

From the Research Desk

MVI Mid-Year Forum Preview:

Retail Brand Architecture and Its Impact on CPG Brands

At MVI, much of our efforts for the last 18 years have been aimed at helping you understand how different retailers grow — and how to align your business more closely and profitably with those growth retailers.

Today many of the simple rules that govern marketplace growth remain the same — we could call these the MVI foundational points:

- Retailers that are relentlessly focused on selling products to consumers continue to gain market share vs. retailers trapped in an economic model based on selling opportunity to suppliers. These are the retailers that are growing faster than the market.
- In order for your company to grow faster than the market, you must align with retailers that are growing faster than the market.
- Therefore, faster-than-market growth involves partnering with retailers that are relentlessly focused on their shoppers.

This leads to one very powerful conclusion: the retailers that are going to enable you to achieve your growth targets will earn the right to build brands.

Most of the research you will see at MVI's Mid-Year Forum 2006 (June 6-8, in Boston, MA) revolves around how retailers create brands and what brand-building retailers will require from manufacturers in the future. This topic may sound abstract, but when you look at the key retailers you care about, you can see that many of them are grappling with branding as an issue — and that grappling can/will have significant impact on your business (as a wise Japanese sportswriter

once said, “If you're in the ring with a sumo wrestler, and they decide to grapple, it's going to have an impact on your day.”):

- Wal-Mart and its move to “relevance” with a different brand positioning — and the increased importance of the marketing function.
- The role of supplier brands at Target as its confidence increases in its own offer.
- What Costco expects from branded manufacturers as it seeks to position itself as a purveyor of the best products in the marketplace — branded or not.
- How SAM'S Club is balancing itself between a B2B wholesale outlet and a destination for affordable luxuries.
- How Kroger is repositioning its value proposition as it learns more about its most profitable shoppers.
- What Walgreens is doing to improve its in-store merchandising experience to communicate a more thoughtful shopping experience.
- How CVS continues to refine its offer for its three target shoppers and what this means for store layout, promotional strategy, and brand selection.
- The balancing act Dollar General/Family Dollar continue to play between its core audience and a temptation to adopt a higher positioning to attract a broader range of value shoppers.
- The “what do I want to be when I grow up” series of retailers — donors undertaking a repositioning of their brand strategy:

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- Safeway;
- Sears; and
- “Albertsons” — both Cerberus and Supervalu.
- The continued rise of “Alternative Alternative Channels” — how Whole Foods, Trader Joe’s, Ulta, Winco, and eventually Tesco will push us to redefine how retailers create brands.

Like many things, it is often easier to establish what retail branding is not — there are a number of misconceptions about this that distract suppliers from the real issues, challenges, and opportunities that branding retailers create. The MVI Shopper ROI Framework can help you think through some of the following issues (Figure 1):

- Retail branding is not a private label strategy: Private label for most retailers is as much an economic strategy as a brand builder, and it is our contention that retailers that simply put their name on products that look like the lead brand in the category are NOT using private label to build brand at all. This type of private label (which we will call brand equivalent private label) is probably the worst way imaginable for a retailer to develop a brand. There are three reasons for this:
 1. The strategy is not differentiated (functional parity of strategy): Every retailer

- thinks the act of putting ITS name on a product is what creates a point of difference — but if every retailer’s private label strategy is precisely the same, how can this be a point of difference? In our Shopper ROI framework, if functional parity is 1 there can be no competitive advantage!
2. The brand equity being used is the supplier’s brand, not theirs (the “emotional” multiplier accrues to someone else’s brand): This is a point that is so obvious I almost regret writing it, but in this case the cliché “imitation is the sincerest form of flattery” could not be more true. The retailer’s brand in this case is highlighted as a provider of value (an equivalent functional return requiring a lower shopper investment), which is fine, but for most retailers a wholly incomplete strategy.
 3. Even if the shopper does emotionally connect to a private label product, the equity isn’t consistent (the emotional connection is not consistent enough to aggregate to the retailer’s brand): A shopper who buys Kroger (or any retailer’s) brand-equivalent private label in soda and mouthwash may be emotionally invested in each of these two Kroger brands, but that emotional investment is probably not consistent enough for the retailer to leverage into sustainable competitive advantage, as it is rooted in two brands (Coke and Listerine) that have very different equities. Coke and Listerine can do a magnificent job of connecting to their consumer because they are focused on their particular relationship with the consumer — a retailer here cannot aggregate these meaningfully.

Do some retailers use private label as part of a broader brand development strategy? Of course they do, but too often the discussion about retailer branding stops here and it can’t if manufacturers are to understand this changing retail world. MVI will seek to give you our best thinking on the state of private label development in the channels and retailers we follow so you are best prepared to go back to your organization and manage this ongoing debate.

- Retail branding is not an advertising strategy: Often, when asked to determine the strongest branded retailers, thoughts go to retailers like Target, which does a marvelous job of constructing marketing cam-

