Tier II		Total # of SKUs[1]	% of sales
	Brand	# of SKUs	Brand	# of SKUs		
Foodstuffs	Budget	250	Pam's	750	1,000+	11-12%
Progressive	Basics	175	Signature	425	600+	7-8%
Woolworth's	No Frills	500	First Choice	1,200	1,700	15-16%

1. Does not include other private label brands (e.g. remaining Foodtown items)
Source: Industry Sources; Coriolis estimates and analysis

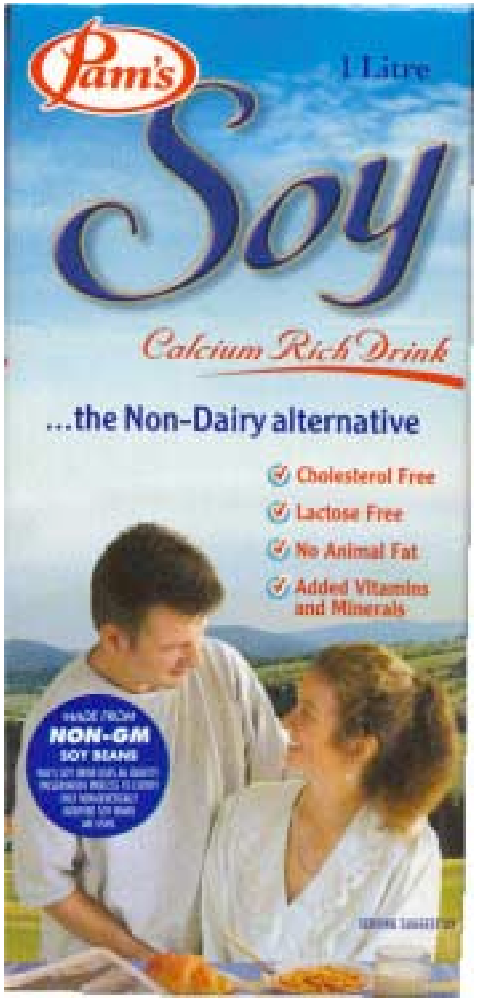
Foodstuffs offers about a thousand products under the Budget and Pam's brands, as well as a produce-only brand (Fresh Express) and some remaining store brands (e.g. New World)

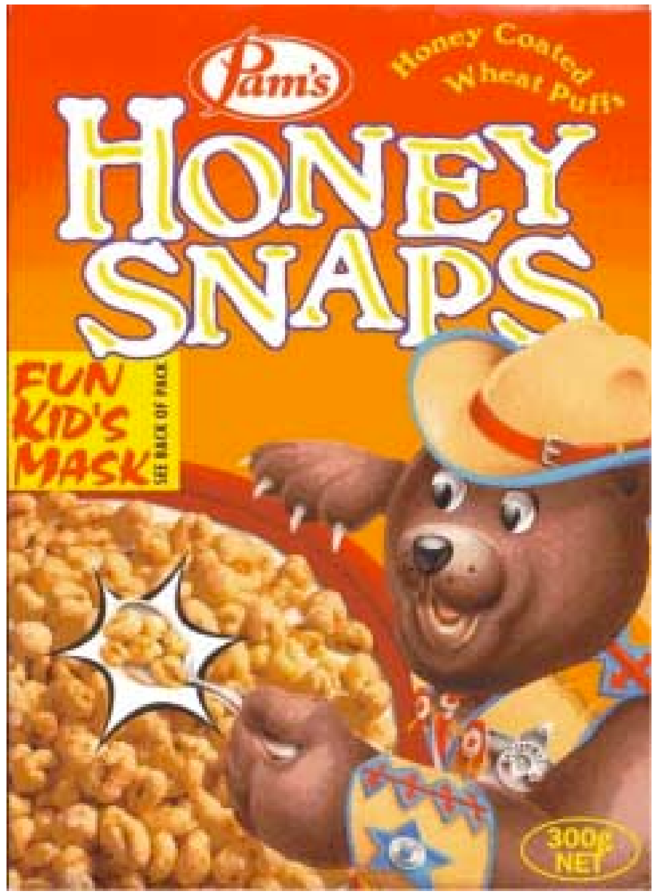
<u>FOODSTUFFS PRIVATE LABEL ARCHITECTURE</u>



Pam's is following the UK model of having packaging broadly similar to that of branded packaged goods and of launching sub-brands where necessary

EXAMPLES OF PAM'S PRODUCTS





FAL/Progressive offers about six hundred products under the Basics and Signature brands, as well as some remaining store brands

