



## 4 Myths & Realities of Private Labeling

Much is talked about regarding private labeling, and unfortunately a number of concepts and words are used interchangeably that obfuscate the issues when discussing private labeling.

Before considering a private labeling endeavor as a distributor, it is important to understand all of the issues – from liability to inheriting the role of a manufacturer; from the message it sends to your manufacturers to the level of support you may receive from reps; from thinking you can maximize your profits to incurring logistics and inventory expenses. As a manufacturer, whether a private label producer or a name brand competitor (or for some, both) how does this affect your profitability, your brand, your distribution strategies?

The past couple of articles shared insights from distributors and manufacturers. We are currently conducting contractor research on the value of brands and customer acceptance of privately branded products. While we await the results, we felt it important to share the following myths and realities.

**1. Myth:** *Distributors are pursuing private labeling to **only** improve their margins or gain lower prices.*

**Reality:** The drive for improved profitability is only part of the answer. Traditionally, companies pursue private label initiatives to increase their market share and to improve overall margins. But more importantly, this is about control of the customer and who has leverage in the channel.

Market share is improved by greater appeal to customers who are more price-sensitive as well as the ability to use price as a marketing tool.

Margin improvements typically emanate from:

- Better margins on the private label products. With acquisition costs 25-50% lower, there is an opportunity to improve margins, albeit profit dollars per unit may decrease due to lower selling prices. Key is achieving high inventory velocity.
- The ability to leverage name brand manufacturers who want to remain on the distributor's shelf. The leverage comes from improved rebates, marketing funds and other sales resources.

Earlier research projects by CMG and separate research by ARA have shown that the top four reasons why contractors purchase from a distributor are 1) relationship with distributor personnel 2) product availability 3) price and 4) overall service. Manufacturer brand is fifth. For most products, a significant percentage of customers are brand agnostic, especially when the perception is that most manufacturers out-source manufacturing.

The importance of this is that for private labeling to be effective, the relationship needs to be with the distributor. Distributors who pursue private labeling will need a high level of salesperson retention, otherwise they will become transactionally-oriented distributors with limited value-added, essentially competing based upon price.

- Increased loyalty from customers who prefer the distributor brand vs. the name brand. Some distributors believe that it is more important to market solely their brand and that there is limited, if any, value in marketing a manufacturer's brand.



- Improved customer profitability. By adding higher margin sales to a customer, and gaining a greater percentage of their business, a distributor can improve the net profit of that customer.

Additionally, companies that are actively pursuing private labeling, feel that their customers are more loyal to them than to manufacturers and that they have more power/control in the channel. Consumer products goods research has shown that 33% of customers are loyal to stores, 50% are loyal to manufacturer brands with the remainder undecided. Coincidentally, research has shown that for unsophisticated private labeling initiatives to be profitable for a multi-brand company, private labeling should represent 20-30% of their business.

**2. Myth:** *Importing is private labeling.*

**Reality:** There was much discussion at the NAED SouthCentral where these two words were interchangeably referenced as threats to the industry.

The desire for increased margins and market share is leading a drive to reduce product acquisition costs. In many instances this is opening distributors to the idea of imported lines, niche and regional manufacturers, and private labeling. In some instances counterfeit products have been encountered. Unfortunately, the perception of product quality is being colored by these counterfeit products. Naively, some say that since private label products are imported, therefore imported products are of poor quality.

While the old adage of caveat emptor (buyer beware) is incumbent upon distributors for all manufacturers/products that they represent, just because an overseas manufacturer wants to expand distribution into the United States does not mean that their product quality is unsatisfactory. Consider that there are many U.S. based manufacturers who seek to distribute product overseas, do they offer inferior products to those countries? If

importing infers poor quality, then the inference carries to U.S. located companies that manufacturer overseas.

Yes, a private label manufacturer could have product quality problems, but this is the exception. More common, the product is of similar quality (but may not be exactly the same). This is called "copy cat" private labeling and enables the distributor the ability to offer a *comparable* product at a significant savings and position the line as a value line. Frequently the product is designed through reverse engineering.

