Status and Trends in Private Label Product Sourcing

WHITE PAPER

Executive Summary

Much has changed since the 1970s, when British retailers Sainsbury, Boots and Marks & Spencer pioneered private labels, quickly followed by counterparts in the United States and elsewhere. Long gone are the days when store brands were most notable for their black-and-white packaging and questionable quality.

Today's private labels account for 17% of the global packaged goods market, and that number exceeds 30% in sectors such as refrigerated goods, paper and plastic wraps. No wonder more and more retailers, manufacturers and wholesalers are now promoting a complete portfolio of private labels that extends from value to premium merchandise.

In an effort to understand the trends in private label sourcing and help companies exploit the associated business opportunities, Centric Software recently conducted an extensive survey of retailers, wholesalers, manufacturers, and private label brokers. This report presents insights from the survey, addressing these and other key questions.

- Which types of companies are leading the adoption of private labels programs?
- To what extent are companies sourcing private label products from low-cost countries? Has their experience been favorable?
- What is motivating companies to expand their private label programs?
- What are the primary challenges that confront private labelers?
- Which tools do companies use to manage their private label programs? Are companies satisfied with these tools?
- Do the benefits of private label programs change depending on the tools used to manage the program?

> According to Mickey North Rizza, a director with Boston-based AMR Research, "Centric sets a new bar in global sourcing from a collaborative standpoint. It has suppliers, agents, distributors, and merchandising folks all coming together on a single platform. It enables them to know where the product is, when it's coming in, and what the problems are. Everyone sees the same information."
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> **Manufacturing Business Technology, August 1, 2007**

Survey Overview

Store brands now account for one of every five items sold in the United States. They represent some $65 billion in sales. Expect those numbers to increase: Global growth of private labels — currently 5% according to market research firm ACNielsen — is more than double the 2% growth rate for brand products. ACNielsen's study finds even stronger growth of 7% for private labels in North America. Private labels in the emerging markets, meanwhile, are now seeing 11% sales growth.

These trends provoke important questions for retailers, wholesalers, manufacturers and private label brokers. Which types of companies are exploiting the potential of private labels? What benefits and challenges have they encountered? Where are they sourcing their private label products? How do they track and benchmark the success of their private label programs?

To answer these intriguing questions, Centric Software conducted an extensive survey of retailers, wholesalers, manufact¬urers and private label brokers across a spectrum of industries. This report summarizes key — and often surprising — findings from the survey.

Profile of Survey Respondents

Among more than 100 respondents, 80% represented retailers or manufacturers or manufacturer-retailers (i.e. manufacturers that retail their own merchandise). Of the remaining 20%, 12% were wholesalers and 8% were private label brokers. Approximately two-thirds (65%) of the retailers were small, distributing through less than 25 outlets. However, a significant minority represented larger retailers: 24% distributed through more than 100 outlets, and 9% through more than 500 outlets.

655 Campbell Technology Parkway Suite 200 Campbell CA 95008 USA
E centric@centricsoftware.com **T** +1.408.574.7802 **F** +1.408.866.5869 **URL** www.CentricSoftware.com

Respondents represented a range of industries including high-tech, healthcare, entertainment, food service, construction and consulting. And their companies manufactured and sold a diverse range of products: high-value hard goods (27%), low-value hard goods (12%), soft goods (12%), and other more specific categorizations such as furniture, apparel, automotive parts, sports equipment, office supplies, software and medical supplies.

The range of company size was also broad: 45% were smaller companies with revenues less than $100 million. 31% were mid-size companies with revenues between $100 million and $1 billion. The remaining 24% had revenues in excess of $1 billion, while 12% had revenues greater than $5 billion. The great majority of the survey participants represent U.S. companies, though many have international operations. For example, some 22% own manufacturing facilities overseas, and a further 8% are either building such facilities or plan to do so soon.

► Gone are the days when store brands were characterized by products of questionable quality in black-and-white packaging.

Private Labeling: Prevalence and Satisfaction

The survey suggests that private labeling will continue to gain ground on branded products over the next few years. When asked what percentage of merchandise they plan to sell under a private label by 2010, fully 22% of respondents answered more than 50%, and 13% indicated more than 75%. These numbers compare with the present in which just 16% of respondents' companies sell more than 50% of their merchandise as private labels, and just 8% sell more than 75% of their merchandise as private labels.

In-keeping with this growth expectation, fewer than 18% of respondents anticipate that private labels would constitute as little as 10% of their revenues by 2010. Today, by comparison, 37% of respondents sell less than 10% of their merchandise as private labels.

Indeed, 85% of companies are planning to increase their private label programs over the next three years. And the average program size should increase from 30% to 42% of merchandise. The survey found no correlation between plans to increase or decrease a program and the countries used for sourcing. This might suggest that "source hopping" (i.e. frequently changing sources from one region to another in search of better terms) is unlikely to fundamentally alter a company's satisfaction with its private label program.

The primary benefit seen from use of private label programs — a benefit cited by 40% of respondents — is margin improvement. This answer suggests that margin pressure has been the chief driver for companies' growing interest in the private label alternative to traditional branded products. After margin improvement, respondents cited other benefits: better brand recognition (27%), sales growth (27%) and superior product quality (6%).