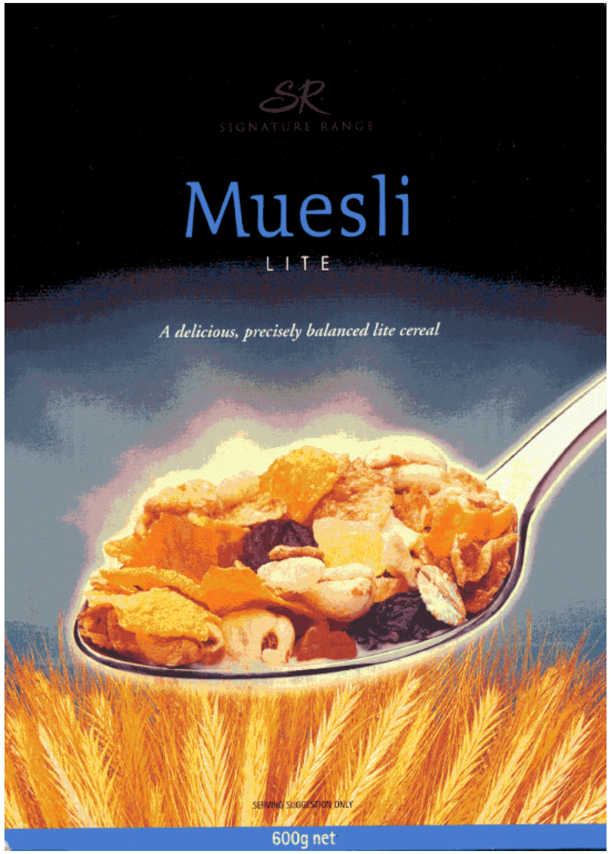
PROGRESSIVE PRIVATE LABEL ARCHITECTURE

- **Progressive**
  - **Tier I**
    - BASICS
    - **175skus**
  - **Tier II**
    - SIGNATURE RANGE
    - **425skus**
    - **Tier II Sub-brands**
      - -
  - **Other**
    - Foodtown
    - countdown
    - **Black&Gold (AU)[1]**
    - **No Frills (AU)[1]**

1. The parent company of Progressive, FAL, offers these brands in Australia as well as the Signature and Basics brands

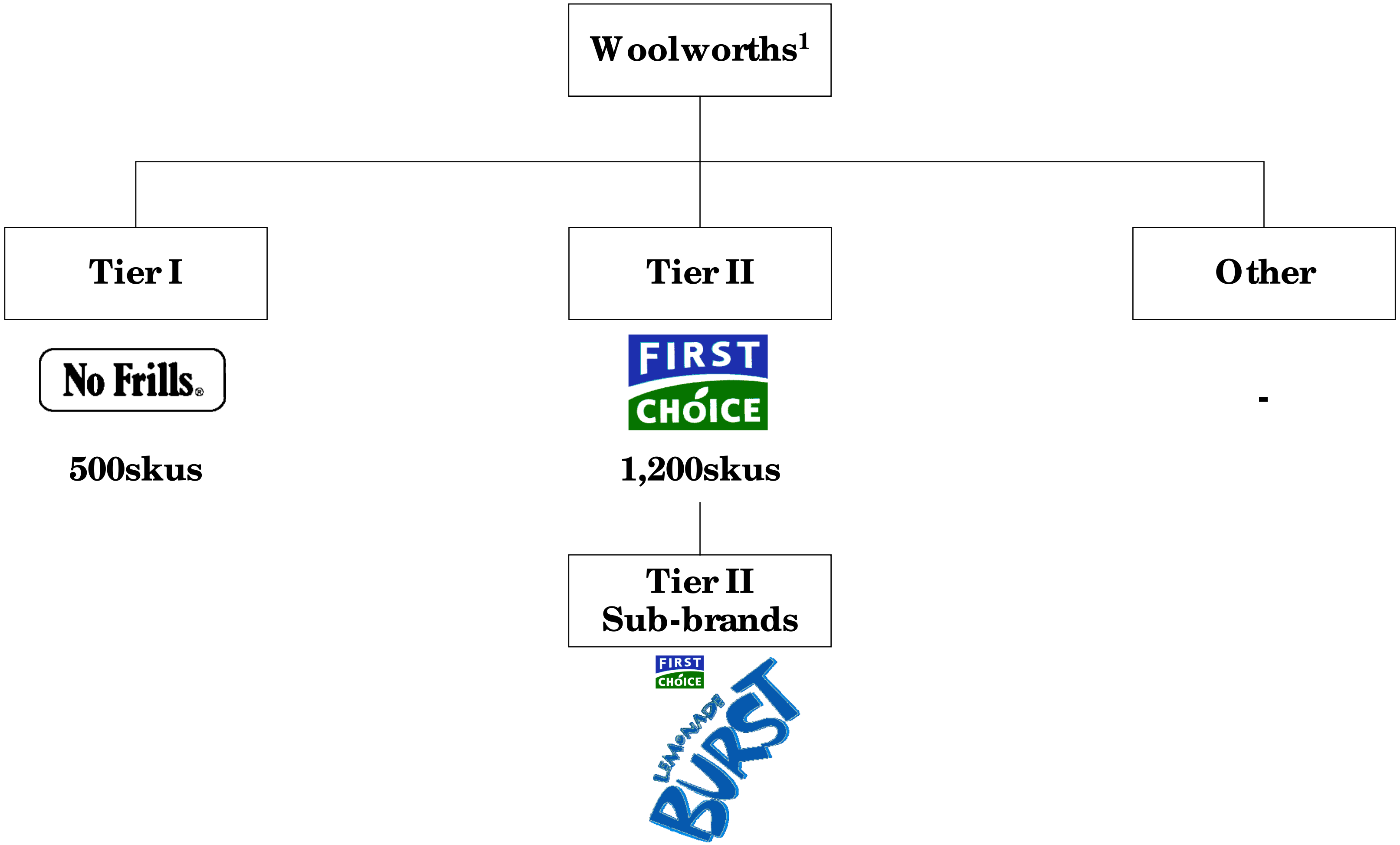
Signature is following the US model of a uniform design architecture across all products, in this case everything black