From a market penetration viewpoint, why do U.S. manufacturers have people with titles like "Global Distribution Manager"? Importing, and expanding distribution networks, is an outgrowth of a global marketplace and a desire to increase sales, not an indicator, or predictor, of product quality.

**3. Myth:** *All private labeling is done overseas.*

**Reality:** Private label brands are produced by a number of different companies. Essentially, any company that is willing to change the packaging of its products can conceivably private label for a distributor. Private labeled products can be procured from:

- Name brand manufacturers (some of which manufacturer overseas, some domestically). Typically these companies believe that they are selling excess capacity. Unfortunately this can create a self-fulfilling prophecy...sell excess capacity, then sell less branded product, which creates more excess capacity (which can be sold to distributors who want to private label!).
- Regional domestic manufacturers
- Sourced by brokers
- Produced by domestic and overseas contract manufacturers.

**4. Myth:** *Private labeled product is not quality product.*



## Article Appearing in Electrical Wholesaling, April 2007



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**Reality:** Consider your life as a consumer. Have you purchased any store brands from your local grocery store? Have you had a drug prescription filled as a generic or purchased a CVS or Walgreen's product? How about Staples-brand copy paper? Does the gas from your local non-branded gas station power your vehicle?

If you purchase store brand apparel or food and feel that those products are quality products, why would you presume that electrical materials would not be quality products?

There is, however, a difference between knock-off and counterfeit products. The difference is intent.

Recently a number of high profile product counterfeit cases have resulted in prosecution as well as contributing to product liability concerns. A drive to buy, and sell, less expensive products can contribute to counterfeiting while increasing channel costs. Costs increase as manufacturers develop processes to reduce counterfeiting; incur increased legal fees to address counterfeiting; and absorb increased insurance costs.

The Better Business Bureau estimates "that counterfeiting costs U.S. businesses as much as \$250 billion every year and results in the loss of 750,000 jobs." Some electrical manufacturers suggested that counterfeiting affects their production costs by 1-3% and, in some product categories, could represent 2-4% of sales!

This should be especially disconcerting to small and medium sized distributors considering private labeling. If a distributor is not knowledgeable about manufacturing and can not ensure product quality, the risk of unknowingly accepting counterfeit products, with the associated product liability, can be significant. Larger distributors can invest the resources to employ personnel to distinguish between counterfeit products and knock-offs,

as well as protect themselves from the liability.

Knock-offs differ from counterfeit products as they are copies of products and don't represent themselves as name brand manufacturer products. Typically, private label products are knock-offs.

The difference between knock-offs and counterfeit products, according to Wikipedia, is intent. "A counterfeit is an imitation made with the intent to deceptively represent its content or origins. By contrast, a knockoff item may imitate a well-known one, may be sold for a lower price, and may be of inferior quality, but there is no attempt to deceive the buyer or infringe upon brand names, patents, trademarks or copyrights."

As you can see, fear breeds misunderstanding. In many industries, private labeling as a percentage of industry sales has grown faster than manufacturer brands. While consolidation, combined with a drive for increased market share and profitability drives the effort, in an industry as fragmented as the electrical industry, there is no need to panic nor copy the competition. Private labeling may not prove to be a significant competitive advantage, or may be successful for only the largest of distributors. Distributors and manufacturers who focus on their core competencies, pay attention to customers, innovate, offer value and market effectively can thrive. Relevancy requires providing the customer with value and creating your own reality.

**David Gordon** is a principal of **Channel Marketing Group**. Channel Marketing Group develops strategic plans and market strategies for manufacturers and distributors. He can be reached at 919.488.8635 or [dgordon@channelmkt.com](mailto:dgordon@channelmkt.com). Register for monthly newsletter at [www.channelmkt.com](http://www.channelmkt.com).

**Allen Ray** is principal of **Allen Ray Associates**, [www.allenray.com](http://www.allenray.com). Allen Ray Associates helps companies improve profitability through effective pricing strategies and streamlining business processes through effective eBusiness utilization. Allen can be reached at 817.704.0068 or [allen@allenray.com](mailto:allen@allenray.com).