Notable is a markedly more pronounced experience of increased profitability by companies that manage their private label programs using specialty software. Illustrated in the chart below, 82% of such companies reported higher profitability, and 18% reported superior brand recognition.

► Those using specialty software did note any challenges with administration or cost management.

Reported Benefits of Private Labeling when Supported by Specialty Software

The trend towards increased use of private labels notwithstanding, some companies (notably, 15% of retailers) are planning to down-size their private label programs. Foremost among reasons cited:

- Difficulties in qualifying suppliers and products
- Delays in freight lead times and uncertainty over production scheduling
- Variability in product quality — for example, discrepancies in product color and packaging inconsistency
- Brand acceptance
- Erratic demand patterns

Among respondents in general, a number of challenges still frustrate many private label initiatives. Unsatisfactory product quality is the most significant challenge, identified by 27% of respondents. Meanwhile, some 21% identified brand acceptance and 20% identified on-time delivery as their primary challenges. Other concerns included cost (11%), slow sales (7%), difficulty of program management (7%) and various supplier issues (7%).

Primary Challenges of Private Label Programs

When using specialty software, the range of reported challenges narrows. None of the respondents who use such software reported, for example, challenges with program management or slow sales, and a much smaller proportion (just 11%) identified concern over brand acceptance. However, users of specialty software continued to emphasize challenges that are inherent to the supplier relationship — especially, concerns over on-time delivery and product quality.

Primary Challenges of Private Label Programs when Supported by Specialty Software

Suppliers

Respondents — predominantly U.S. companies — sourced about half their goods from the United States and half from elsewhere. However, for companies with private label programs, reliance on the U.S. supplier market is much greater: 92% of surveyed companies source from the United States for at least some portion of their program. The survey also revealed a tendency to source from multiple regions. For example, 66% of respondents source from two or three regions; 14% source from four or five regions; and 10% source from as many as six regions.

Smaller companies tended to source a lower percentage of finished products from overseas. Indeed, 50% of small companies source less than 10% of their private label products as landed (finished) goods from overseas, and only 16% of small companies source more than 50% of their private label products as landed goods from overseas.

Larger companies, in contrast, sourced much higher percentages of finished products from overseas, with some 30% sourcing more than half of their private label products as landed goods. Further, some 22% of very large companies (revenues greater than $5 billion) reported sourcing at least 75% of their private labels as finished goods from overseas.

Not surprisingly, larger companies tended to source from more suppliers, and smaller companies tended to source from fewer suppliers. For example, 35% of large companies (revenues greater than $1 billion) each sourced from more than 500 suppliers, whereas some 17% of mid-size and 10% of small companies (revenues less than $100 million) sourced from this many suppliers. Indeed, 80% of small companies sourced from less than 100 suppliers.

Sourcing from Low-Cost Countries

Sourcing from low-cost countries (LCCs) is widespread, especially among wholesalers: Just over three-quarters (76%) of all respondents now source from LCCs, and that proportion rises to 86% for wholesalers. Moreover, a further 19% of respondents are considering LCC sourcing in the future. The chart below illustrates the regions from which respondents source their private label programs. Not surprising, most companies that source from LCCs are large.

At the present time, the most sourced low-cost country is China: 72% of respondents source at least 10% of their finished products from China, 52% source at least 25% from there, and 22% source at least 50% of their finished products from China. Among other low-cost regions, Southeast Asia (excluding China) accounted for at least 25% of the finished products among some 30% of respondents. India, Mexico and Eastern Europe accounted for substantially smaller but still significant proportions: All three regions were comparable with some 11% of respondents sourcing at least 25% of their finished products from India, Mexico, or Eastern Europe. The survey did not ask about changes and trends in the regions used.

Regions for Sourcing Private Label Products

The survey findings suggested that smaller companies are more likely than their mid-size counterparts to source from Southeast Asia, Mexico, or Eastern Europe. For example, 16% of small companies sourced from Eastern Europe, which compares with only 9% of mid-size

Almost one-quarter of respondents are unable to track product margins. Less than half can track the brand-equivalent SKU.

Most companies are not able to assess the top- and bottom-line impact of cannibalization.

companies. However, 18% of large companies also sourced from Eastern Europe, suggesting this region is not unfriendly to high-volume customers.

Beyond a quantitative assessment, the survey inquired into participants' reasons for sourcing private label products from LCCs. More than two-thirds (68%) identified increased margins as the driver. Clearly companies are experiencing margin pressure. Distant second among reasons were a need for increased revenue and a need to build out a fuller product line, each cited by some 12–13% of respondents. Faster time to market accounted for 7% of respondents.

► 41% of respondents are dissatisfied with their existing tools for tracking SKUs and suppliers. Fewer than half of respon¬dents who use spreadsheets are satisfied with this method of tracking.

