

Commentary

Branded Versus Private-Label Consumer Staple Products: The Battle Continues

Morningstar DBRS

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Key Highlights

- Sales of private-label CSPs are growing as global consumer purchasing power is still squeezed.
- Private-label CSPs have become brands themselves, benefitting from grocers' investments in product innovation, branding, and packaging and marketing.
- Grocers are using data-driven insights to manage their merchandising mix of branded and private-label CSPs to meet customer needs and demands and maximize profits.
- Branded products still dominate the CSP industry and grocery shelves as they are an integral part of grocers' merchandising mix to drive store traffic.

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Although inflation is normalizing, prices of consumer staple products (CSPs) remain elevated. This, combined with high interest rates that are only slowly declining, has continued to squeeze consumer purchasing power, contributing to the growing penetration of private-label CSPs. In 2022 and 2023, sales of private-label CSPs grew considerably more than those of their branded counterparts, and now account for around 40%¹ and 20%² of the total grocery market value in Europe and the U.S., respectively, while in the U.K., private-label CSPs make up more than 50% of all grocery sales.³ These products have won favour with customers not only because of their attractive price tags, but also because such private-label CSPs have become brands themselves, benefitting from years of investment by grocers in product innovation, branding, packaging and marketing, which should contribute to further market penetration.

Private-label CSPs are also jostling with their branded counterparts to grow their presence in grocery stores and be positioned in the strike zone—the best place on the grocery shelf to catch customers' attention. Placement is particularly important as, according to NielsenIQ,⁴ customers decide what to purchase in only six seconds. In response, grocers are becoming more dynamic in their inventory management, and are increasingly relying on data-driven insights to gauge (1) the number and type of SKUs they should carry, (2) the most lucrative shelf placement, and (3) the optimal mix of branded and private-label CSPs.

Notwithstanding the growing popularity of private-label CSPs, their branded counterparts continue to generate the lion's share of sales in all grocery departments. Branded CSPs, particularly those manufactured by larger consumer product companies, remain an integral part of grocers' merchandising mix to drive customer traffic, largely because these manufacturers invest significantly in advertising and marketing. Thus, grocers must carefully tread the line between growing their portfolio of private-label CSPs and maintaining strong relationships with manufacturers of branded CSPs. We believe that these dynamics, combined with brand reputation, ongoing research and development, product tiering, and advertising and promotions of branded CSPs, should stand the credit risk profiles of larger consumer product companies in good stead, and they can expect their products to continue to enjoy pride of place on the grocery shelves in most—if not all—departments.

1 Private Label Manufacturers Association International Council. No surprise, private label sales set new record.

2 Private Label Manufacturers Association International Council. PLMA's 2024 Private Label Report. A statistical guide to today's store brands.

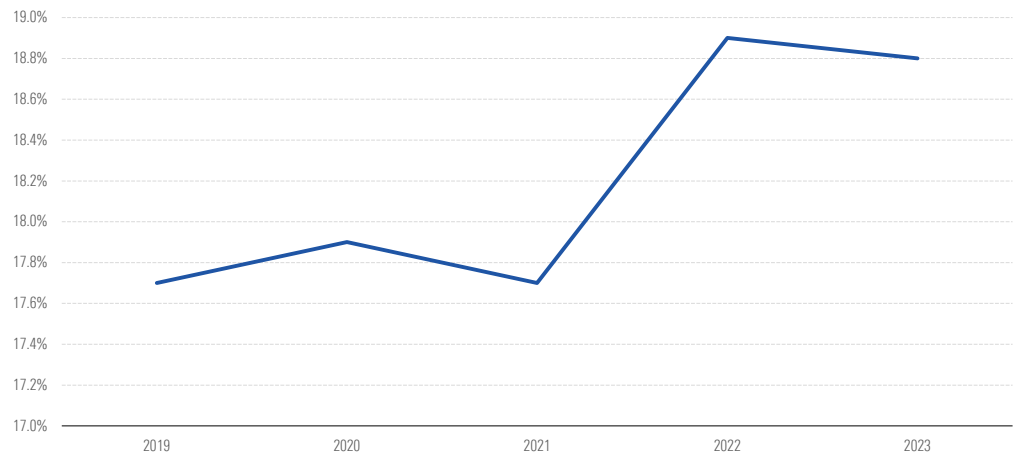
3 The Grocer. The facts and figures behind own-label's incredible growth. May 14, 2023.