<u>EXAMPLES OF SIGNATURE PRODUCTS</u>



Woolworths offers consumers over one thousand seven hundred products under the No Frills and First Choice brands

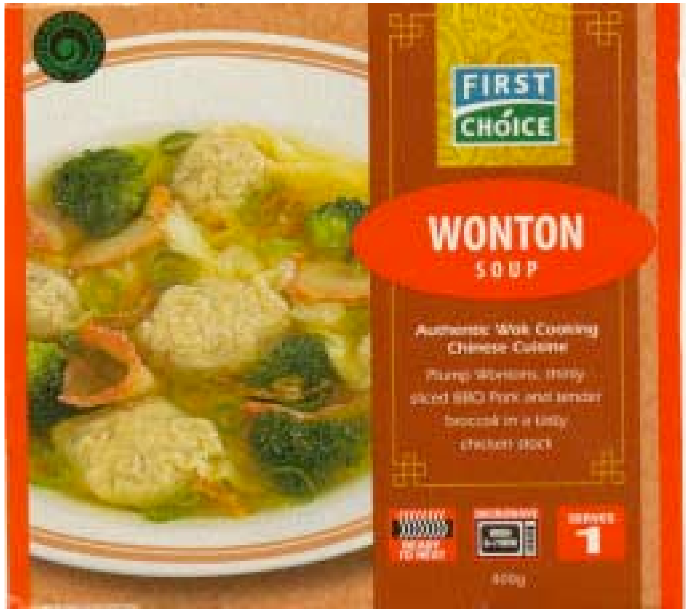
WOOLWORTHS PRIVATE LABEL ARCHITECTURE



1. The depth of Woolworth's range is partly a result of its sharing some of its range with he other stores of its parent company, Dairy Farm

Woolworths success has been driven by its depth of range

<u>EXAMPLES OF WOOLWORTHS PRODUCTS</u>



All of these strategies have both strengths and weaknesses

RETAILERS PRIVATE LABEL STRENGTHS & WEAKNESSES

	Strengths	Weaknesses
Foodstuffs	– Following proven UK model – 7.5% rebate system incentivises owner-operators to support – Existing and new product manufacturing capacity – Top management willingness to invest in brand (e.g Jamie TVC)	– Variable store execution of programs and promotions – Confusing message of Fresh Express brand – Pam's name may limit upside
Progressive	– Buying for total Australasian business – Chain able to enforce uniform store execution	– All black Signature architecture may limit product acceptance – Distant third playing catch-up – Shelf prices often out of line
Woolworths	– Solid brand and program support for five+ years – Large and wide range – Buying for total Asian business	– Loss of Franklins volume – No Frills looking tired (vs. Basics)

Foodstuffs currently has the best program overall

PRIVATE LABEL PERFORMANCE SCORECARD

	Range	Packaging	Shelf Support	Ad Support	Brand Building	Overall
Foodstuffs	Medium	High	Medium	High	High	High
Progressive	Low	Medium	Low	Medium	Low	Low
Woolworths	High	Medium	Medium	Medium	Medium	Medium

Low ○ Medium ◐ High ●

All three New Zealand retail groups are firmly committed to growing their private label programs

- **"We continue to have increasing private label sales. Private label is an important weapon in our competitive arsenal. Private label is not going to go away – manufacturers need to decide if they want to be a part of that action or not."**

  Des Flynn, GM Marketing, Woolworths

- **"This organisation has a clear focus on building our private label program, both under the Signature and Basics brands."**

