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Customers Speak Out on Private Labeling

Over the past couple of months there has been much discussion within the industry regarding the pros and cons of private labeling. Many national chains are private labeling product, or discussing it. Independents are debating how to compete, and in some cases are private labeling. Name brand manufacturers are addressing specific customers and internally discussing how to compete while marketing groups are contemplating how to support their distributors.

Much of the discourse centers around the profit opportunity, using private labeled product as a "price play" to capture increased market share, with some discussion on how to use private labeling as a branding initiative. Manufacturers talk about private labeling as either a revenue source or a competitor.

But like any major line change, the key is your customers. What do they think? Will they support "the line"? What is important to them? Essentially the same questions you ask before you make a lamp, wiring device, switchgear or tool or other significant conversion.

Given the adage "the customer is king", or "follow the money", Channel Marketing Group and Allen Ray Associates, in conjunction with Electrical Contractor & Maintenance and Electrical Wholesaling, conducted a customer e-survey. The goal survey was to solicit customer input on the value of brands and their exposure, and acceptance level, of non-branded products.

Approximately 12,000 emails were randomly selected from EC&M's database. A 4.7% response rate was received, exceeding traditional blind e-survey response rates of 2%. Respondents were offered a copy of the survey results and, at their option, an entry into a sweepstakes for one of four high-definition televisions. To validate open-ended responses, a number of telephone interviews were conducted.

Audience

Survey respondents came from a broad audience, both in type of business and geographically.

Contractor Revenues
- 47.2% had revenues less than $2 million
- 11.8% had revenues of $2-5 million
- 9.5% had revenues of $5-10 million
- 7.9% had revenues of $10-25 million, and
- 23.5% had revenues greater than $25 million

Geographically, 30% install and purchase electrical materials in the Northeast, 7% in the Mid-Atlantic states, 19% in the Southeast, 27% in the Midwest, 10% in the Southwest, 5% in the Rocky Mountain region and 12% on the West Coast. Percentages exceed 100% as end-users may work in multiple region

In considering respondent type, senior managers/owners represented 39% of respondents, 10% were project managers, 27% were electricians, 4% were estimators, 15% were engineers and the remainder were purchasing managers and architects.

Given the diversity of the marketplace, respondents were asked about their business focus. The responses were:

Industrial Contractor	7%
Commercial Contractor	18%
Residential Contractor	14%
Multi-focused Contractor	28%
Industrial Facility	12%
Institutional, Gov, Healthcare	8%
Specifier - Engineer, Architect	14%

Whom do they buy from

Survey results show that customers continue to purchase the vast majority of their products from independent distributors.

In considering where they purchase more than 26% of their electrical materials,

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- 53% stated independent distributors, inclusive of "regional" distributors
- 26% purchase from national chains
- 11% purchase from retailers
- 6% direct from manufacturers
- 5% from catalogs

This correlates with expected 2006 industry sales revenue which projects that independent distributors represented approximately 63% of the electrical market.

Based upon comparison research conducted two years ago, there is increased activity by contractors who purchase over the Internet or through large retailers. Surprisingly, slightly over 9% of respondents reported buying some material from manufacturer reps.

With national and regional distributor market share increasing due to consolidation, it is expected that private labeling will spread into more markets. While acquisition's increase the acquirer's share, the introduction of private labeled products will enable pursuit of additional opportunities in that marketplace. While this may reduce the "street" price for some products, the acquiring company expects to take share and improve the profitability of their acquisition. Local incumbents will need to focus on relationships, improve processes and be more proactive in their market and with their preferred partners. This is apropos for distributors and manufacturers.

Almost 20% of the respondents stated that they know of at least one distributor who is selling private label products. The most frequently mentioned distributors were:

Rexel	19.8%
City Electric Supply	12.1%
Graybar	12.1%
Grainger	5.5%

Independent distributors were mentioned infrequently, indicating that this is an issue that many distributors are debating since 35% of distributors who responded to a November 2006 CMG/ARA survey mentioned that they were offering or considering offering private label products (private label could also mean no brand associated with the product, not necessarily a sourcing relationship).

Brand Sensitivity

To understand commitments to brands, contractors were asked how they request products from their distributors. Essentially, do they use the manufacturer name (Arlington or Steel City) when they purchase, mention the distributor's brand (we'll let you fill in the blank) or use a generic description for their needs (i.e. a 4" steel box). As expected, each customer utilizes multiple methods so responses total more than 100%.

- 66% utilize manufacturer names
- 44% of the time they speak in product type/generic terms
- 23% of the time they mentioned a distributor name

Recognizing that frequently customers know the lines that a distributor carries, it was expected that the answer would be skewed to manufacturer names. While the generic response was not overly surprising, these are the product categories that are most susceptible to pricing pressure and hence private labeling as there may be brand apathy in these product categories.

