

# Driving private label growth

*Understanding and improving your private label performance*



## Introduction

Private label has evolved over the past 20 years. In fact, studies find that the most successful retailers sell more private label goods than other retailers. Private label products increase sales, gross margin and provide a retailer with a level of control around their products. Reaping the benefits of a private label strategy, however, offers a host of unique challenges and opportunities.

While private label has historically and often been used as the lower-priced offering in the merchandise mix, private label has also evolved to the point where many items offer high quality ingredients, product performance and packaging. Whether competing on price or differentiating based on quality, selection or other factors, retailers are effectively using private label to create value for consumers and to differentiate their businesses. For others, strategies have not changed to reflect product improvements and changing consumer attitudes.

Consumers simultaneously pursue greater value and greater quality and retailers have historically used private label products to convey a value image. In recent years, private label products and the private label consumer have changed.

Managing a private label portfolio means that you will need to determine:

- What private label products will appeal to your customers overall, and by segment.
- How to price and promote these items relative to national brands.
- How various merchandising decisions impact your category goals, as well as your customer goal.

## The private label opportunity

Private label growth has accelerated during the recession as consumers are looking for ever greater values and switching to private label from national brands. Although the recession is prompting consumers to switch to private label, most research indicates that consumers do not intend to switch back when the economy recovers.

## Driving private label performance

All this research underscores what retailers know: private label is a great opportunity, and demands attention to drive growth. Effectively driving private label performance requires a retailer to deeply understand both consumer behavior as it relates to private label, as well as their competitive position regarding private label.

Based on over 10 years of experience, IBM has developed a programmatic approach to aid retailers in driving their private label growth.

## Baseline your performance

The first step is to baseline your private label performance. You want to understand how fast your private label brands are growing, and how fast you should expect them to be growing.

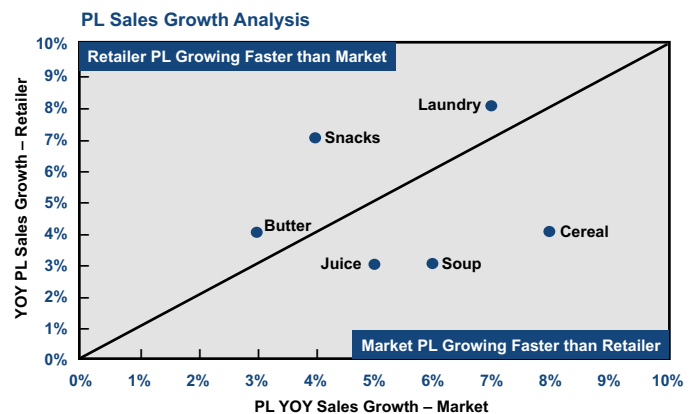


Figure 1: Private Label Sales Growth Analysis

In the example chart above, categories of products above the diagonal line are growing faster than the market; below the dividing line are growing below the market average. In this example, we can see that laundry, snacks and butter are growing faster than overall market for private label sales, but juice, soup and cereal are underperforming.

Through analysis of readily available syndicated data, you will want to analyze your private label products, and place them on this chart.

**Determine the role of private label in each category**

Many retailers mistakenly believe that their private label products—since they can’t be purchased elsewhere—are not image items. However, this is not necessarily true. It is critical to understand which of your products is an image item.

In this example, we see a grid with four quadrants.

- Products that are important to a customer (as defined by the category lift), and the retailer (as defined by sales) are in the upper right. Those are the best candidates to be your image items.

- Products that drive a lot of your sales, but are perhaps not as important to your customers are in the bottom right. Those items are more likely to be profit drivers.
- Products that don’t drive a lot of sales, nor are they critical to your customers are niche products, and go in the bottom left.
- Products that are important to your customers, but don’t drive a lot of sales are defined as assortment completers and are in the upper left.

Here we see that private label laundry and cereal are image categories, and you need to price aggressively, to help ensure that they are priced at or below the competition. On the other hand, juice and butter are potential profit drivers and you can be less aggressive in your pricing.