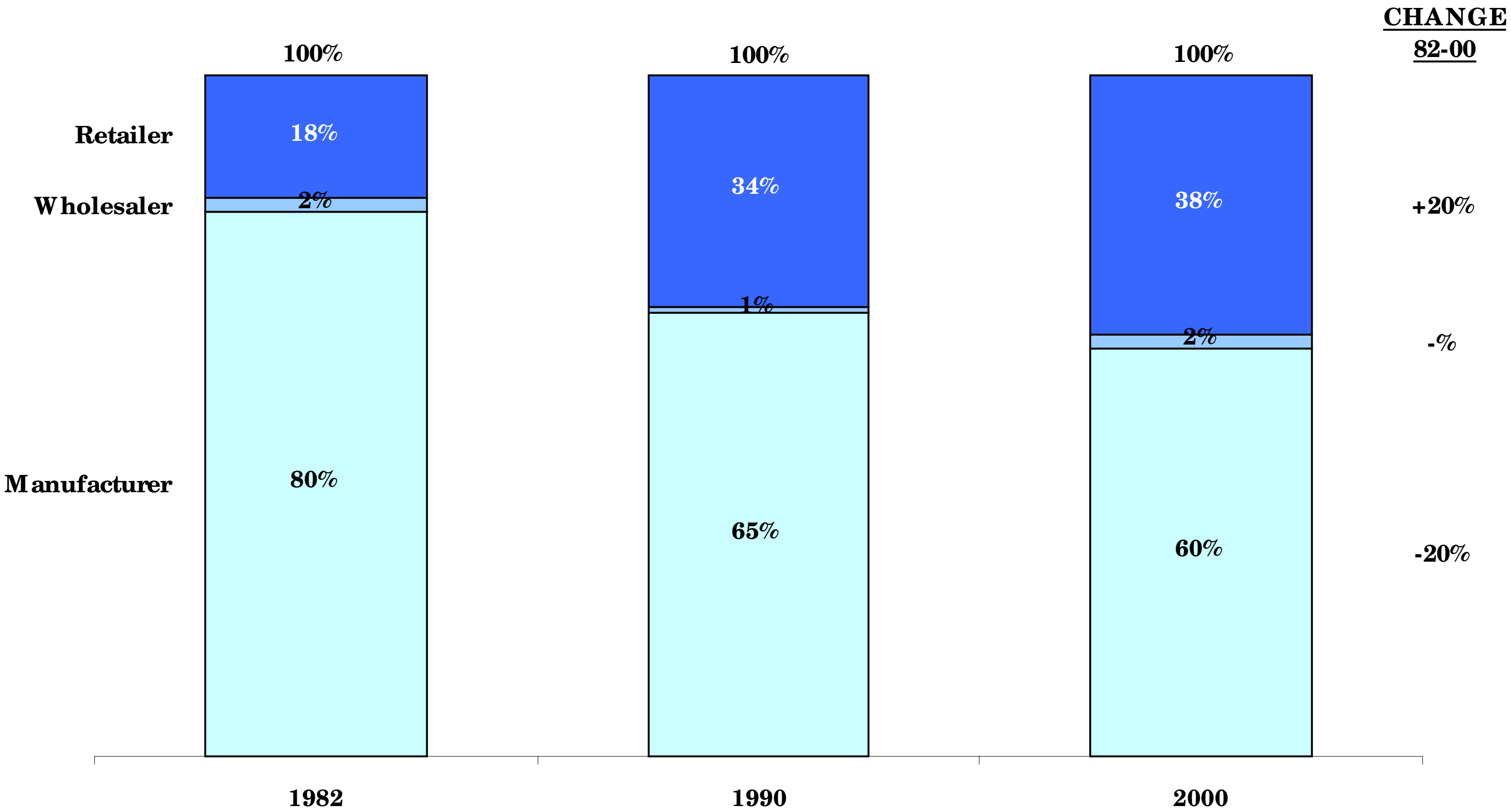
  Mark Brosnan, GM Merchandise, Progressive

- **"Private label makes good money."**

  Hugh Perrett, ex-Managing Director, Foodstuffs Auckland

The experience of the UK market suggests that private label has the capability to dramatically re-divide the available industry profit pool

REDIVIDING THE UK FOOD INDUSTRY PROFIT POOL
(Percent of total UK food industry operating profit; 82v90v00)