To establish the level of brand support within each product category, survey respondents were asked to rate which product categories were brand sensitive. "Brand sensitive", or the alternative, "brand apathy" were defined as:

- "Brand sensitive" – that the customer requests a specific manufacturer or is willing to accept any known manufacturer
- "Brand apathy" – that the customer is willing to accept any manufacturer, doesn't care whom the manufacturer is or is willing to accept a distributor brand.

The aggregated results can be seen in Figure 1.

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Product Category	Brand Apathy	Brand Preference
Cable Ties	60.4%	39.6%
Fasteners	52.5%	47.5%
Chemicals & Lubricants	44.2%	55.8%
Metal Fittings	43.2%	56.8%
Boxes & Enclosures	38.5%	61.5%
Lamps	36.9%	63.1%
Tape	36.2%	63.8%
Ballasts	36.0%	64.0%
Electrician Supplies	32.6%	67.4%
Weatherproof / Waterproof	30.7%	69.3%
Connectors	30.3%	69.7%
Recessed Cans	29.5%	70.5%
Explosion Proof Products	21.8%	78.2%
Wiring Devices	20.9%	79.1%
Hand tools	15.5%	84.5%
Controls / PLCs	15.2%	84.8%
Switchgear	10.6%	89.4%
Breakers	8.2%	91.8%

Research, and market activities, have shown that product categories that received a score of 30% or more “apathetic” are more likely to be considered as early private label opportunities for distributors. There is a clear delineation between what we call “electrified” and “non-electrified” products. Based upon the open-ended responses, it appears that the primary reason for this is concern about product liability.

As expected, the sensitivity, or apathy, changed somewhat whether the customer was focused in the industrial, commercial or residential markets. Specifically:

- ***Industrially-oriented installers*** favor brand name products as a measure of quality but commented that lack of pricing competitiveness can provide opportunities for less expensive lines.
- When ***MRO type*** customer input was solicited, a number of respondents were surprisingly willing to try non-branded products that are UL listed or used for non-critical systems. Respondents segment themselves into two camps - either willing to try/use or focused on name brands for quality and support issues. For those who were willing, they stated that specs that are written "or equal" are moving to non-branded products presuming adherence to specs due to price considerations.
- ***Commercial contractors*** are concerned with product quality, would prefer to "buy American" if price was comparable, and felt that name brand manufacturer benefits also include warranty coverage and population of information in contractor billing/estimating systems. But price can still be king depending upon product category.
- ***Residential contractors*** are the most apt to purchase private label products due to price benefits. For the most part they do not perceive product quality differences nor does the homeowner/customer know brands or quality differences. Additionally, the pricing benefits of non-branded products enable contractors to earn jobs and retain project profitability.
- 28% of respondents classified themselves as ***“multi-focused”*** (typically meaning industrial/commercial for larger contractors and “commercial/residential” for smaller distributors) and represented 61% of respondents less than $2M and over 10% of large respondents. For many distributors, these are their “core” customers. Their preference is for name brands due to quality, reliability, warranty and product liability coverage, however, due to pricing, an increasing number are willing to install non-branded products as long as the product is UL listed and will pass inspection. They also lamented that name brand product quality has declined over the years as has local sales support.

(note: specific comments from respondents in each customer category can be found on the author’s websites)

Pricing is Important

With product quality becoming less a differentiator, price drives many decisions. According to one contractor, “ For our part, some name brand product quality has declined over the

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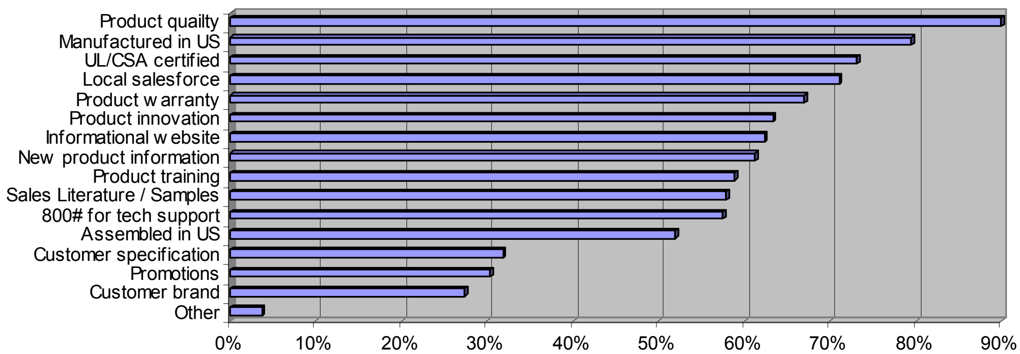
years along with product support locally. I suspect that we get more information via the Internet than from our distributor. Although our purchase volume has gone up with specific distributors, product and sales support are waning. Good prices allowed us to get the jobs.