Tracking SKUs and Suppliers

When asked about their tracking of private label SKUs, almost one-quarter (23%) of respondents acknowledged they were unable to track product margins. Perhaps even more surprising was that less than two-thirds (60%) —and, in some cases, considerably less than half — tracked other critical metrics such as brand-equivalent SKU (43%), brand-equivalent price (57%), landed cost (58%), distribution cost (55%), and sales of private label versus brand-equivalent products (45%). Clearly, most companies are not currently able to assess the bottom-line impact of critical market dynamics.

The survey validates this conclusion by revealing that 82% of companies who are tracking sales of private labels versus brands are seeing benefits such as higher margins and revenue growth. More¬over, 41% of the companies who are not tracking private label versus brand sales, mean-while, failed to achieve these same stated goals.

Companies that employ advanced SKU tracking also cited other benefits such as:

- The ability to capture a price point different from brand-equivalent
- Less dependence on other dominant name-brand producers
- Increased customer loyalty
- Superior brand awareness
- Larger market share

Tracking of suppliers shows a similar pattern to tracking of SKUs. Whereas a large proportion (85%) of respondents said they track the operational metric of delivery date variance per shipment, less than half track other key risk data such as the supplier's liability insurance (46%), C-TPAT audit (29%) and code-of-conduct (0%) status. And barely half (55%) of respondents track the supplier's percentage of revenue from their company — an important consideration when assessing the supplier's resilience to withstand a reduction in orders from the company.

Meanwhile, a similarly modest proportion of respondents are tracking another key metric: the percentage of the company's revenue that derives from that one supplier. Again, issues of dependency-based risk arise if this percentage is too high.

Tools for Tracking SKUs and Suppliers

The survey sought to understand the tools used by enterprises to support their private label programs. Which tools are in use for tracking SKUs and suppliers? Are companies satisfied with these tools? Which solution types are providing a competitive advantage? Respondents identified a range of existing tools including spreadsheets (used by 55% of companies), third-party ERP applications (48%), applications developed in house (23%) and specialty third-party sourcing solutions (23%).

Fully 41% of respondents are not satisfied with their existing IT support tools. This dissatisfaction was expressed by small and large companies alike with all levels of private label programs. More specifically, fewer than half of respondents who use spreadsheets are satisfied with this method of tracking. And among those who use either an in-house application or an ERP system for source tracking, 36% of respondents are not fully satisfied. Satisfaction was only high among respondents who use sourcing software: 78% of respondents said they were satisfied with their solutions.

Such widespread dissatisfaction suggests an awareness of superior solutions. Indeed, the survey showed significant willingness among respondents to switch to dedicated source-tracking solu-tions: 50% of respondents who use spreadsheets expressed immediate readiness to move to a new application. And 40% who currently use ERP systems for tracking would consider better options.

Most interesting, given the level of technology available to U.S. companies, is that dissatisfaction with solutions for tracking sourced finished goods was greatest among companies that source from the United States: 55% of companies that source a large majority of their from the United States were dissatisfied with their tracking solution. Dissatisfaction among those who source the majority of their goods from China, Southeast Asia and Mexico, by contrast, was just 25%, 15% and 5%, respectively. The data is illustrated in the chart below.

In speculating on the reasons for this difference, one factor may be that the sample of survey respondents — most of whom are from the United States — expected better tracking when sourcing from fellow U.S. companies given these suppliers' ready access to technology and the absence of geographic barriers within the United States.

Dissatisfaction with Tracking Solution by Predominant Region

Centric Product Sourcing

Without a better alternative, retailers, wholesalers, manufacturers and private label brokers try to manage the critical sourcing process using spreadsheets, email and other desktop productivity tools. Indeed, office applications have become so ubiquitous that users may barely stop to consider their unsuitability for the complexities of product selection, sourcing, development and marketing.

Centric Product Sourcing allows users to identify and compare suppliers, track all sourced products from concept to SKU, collaborate globally through a secure web-based interface, assess financial implications, and track status and other issues via highly configurable, interactive dashboards. This powerful but easy-to-use solution delivers real-time intelligence by automatically collecting live information from suppliers and in-house repositories such as product databases, ERP systems and email and office documents.

No less important, Centric Product Sourcing deploys rapidly. Users can expect a return on investment in months rather than years. Specifically, with Centric Product Sourcing:

- Executives can view summary reports of schedules, costs and sales and drill down to assess key performance indicators for thousands of SKUs.
- Sourcing and procurement personnel can manage vendors, compliance issues, track shipments and pay invoices.
- Merchandising managers can identify and rectify bottlenecks as they arise.

About Centric Software

Centric is the only PLM company to incorporate line planning, global sourcing, calendar management, and product specification in one platform to improve global collaboration for apparel, retail, and consumer goods companies.

"Rather than a lengthy deployment, Centric had a demo with live data ready within a week, and within a few months, we had a full deployment. The application is a delight to use. Our managers can quickly navigate through products and suppliers and easily get the cost and schedule information they need."

Senior Vice President of Merchandising

655 Campbell Technology Parkway Suite 200 Campbell CA 95008 USA
E centric@centricsoftware.com **T** +1.408.574.7802 **F** +1.408.866.5869 **URL** www.CentricSoftware.com