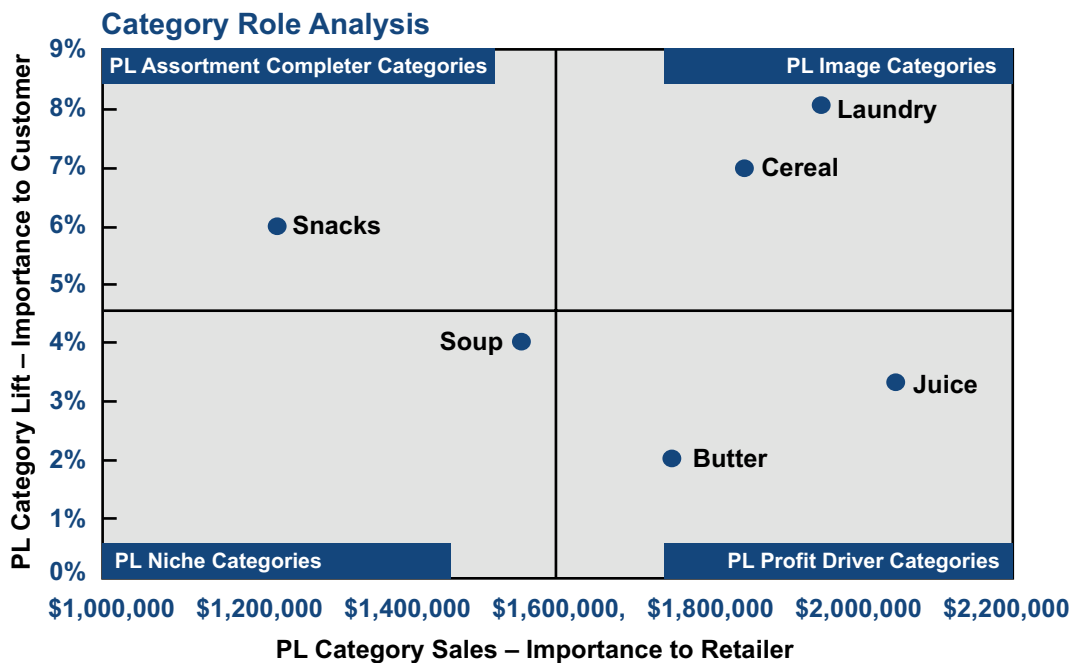


Figure 2: Category Role Analysis

It is not enough to understand your private label image items for your business overall. Each store is made up of a different set of consumers, and the private label image items may vary from one store to the next. Moreover, if you have a loyalty program and a customer segment strategy you will also want to understand the image items for specific customer segments to make sure you do not miss out on any private label products that are not image items for your customer base overall, but are for specific segments that are important to your business.

Once you know how sensitive your customers are to price – by store and by customer segment – you can use that data to price accordingly. Be more aggressive on your image items and less aggressive on your profit drivers.

Identify the promotional levers that work best for private label. Beyond having an understanding of how customers will likely react to pricing for your private label products, you'll also want to understand what types of promotions, by product and category, will work best for your private label products.

In this example we see a chart that shows the promotional levers across the top, and the categories on the left. As we can see private label products in the laundry category are the most responsive to discounts and a feature plus display. Likewise, private label snacks are the most responsive to displays, and soups are most responsive to multiples. Having this understanding will help you to plan and execute more effective promotions.

You will also notice that the promotional responsiveness in a given category will differ between private label and national brand. In other words, things that may work for a specific national brand product will not necessarily work for its private label equivalent. This holds true in reverse as well.

		10% TPR	Feature	Display	Feature + Display	Multiples
Snacks	PL	12%	60%	140%	110%	40%
	NB	15%	75%	110%	150%	60%
Soup	PL	17%	40%	60%	90%	120%
	NB	20%	25%	40%	75%	100%
Cereal	PL	35%	30%	60%	120%	25%
	NB	25%	50%	120%	180%	40%
Laundry	PL	45%	80%	120%	210%	20%
	NB	20%	100%	130%	190%	10%
Butter	PL	15%	20%	40%	50%	35%
	NB	10%	15%	25%	30%	25%
Juice	PL	25%	70%	50%	140%	90%
	NB	15%	60%	60%	100%	60%

*Figure 3: Promotion Response Analysis*

To understand promotional performance in your stores, you must analyze your own sales data and understand what will work for you. Again, as with prices, you will want to make sure you conduct this analysis at a store/SKU level so that you understand how each product behaves in each store and can act on that data accordingly. Moreover, if you have a loyalty program, you will uncover interesting and actionable differences by customer segment. This will allow you to pinpoint promotions to be most responsive in each store, and to the customer segments that matter most to your business.

## Determine the optimal price gap

The price gap between private label and national brand is a key lever for private label. Before you decide on a price gap for your business, you will also want to make sure you understand how you compare to the market overall. Many retailers look to have a standard price gap. Through our research, IBM has found that this is a costly approach. In fact, some products and categories can support smaller price gaps, whereas others require a larger price gap. This will vary by store and customer segment.

Again you will leverage consumer demand science to understand the impact of different price gaps on category

units, sales and profits, and then use this analysis to help you find the optimal price point to maximize for your goal (profit, sales or volume).

You will want to have an understanding of the impact of price changes on volume, overall sales as well as profit. With this comprehensive picture, you can make decisions about the optimal price point. In this example, we can see that for juice, a price gap of 10 to 20 percent between the private label and the national brand generates the highest overall profit and sales dollars for the juice category. Above a 20 percent price gap and you don't pick up a lot more sales, and your margin begins to drop dramatically. Below a 10 percent gap, you lose a lot of sales to the national brand and your margin also drops off precipitously.