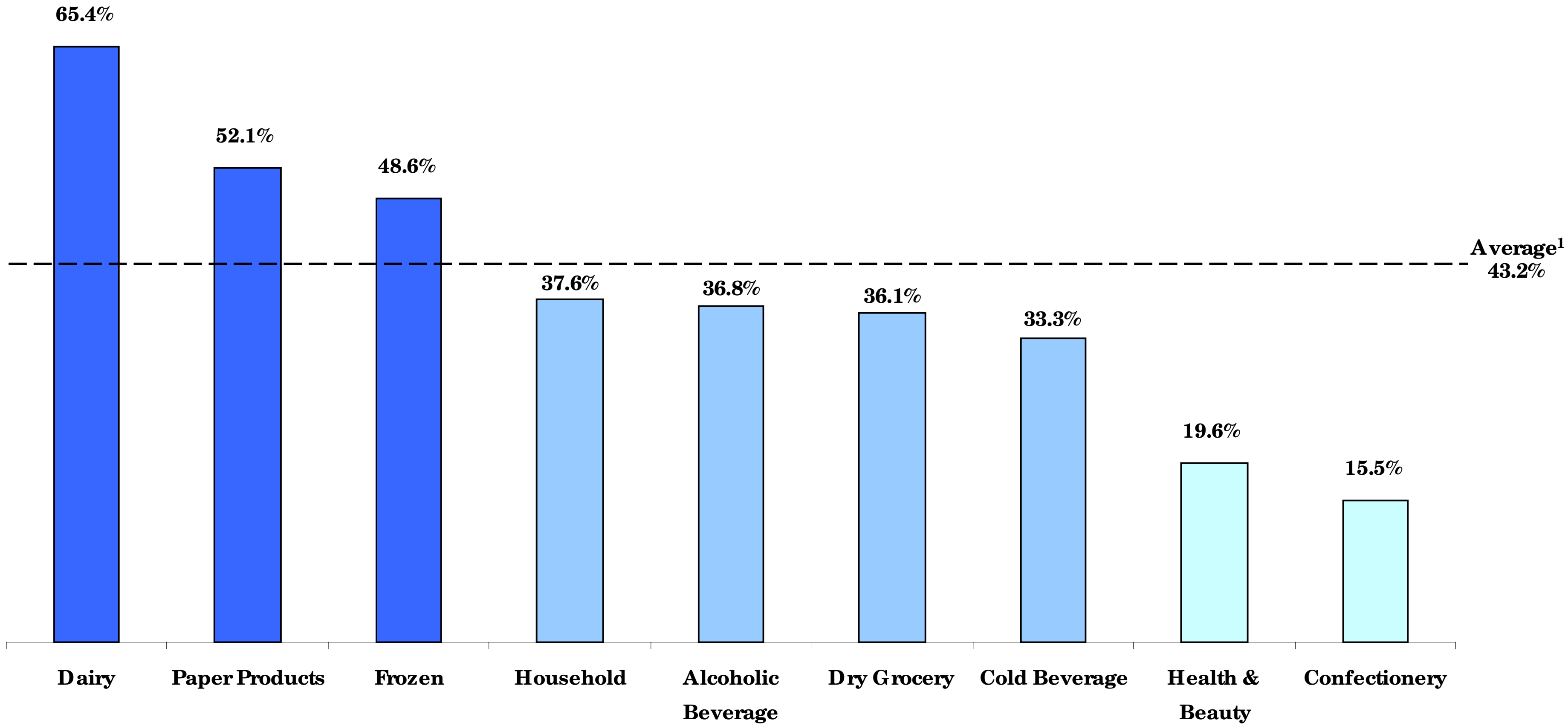
Private Label % of Sales	25%	32%	45%

RESPONSE: Successful FMCG Manufacturers will act now to choose their own private label destiny

1. **BUILD STRONG BRANDS**
   - Even in the UK, with high overall penetration, private label is more successful in some categories than in others
   - Private label is most successful in categories where consumers have no brand preference
2. **INNOVATE OR DIE**
   - Although it is counter-intuitive, private label has the highest penetration in the categories where the price difference is lowest
   - Private label is most successful in categories with low-innovation by manufacturers
   - There are a number of excellent examples of both product innovation and packaging innovation in the New Zealand market
3. **BE HONEST ABOUT YOUR PROSPECTS**
   - There are two main models for the growth of private label in a category: same proportion of a smaller pie or the squeeze on smaller brands
   - Try to objectively assess whether your brand will succeed against private label
   - If your brand won't succeed, focus on being a private label supplier

Even in the UK, with high overall penetration, private label is more successful in some categories than in others

UK PRIVATE LABEL SHARE BY MAJOR CATEGORY
(% of sales; UK market; 1998)



