



## Are Generics Overtaking Private Label as a Threat to Brands?

And, in the words of Juliet, "Where art thou branded products?" or should distributors ask "If there is a branded product in the middle of my warehouse and no one knows about it, or requests it, will it ever sell?"

Over the past year we've written extensively regarding the advent of private labeling in the electrical industry. We've surveyed and interviewed distributors, manufacturers, manufacturer reps and customers in an effort to understand the impact that is being, or will be, felt within the industry. Throughout our research, as chronicled in a series of articles for *Electrical Wholesaling*, we have shared our research and tried to present others' opinions in a coherent fashion.

While some predict that private labeling will become a significant component of the electrical industry and that a plethora of distributors will undertake such initiatives, we've concluded that private labeling may not be the growth engine that many prognosticate, and fear, that it will be.

Yes, private labeling can provide a distributor with opportunities to compete, enabling them to sell lower cost products to gain market share and potentially generate significantly higher gross margins. And yes, there will be distributors who will develop their own brands, especially regional and national distributors. But it will not become a strategy of choice for a vast majority of distributors.

The challenge to private labeling is that to effectively develop a private label initiative requires:

- The ability to forecast product demand
- A willingness to manage potential product liability
- Enhanced supply chain logistics

- Treating procurement as a strategic asset and seeking sourcing relationships.
- Development of brand identify for the product offering. This brand may differ than the distributor's name (i.e. Wal-Mart offers Great Values as one of its brand names). Some distributors are adroit marketers, others are "challenged" and would need to invest in people or outside resources.
- Potentially become involved in product development, or, at a minimum, commit to continuously identifying and sourcing product needs.
- And, a significant financial investment in product design, inventory and marketing.

The private labeling topic has been masking three, potentially more important, issues.

These issues are:

- The desire to reduce procurement costs, especially in light of the fact that many manufacturers openly tout that they source products.

Large distributors have the financial ability to purchase from the same, if not similar, sources as name brand manufacturers. Smaller distributors are seeking alternatives to remain competitive.

- Manufacturer brand equity is at an all time low. Our research confirmed that in many instances, customers are brand agnostic. In the words of Sara Lee CEO Brenda Barnes, in commenting about private labeling in the grocery industry in a recent *Wall Street Journal* article, "The challenge for a branded company like ours is that you have to be No. 1 or No. 2 in your category, because why would a retailer want to carry 10 products in a category?"

Essentially, if a manufacturer can not engender brand preference from influencers (architects & engineers), contractors/end-users or consumers (for the residential market), their products are a commodity



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and, presuming comparable quality, price will win.

- Price, as a component of the buying decision, is more important than ever. Some of this is due to the fact that the buyer does not perceive significant product differences. Some is caused by over capacity within distribution and the purchaser knows that they can leverage one distributor vs. another to get a lower price. Another reason is a distributor's need (or salesperson's) to generate cash flow (and customer loyalty) to keep their doors open. In essence, manufacturers, and distributors, seek ways to reduce prices to their customers. The customer willingly will take advantage of the opportunity.

While some are just starting to write about private labeling, and Adam Fein, in the August issue of TED magazine predicted that up to 33% of electrical distributors (about 1000 distributors based upon 3,200 distributors in the industry!) will offer private labeling by 2012, our contention is that no-name / unbranded products (we'll call them "generics") will become more of a threat to the industry than private label products.

- Consider that there are currently only 200 distributors with revenues greater than \$25M in the industry. To achieve others' predictions, this would mean that 800 small distributors would need to develop their own brand.
- Also, with marketing groups representing approximately 1,000 electrical distributors, unless the marketing groups become involved in private labeling, the odds of many of their members individually undertaking this initiative, expense, and liability, is unrealistic.
- The investment to develop, and expand, private labeling to represent a significant revenue stream within a distributor would be considerable, dissuading many. For private labeling to be effective, what percentage of a distributor's available business would need to carry their label?

- There are indications that manufacturer reps will react to the threat of lost income by either redirecting business to more supportive distributors or consider more drastic actions such as beginning to represent private labeled products and "generic" offerings.
- And lastly, the alternative, purchasing generic products, requires a nominal investment. Frequently the cost is only changing, or adding, a supplier. Order size or duplicate inventory may be a consideration. No product development, sourcing, branding, supply chain or liability costs are typically incurred.

We do feel, however, that many of the national chains, and some of the larger regionals, will develop private label lines as a point of differentiation and as a profit enhancer. While a few do it today, within 5 years we would expect most to offer an array of self-branded products.

Recognizing that larger distributors will develop private labeling strategies and that this will become a competitive issue, there are a number of strategies distributors and manufacturers can undertake to retain their market share and grow their business.