4 Nielsen IQ. Data-Driven Decisioning: The Ultimate Guide to Merchandising & Assortment. July 26, 2024.

Branded Versus Private-Label CSPs: The Battle Continues

Distressed consumer purchasing power has contributed to the continued growth in sales volumes of private-label CSPs. In Europe, sales of private-label CSPs grew by approximately 13.0% year over year (YOY) in 2023, while sales of branded CSPs grew by less than half of that, at only 6.0%, in the same period. Private-label CSPs now make up 38.5% of Europe's total grocery market value.¹ While the penetration of private-label CSPs in the U.S is considerably smaller than in Europe, the private-label CSP share of total U.S. grocery sales has been on an upward trajectory over the past few years. In 2023, U.S. dollar sales of private-label CSPs grew by 4.7% YOY, while sales of their branded counterparts grew by 3.4% over the same period.² Private-label CSPs comprised almost 19.0% of total U.S. grocery sales in 2023 compared with 17.7% in 2019 (see Exhibit 1).² This trend continued in H1 2024 when, according to the Private Label Manufacturers Association International Council, dollar sales of private-label CSPs increased by 2.3% compared with H1 2023, while sales of branded CSPs grew by a modest 1.1% in the same period.⁵ In H1 2024, the dollar market share of private-label CSPs was approximately 20% in the U.S.⁵

Exhibit 1: Private-Label CSP Sales as a % of Total Sales in the U.S.



Source: Private Label Manufacturer's Association Private Label Reports for 2022, 2023, and 2024.

Private-Label CSPs Are Brands Themselves

As outlined in our commentary *Battle of the Brands: Private Labels Filling Grocery Carts... For Now*, we believe that the growing penetration of private label CSPs reflects a longer-term trend: they have become brands themselves, benefitting from grocers' multipronged investment approach over many years.

- *Grocers are broadening the scope of their private-label CSP offerings.* Attracting and retaining customers is a key challenge for all retailers, particularly grocers. It can be especially difficult if the assortment of branded products is relatively consistent across stores. As such, grocers have made considerable investments differentiating themselves, in some cases by placing a greater emphasis on the scope of

⁵ Retail Dive. Private brands hit record highs in unit and dollar share in first half of 2024. July 11, 2024.

their private-label offerings, including food and beverages, pet care, and home care products. For example, in May 2024, Target Corporation announced that it wanted to be known as a snacking and food destination and was adding 125 new snacking and food items to its Favorite Day and Good & Gather private-label brands. Furthermore, in Europe and the UK, particularly in metropolitan areas, grocers also offer a wide selection of ready-made convenience foods under their private-label brands. This requires that grocers manage a just-in-time supply chain (or work with specialized outsourced manufacturers) to provide their customers with fresh and safe prepared-food offerings.

- *Product innovation has enhanced private-label offerings.* Grocers are differentiating their private-label CSPs not only on price points but also on quality. They are increasingly investing in product innovation that incorporates customers' wants and needs, including plant-based, natural, organic, and non-GMO offerings. Earlier this year, Walmart Inc. (Walmart) launched bettergoods, a new private-label grocery brand that focuses on three key consumer preferences: culinary experience, plant-based, and made without. Grocers are also expanding their private-label brand tiers and price points, such as Loblaw Companies Limited's (Loblaws; rated BBB (high) with a Stable trend) entry-level No Name and premium-level President's Choice lines, and Sainsbury's entry-level Stamford Street and premium-level Taste the Difference lines of private-label CSPs. These varying tiers provide customers with more price options and different value propositions.⁶
- *Grocers have increased their focus on branding, packaging, and marketing.* Private-label CSP innovations extend beyond enhancing existing product ranges and/or introducing new products. Grocers are increasingly investing in branding and marketing their private-label CSPs to (1) emphasize their range, quality, and value; (2) compare quality and price with branded CSPs; and (3) accentuate product attributes, such as organic, vegan, locally sourced, etc., through innovative packaging. For example, in 2023, the U.S. grocer Albertsons gave its O Organics private-label a modern look with redesigned packaging. Albertsons also consolidated its Signature Farms, Signature Care, and Signature Café private-label product ranges under its Signature Select brand, developed a refreshed logo, unified packaging design for that line, and launched a new advertising campaign.⁷

And customers have taken notice. According to The Food Industry Association, customers cited cost and value as the number one reason for buying more private-label CSPs, followed by quality and taste. Furthermore, customer perception of competitive prices and value for money that private-label CSPs offer is improving, increasing by 3% and 5%, respectively, in 2024 compared with 2023.⁸

Dynamic Inventory Management

Manufacturers of branded CSPs often pay grocers slotting fees for the space their products occupy on store shelves, which is a crucial part of their strategy as optimal shelf placement can influence a consumer's choice or make a new product launch more successful. These fees are negotiated based on numerous factors, such as the product category and its turnover, as well as the power of the brand and how likely consumers are to seek it out.

⁶ 4 ways retailers are boosting their private brands. Grocery Dive. August 15, 2022.

⁷ How 9 food retailers are jazzing up their private brands. Grocery Dive. June 5, 2023.

⁸ Grocery Dive. Private label momentum shows no signs of slowing. June 17, 2024.