1. 1998 data (2000: 45.0%)
Source: PLMA; Coriolis analysis

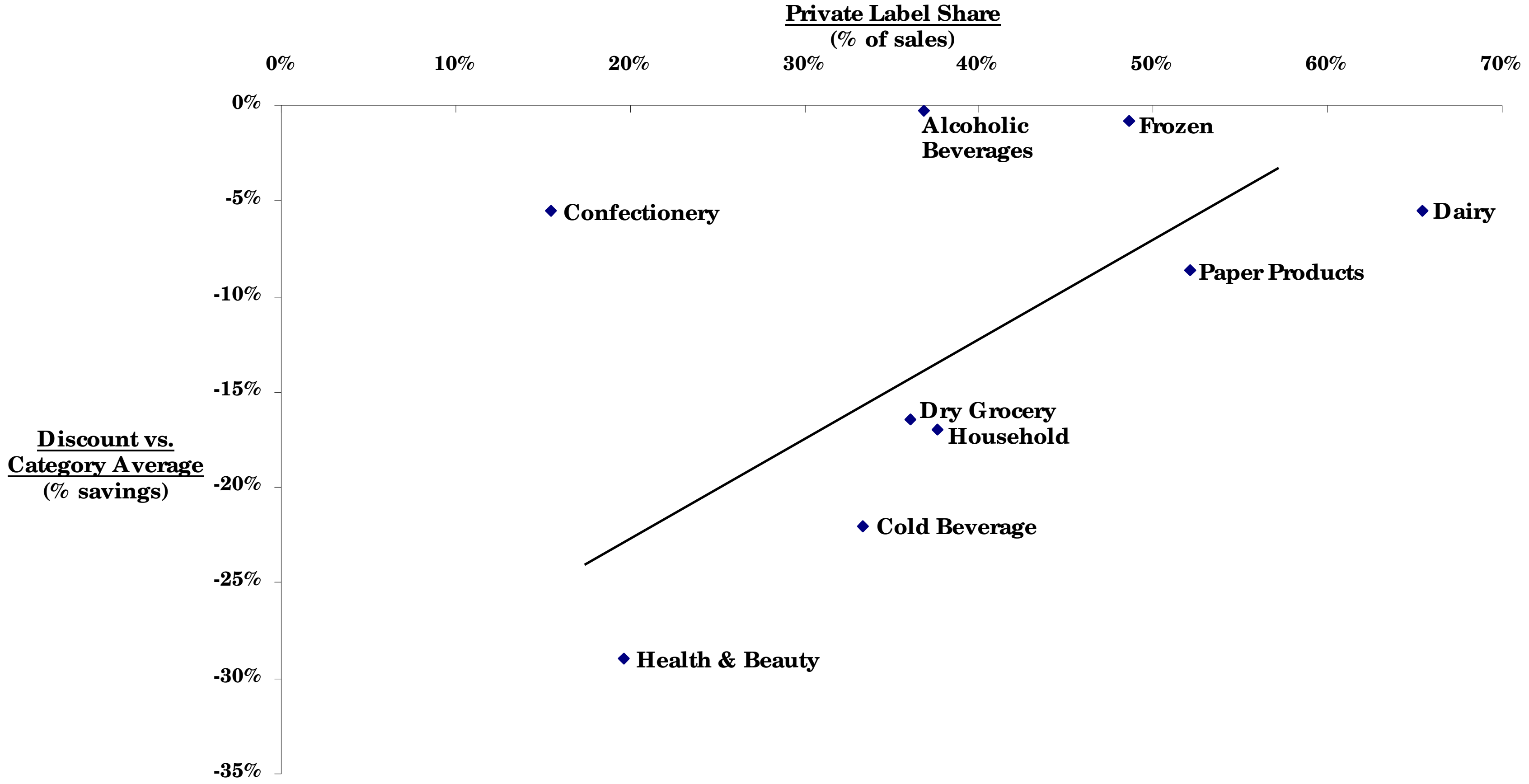
Private label is most successful in categories where consumers have no brand preference

CONSUMER BRAND PREFERENCE AND PRIVATE LABEL

	No Preference	Relative Preference	Absolute Preference
Product Characteristics	• Undifferentiated commodity products • No performance difference between brands	• Product differentiation created through marketing mix: - advertising - promotion - merchandising	• Innovative or complex product technology • Items with unique flavour profile
Consumer Behaviour	• Consumers may recognise brands but do not differentiate between them • No sense of loss if consumer fails to find known brand	• Purchase decision made at point-of-sale from repertoire of brands • Sensitive to in-store promotion and display	• Consumers may switch stores to get preferred brand • Consumer needs full confidence in store and product
Private Label Characteristics	• Fast share growth • Low investment • Products feed off store traffic	• Share growth takes time and effort • In-store support critical • Image of store carries over to image of brand	• Share growth is difficult • High investment in time and resources - media support required • Products draw customers to store • Sub-branding often used
Examples	• Milk & butter • Paper products • Flour	• Film • Household cleaners • Cold beverages	• Razors • Chewing Gum • Cigarettes