## We use our customer demand models to understand the impact of price gaps on category units, sales and profits.

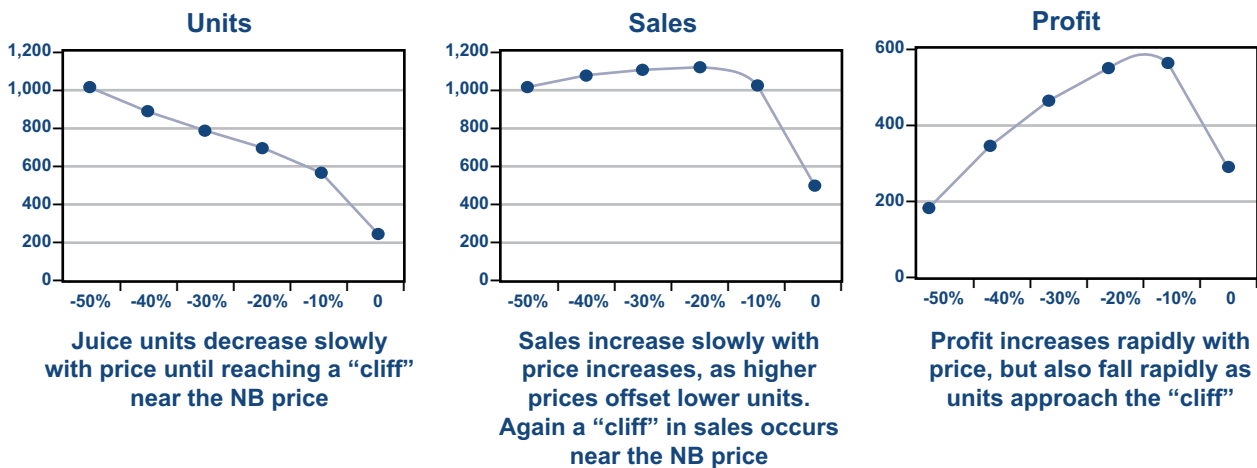


Figure 4: Volume, Sales, Profit Analysis

Once you have identified the optimal price gaps for your products, you may want to gain an overall understanding of your price gaps relative to market.

In this chart, the products above the diagonal line are categories that have a larger price gap than market; below the diagonal line are categories where the price gap is below the average. In this example, we can see that the private label price gap relative to national brand is greater for the retailer than the market in juice, laundry and butter, but is lower for soup, cereal, and snacks.

By optimizing these prices with IBM consumer demand models and optimization technology for entire categories in order to increase category sales, volume and profit by increasing private label share. In these scenarios, we found that there wasn't a standard, universal price gap that was optimal, but that the optimal price gap between private label and national brand varied depending on the specific item and category.

By tailoring the price gap to the specific product, store and even customer segment, you can drive performance for your private label business. Like image items and promotional levers, the optimal price gap will vary by product, store as well as customer segment.

## Conclusion

As private label continues to evolve, becoming an ever more important component of a retailer's strategy, it is imperative that retailers use the best tools and techniques available to drive their private label growth. Leading edge retailers today

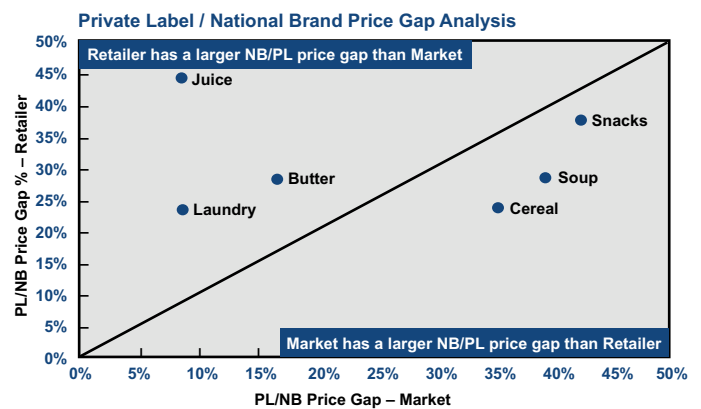


Figure 5: Private Label to National Brand Price Gap Analysis

are driving their performance with consumer demand science to help them understand the price sensitivity of various products, the responsiveness of various products to promotional levers, and the optimal price gap for each product.

IBM's omni-channel merchandising solutions enable retailers to take a customer-centric approach to pricing, promotion, assortment planning, and other merchandising and marketing strategies. Based on a holistic understanding of customer behavior, customer segments, and retail market dynamics, IBM solutions help retailers improve their price image and strengthen customer loyalty while achieving their sales, volume and profit goals.

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Produced in the United States of America  
May 2015

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