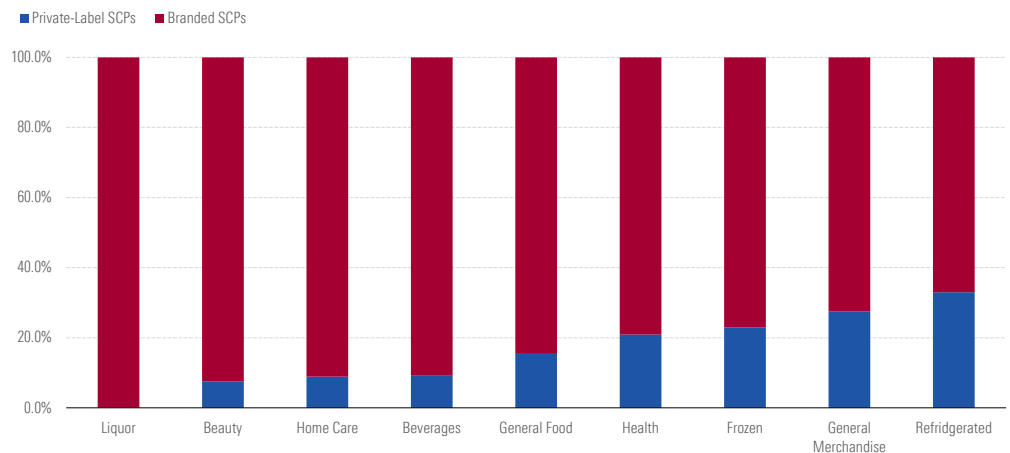
Grocers are also increasingly using artificial intelligence (AI) and data analytics to drive effective customer engagement and merchandising operations, including identifying which SKUs to carry, the optimal mix of branded and private-label CSPs, and the best shelf placements to provide themselves with a competitive advantage, as outlined in our commentary *Artificial Intelligence: Empowering Firms Like Never Before—Global Grocery Sector*. Walmart, for example, leverages its historical data paired with predictive analysis to strategically place its holiday-season inventory across distribution and fulfillment centers as well as in stores.

Some grocers, including Loblaws in Canada, ShopRite in the U.S., and Carrefour Group in France, use smart-shelf technology. It allows these grocers to gain insight into their customers' buying behaviour by tracking their interactions with products, analyzing traffic patterns, and identifying where they linger. Grocers are increasingly leveraging this data to (1) streamline inventory management to maintain optimal levels of popular CSPs and reduce their inventory of slower-moving items and (2) optimize shelf placement by keeping popular items within the strike zone and rearranging shelves and aisles to improve traffic flow. Smart shelves also have built-in weight sensors and other technology to help grocers manage their shelf placement so that customers can easily reach products. Even grocers that don't have smart shelves are turning to AI and other high-tech tools, such as real-time video surveillance, for insights into customer behaviour.

Bottom-Shelf Placement for Branded CSPs? Unlikely...

Private-label CSPs are increasingly sought by customers because of the assortment and quality offered by grocers combined with the benefit of their lower price tags. That said, branded CSPs continue to generate the lion's share of sales in all grocery departments (Exhibit 2).

Exhibit 2: Private-Label and Branded CSPs Share of Grocery Department Sales in the U.S. in 2023



Source: Private Label Manufacturer's Association Private Label Reports for 2024.

As branded CSPs remain an integral part of grocers' merchandising mix to drive customer traffic, we expect them to continue to enjoy pride of place on the grocery shelves in most—if not all—departments. Furthermore, consumers' familiarity with the most popular private-label CSPs and their budget-friendly pricing that supports relatively stable sales regardless of shelf placement. It is therefore not uncommon for some of these products to have bottom-shelf placement, which creates a win-win situation for grocers who enjoy the profit from the sales of their own labels while offering premium shelf space to their valued branded suppliers.

Larger Consumer Product Companies Will Weather the (Private-Label) Storm

We believe that larger consumer product companies, such as PepsiCo Inc., Unilever PLC (rated A (high) with a Stable trend) and Nestle S.A. (rated AA (low) with a Stable trend), will continue to dominate the consumer products industry by (1) improving their product offerings through larger investments in innovation, (2) expanding their entry price point branded product offerings to directly compete with private-label CSPs, and (3) increasing their advertising and promotional spend.

We expect the credit risk profiles of such companies to withstand the pressure from private-label CSPs because of the breadth of their product offering within different price tiers. Consequently, during periods of financial distress as customers trade down to more affordable product offerings within the same product category, larger consumer product companies are better insulated from the threat of private-label CSPs than companies with narrower or premium product offerings. Moreover, we believe that grocers will remain incentivized to balance the growth of their portfolio of private-label CSPs while maintaining collaborative relationships with the key brands that drive traffic to their stores. As such, we expect the brand heavyweights in the consumer products industry to continue to yield significant influence over grocers, ensuring that their branded products retain their sought-after placements on grocers' shelves.

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