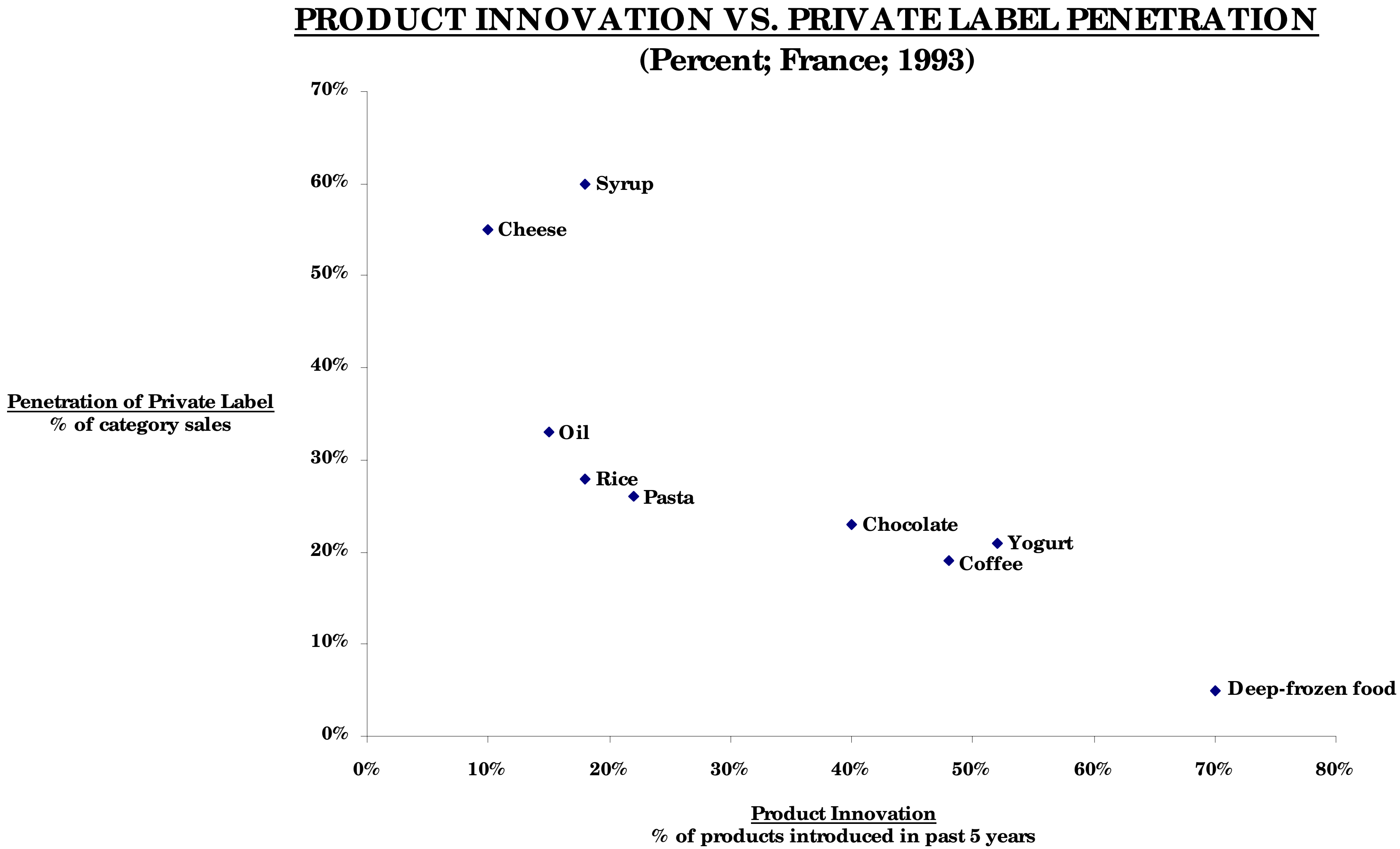
Although it is counter-intuitive, private label has the highest penetration in the categories where the price difference is lowest

PRIVATE LABEL DISCOUNT VS. PRIVATE LABEL SHARE BY CATEGORY
(% discount v. % of sales; UK market; 1998)



 Source: PLMA; Coriolis analysis

Private label is most successful in categories with low-innovation by manufacturers



Source: BCG

There are a number of excellent examples of both product innovation…

PRODUCT INNOVATION: EXAMPLES

Company	Example
Kimberly Clark	3-Ply Aloe Vera Toilet Paper
King Land	Organic Soy Yogurt
Johnson&Johnson	Reach Powerbrush
Gillette	Mach 3 Razor
Tegel	Boneless Turkey Roast
Libra	G-String Panty Liners