### Distributors who don't offer PL products

To compete effectively in the future, distributors should consider:

1. Converting their purchasing departments into strategic assets, enabling them to
  - Purchase more effectively
  - More critically evaluate suppliers
  - Identify premium and value lines from which to purchase from
  - Ensure that correct costs are entered in the system
  - More effectively manage inventory
  - Identify new, and complementary, product opportunities (tag along product)



2. Charge their sales and marketing departments with identifying and developing cost-effective competitive differentiation.
  - Dispassionately consider your customer relationships. Why do they, or don't they, buy from you? When was the last time you asked them? Do you integrate the voice of the customer into your company? If you don't integrate the voice of the customer, why don't you?
  - Consider why a customer should purchase from you? How do you save them money? What differentiates you from other distributors in your market?
    - How can you be the "distributor of choice" to your manufacturers and manufacturer sales personnel? Is it items in stock with a fair price? Or is it only price?
    - What is your "brand" in the marketplace? What does your brand include? If customers are willing to pay a slight premium for brand name products, and service is your product, don't you need a strong brand?
3. Review your pricing strategy. Pricing includes the "right" procurement cost, the "right" cost in the system, and the right "cost" to every customer. Just because it has been done a certain way before doesn't mean that it is the best profitable strategy for the future. Have you updated your pricing matrices recently? Are accounts with significant potential treated like walk-ins? Do you model your pricing strategy? Have you considered progressive discounts and other rebating / incentive strategies for loyalty? How could your pricing strategy encourage customers to purchase additional product categories?

Alternatively, the decision to develop a private label brand can be an astute decision for distributors that have a long-term horizon, are willing to invest in the infrastructure to replicate manufacturer core competencies, and recognize

that private labeling is not solely a pricing / gross margin strategy.

Alternatively, from a manufacturer viewpoint, competing against private label and generic products may cause reconsideration of your marketing and distribution model. Issues, and opportunities, to consider include:

- Are there ways you can create brand preference at either the contractor/end-user level, the influencer level (architects, engineers) or at the "buyer" (homeowner, developer, facilities manager) level. Why should someone want your product? This will require marketing to understand customer needs and communicate directly to customers.
- Should your distribution model be more selective, providing greater benefits to fewer distributors in a marketplace? How many distributors can your salespeople support? Would fewer, more committed, distributors, provide greater focus?
- Consider strategies to be your distributors' preferred choose by being easy to do business with as well as the company that helps them grow their business.

Manufacturers who provide private label products and name brand products will be challenged to explain how they are supporting any distributor. Yes it can be an effective, short-term financial / revenue play, but in the long-term it dilutes the value of doing business with the manufacturer.

Over the longer-term, we see distributors and manufacturers trying to more effectively "pair off" for specific geographic areas and market segments.

### The Real Threat

The underlying challenge to the industry appears to be coming from generic product manufacturers, especially ones that appear to receive, and carry, UL and/or CSA approval.

The key advantage of generic products is that they enable a distributor to achieve a customer's



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price point for an “acceptable” quality. Consider it as “a quality product for a fair price”, especially if no value-added services are desired. And some of these manufacturers may belong to marketing groups, hence rebates are still earned!

Based on our findings, some distributors are using generic products to test the marketplace with a goal of establishing a lower price range for a future product offering. Once established, then the distributor may take the steps necessary to offer their own private label products.

Additionally, especially in the residential market, the end-customer is not concerned about product brands ... they are concerned with acceptable quality at a low price. As industrial specs continue to add “or equal”, this trend will migrate to all market segments for many product categories.

Another potential threat from some generic, or contract, manufacturers is that these companies may offer products to directly to the end-customer, either through manufacturer rep or direct.

### Conclusions

Given the present market conditions and the continued tightening of the residential market, distributors will be pressed to continue to lower their pricing to maintain cash flow and market share while responding to contractor, and end-user, demands. Many will look at generic/no-name products as a way to satisfy their price needs, while others will take the plunge into the world of private labeled products.

Of concern to some will be potential product liability issues from private label / no-name products. But until a distributor becomes involved in a lawsuit due to “their” product, the issue will only be a concern to be managed vs. a financial reality.

Generic/no-name products will pose the greatest threat to manufacturers and distributors because of low unit prices, the availability of warranties for many products and the low cost of entry. With a noticeable change in end-user attitudes to “just so long as it is good for a year”, we predict that

many distributors will soon offer more no-name / unbranded products for price sensitive product categories while continuing to offer name brand product from companies that can show a clear brand preference in the marketplace.

While private labeling is an issue to be aware of, developing strategies to more competitively position your company to combat the commoditization of the industry is critical to long-term success. Only when manufacturers and distributors gain “customer” preference can the branded products in the warehouse move to the jobsite.

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