Another provided responded, "We have "price house distributors" approach us all the time. For certain product groupings they have great prices and deliver in a timely fashion. But more often than not, these same houses don't offer the name brand product that is approved for the current job. We become suspect of a distributor when they substitute non-branded or product with their name, without notifying us before hand. While on most of our residential jobs we are only concerned that the product is good for the first year, we do have industrial contracts that demand certain brands, even when there is a substantial cost differential. I would say in those situations there is a perceived name value to our customer….as they are asking for it by name and part number. Outside of the industrial setting, price and delivery rule the landscape."



And contactors are seeing significant price differentials as exhibited by their acceptance of private label products. They will more readily accept non-branded products at the following discount levels:

- 22% will purchase non-branded products for an 11-20% discount
- 26% need a 21-30% discount, and
- 39% expect a 31+% discount.

The higher discounts would effectively dis-intermediate manufacturers and provide all of the cost-savings to the customer with the distributor maintaining no incremental gross margin percentage on a lower dollar volume per unit!

Product Substitutions

While some respondents are adamant that they do not allow substitutions, 84% of respondents were aware that distributors do make product substitutions for either product availability or distributor profit opportunity reasons.

The top four reasons respondents allowed substitutions are:

1. Urgent need to get product
2. Believe product quality is comparable amongst brands
3. I trust my distributor regarding product substitutions
4. More concerned with whom I buy from than the brand

While it is understandable that product availability is critical, from a manufacturer viewpoint it is disconcerting that there is less recognition of quality differentiation and brand allegiance in the marketplace. For very fast moving items ("A's) and fast moving items ("B's) within a manufacturer's product portfolio, encouraging distributors to stock inventory is critical to capturing incremental business, however, this needs to be balanced against a distributor's interest in managing their inventory investments.

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At the same time, some distributors routinely substitute non-branded products for profit reasons. 30% of respondents said that they knowingly allow distributors to substitute with non-branded products! The customer receives a lower price, the distributor earns incremental margin.

Product Liability

Product quality and liability are important issues for customers. Respondents were asked to rate "which manufacturer services are of value to you". As can be seen in Figure 2, the top 5 value areas are:

1. Product quality 90%
2. Manufactured in USA 80%
3. UL/CSA certified 73%
4. Local sales force 71%
5. Product warranty 67%

"We have industrial customers who ask about whether or not the product carries a UL or CSA label, but there are smaller customers that don't seem worried about any type of certification **...** just so long as it works. Some of our customers have shrunk there purchasing departments to where there is not the same product knowledge as 5 to 10 years ago. So acceptance of what appears to be "or equal" product by function is acceptable more times than not. Price really becomes a consideration in the switch out of product" said one contractor.

Interestingly, while "Made in the USA" is important, installers typically are not willing to pay significantly, or any, higher prices. According to industry sources, over 70% of electrical materials are manufactured outside the United States. Nationalistic pride is evident in a number of the open-ended responses which is understandable given global concerns and the growth of China.

While liability is a concern for installers, it should also be a major concern for distributors. Of the 10% of respondents who have had product liability issues, 71% stated that a distributor was involved in subsequent legal action and all knew, based upon invoices, the distributor who sold them the product.

Brands Carry Less Value than Distributors

While much of the survey focused on the acceptance level of brands, it is important to note that a key installer decision criteria is from whom they purchase products. Given that installers, and especially contractors, purchase from multiple distributors, respondents were asked "what is the most important reason you purchase from a distributor?". Respondents ranked each attribute based upon their importance level. The main decision drivers, and their ratings, are:

Attribute	Avg Rating
Price	3.76
Relationship with people at distributor	3.42
Product Availability	3.35
Need for specific manufacturer brands	3.08
Overall distributor service	3.06
Location - nearby to project	2.56
Company has contract with distributor	1.77

This speaks to manufacturer need to strengthen local brand awareness and identification of where their products are available.

Conclusion:

Contractor acceptance of private labeled product is growing due to pricing pressures, perceived lack of quality differentiation, and, in many product categories, indifference to brand. Private label offerings by distributors are expected to grow due to national chain product sourcing efforts, industry consolidation, the need by larger regionals to compete against national chains, and margin pressures.

Name brand manufacturers need to compete both at the distribution and customer level by reinforcing product attributes, focusing on quality differences, increasing brand awareness, and encouraging distributor inventory. While price is important, each manufacturer will need to consider which market segments, and sub-segments, it wants to compete in and then price

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accordingly, with either their standard brand, by offering a value brand that may offer different services, or through different pricing strategies with distributors based upon support.

While many distributors have focused on their brand (witness promotional, advertising, and merchandising initiatives), and some are using private labeling and packaging similarly, for most manufacturers and distributors the key to success will be *jointly* working the market to deliver on customer expectations and *jointly* building brand identity. The loss of brand identity encourages product commoditization and price erosion unless manufacturers differentiate their product.

While electrical purchasers may prefer brands, they are more partial to getting the job done and purchasing products that meet customer demands at the lowest price to enable them to maximize their profitability. Name brand manufacturers need to show end-customers how their brand can help achieve the purchasers' goals while delivering incremental margin opportunity to the distributor.

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