… and packaging innovation in the New Zealand market

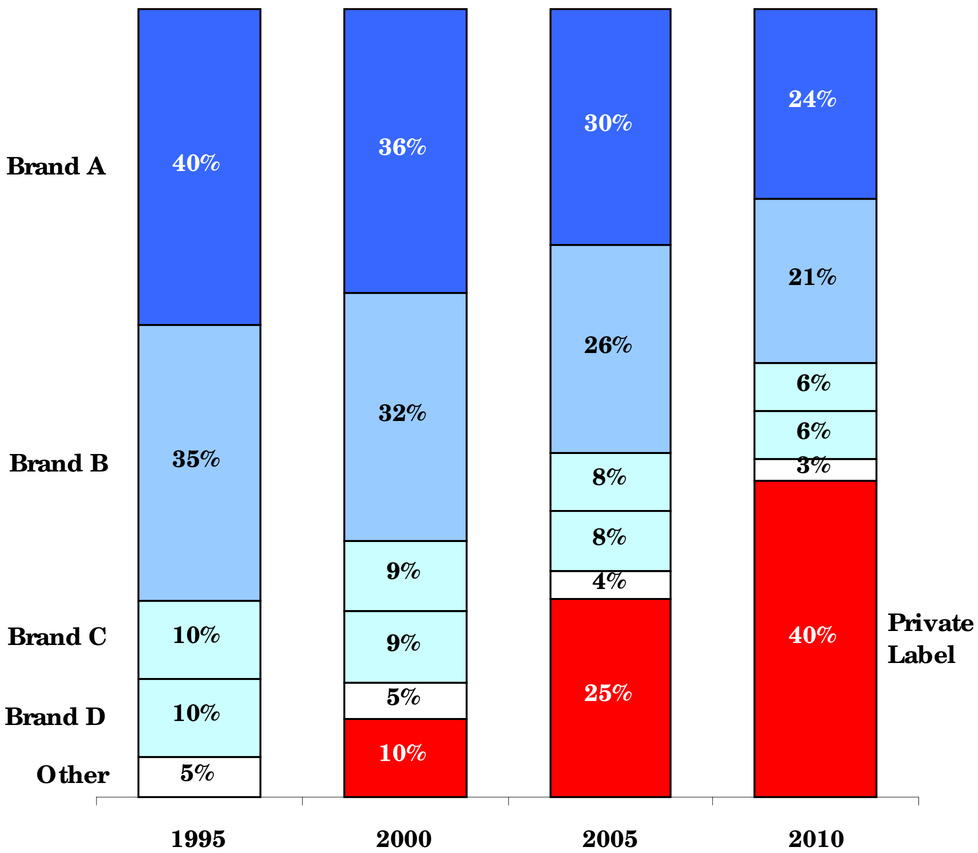
PACKAGING INNOVATION: EXAMPLES

Company	Example
Mainland	Re-sealable zip on cheese brick
Dairy Foods	Integrated large handle on milk
Heinz	Microwave-ready Soup-To-Go soup containers EZ Squirt Blastin' Green Tomato Sauce
Hansells	Pancakes in a Flash
Masterfoods	Grinder Top Peppercorns
Sealord	Shelf-Stable Tuna & Crackers Tuna Snacks

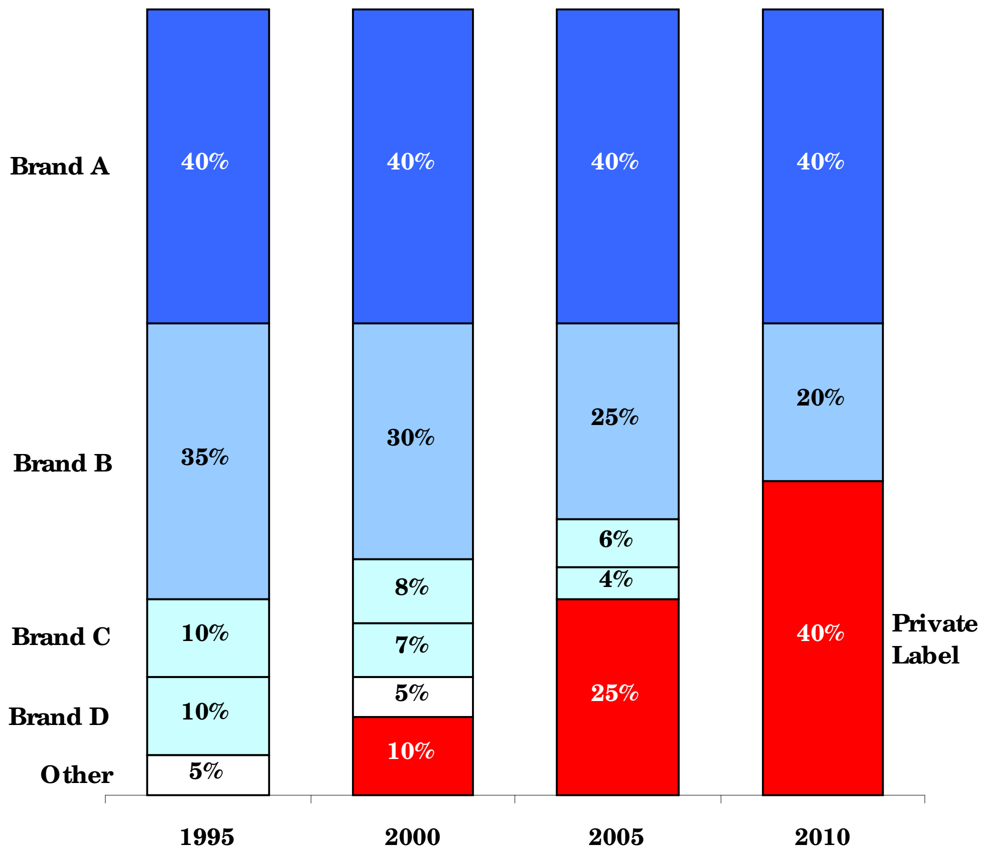
There are two main models for the growth of private label in a category: same proportion of a smaller pie or the squeeze on smaller brands

TWO MODELS FOR PRIVATE LABEL GROWTH
(% of category sales by brand)

Model I: Smaller Pie



Model II: The Squeeze



Try to objectively assess whether your brand will succeed against private label

WILL YOUR BRAND SUCCEED AGAINST PRIVATE LABEL?

Variable	Score
Product performance difference	
Packaging innovation & differentiation	
Market leadership position	
Brand strength (BVI or other measure)	
Strength of private label in category in other countries	
Overall	

If your brand won't succeed, focus on being a private label supplier

ARGUMENTS FOR AND AGAINST PRODUCING PRIVATE LABEL

For	Against
Increase plant efficiency	Can you serve two masters?
Increase sales	Decrease margins
	Hard to keep product or packaging innovations from retailers