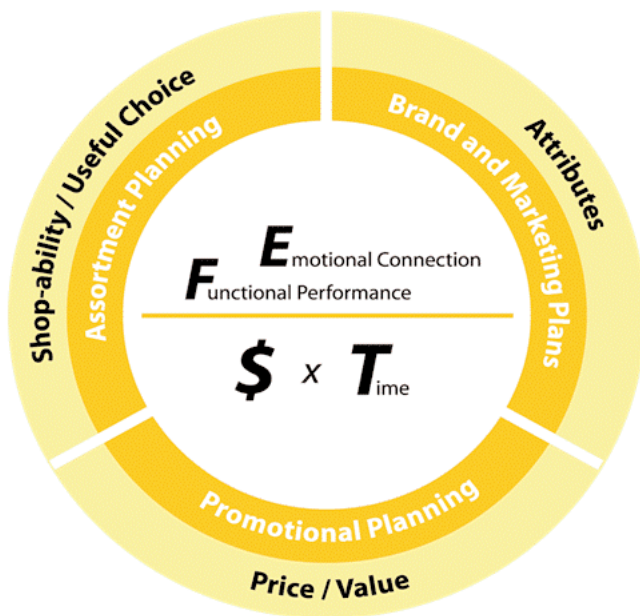


Figure 1: MVI Shopper ROI Framework

Source: MVI research

paings that capture shoppers' (and marketers') imaginations. However, there are many other retailers that build a strong connection without significant investment in sophisticated advertising (like Wegman's) or without investment in advertising at all (Costco and Trader Joe's come to mind). Advertising can be a part of successful retailer branding, but it is neither necessary nor sufficient.

- Retail branding is not a flagship store strategy: Although prototype or lab stores can be an interesting, fun, and sexy way for retailers to generate buzz or learn something, a retailer cannot change its brand fundamentally through a single store. It is important to understand these prototypes (like the Wal-Mart Plano store pictured in Figure 2) but a mistake to pin the retailer's total brand on a one-store pilot.
- Retail branding is not a monolithic strategy: There is more than one way to build a successful retail brand, and evaluations of successful retailers must be able to reflect a variety of these. Also, manufacturers will need more than one response to grow effectively with tomorrow's branded retailers — they will continue to build brand in different ways.
- Retail branding for suppliers is not simply a “store as a media outlet” strategy: Although many retailers (most notably, Wal-Mart) have been successful at getting suppliers to think about stores as a brand-building environment, the first wave of thinking on this has simply been to adapt conventional TV messaging to the media the store makes available. David Muir, CEO of WPP's The Channel (in a recent presentation entitled “Retail As Media - The State of Play in US and Europe”) argued rationally that even if in-store TV is effective, it requires an entirely different creative brief and mindset than existing TV marketing in order to maximize its effectiveness.

With that, much of the excitement around this area may be as much an old mindset trying to cling to what has worked in the past as much as anything — if TV ads are what marketers know how to do well, we need to be careful that with that “hammer,” any place where people congregate begins to look like a “nail” — i.e., a place where people are situated to passively receive broadcast communica-



Figure 2: Wal-Mart Plano, Texas Prototype

Source: MVI store visit

tion. Organizations must be careful to not let conversation around an emerging technology distract from the broader issue — how do we build brands in a retail environment if retail brands are built differently than CPG brands?

So, if we now know what retail branding is not — what is it? Retail branding is all about maximizing the shopper's ROI. This leads us to five conclusions that we will investigate on Day 1 of our Mid-Year Forum:

- Shoppers, like investors, manage a portfolio of formats to maximize Shopper ROI; therefore, no retail brand operates in isolation. Figure 3 highlights the results of Cannondale Associates' Industry Shopper Study — it shows that even with shoppers as time pressed as they are, 80% of American shoppers will shop five or more different retail outlets over a three-month period to meet their grocery and consumable needs. 26% use 10 or more outlets over that same time period! This suggests several important things:
- The importance of shoppers “being able to get everything in one place” may be overblown...we may need a more sophis-

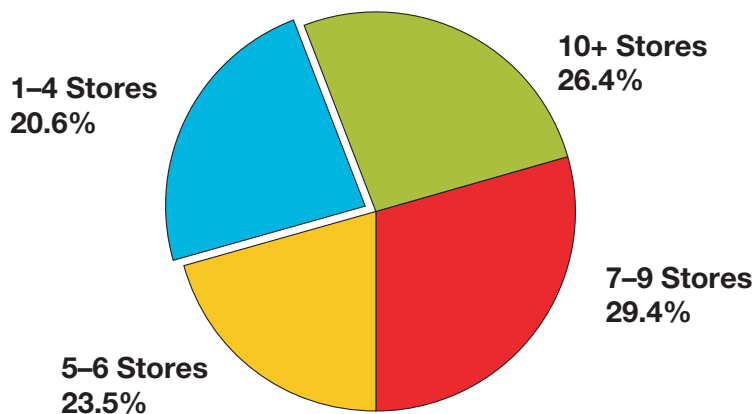


Figure 3: Industry Shopper Study

Source: Cannondale Associates

ticated way of thinking about retailers that sell a wide variety of products.

- This may dramatically shift as shoppers begin re-adapting purchase behavior to gasoline prices (this survey was conducted in the fall of 2005) — most retailers are reporting declines in trip frequency but increases in market basket as gas prices change driving behavior.
- Retailers have understood the negative impact of having certain retailers in their trading area for years; however, shopper portfolio theory would suggest there may be a positive benefit to certain retailers operating near each other as well.
- Retail branding is more about the retailer's store base than its advertising strategy, and inconsistency in the quality of the store base for a retailer is like sporadic quality of ad copy for a CPG company — fatal to brand messaging. Two things usually allow a retailer to build a consistent retail brand:
 - Real estate similarity: allows consistency of design. A key enabler to a retailer's brand development strategy can be a consistent store base. Complexity in layout and prototype (other things being equal) make managing a retail brand very challenging (SAM'S Club is a great example of a retailer that through the years has tried to develop a core message that is hard to manage given how different its store base is). Also, demographic similarity of that real estate can be important. Sears/Kmart continues to battle its legacy real estate portfolio as it seeks to create meaningful difference in-

store - its stores are simply in too many different demographic areas to create a meaningful single story.

- A commitment to maintaining store standards: allows consistency of execution. Imagine if in a CPG company every individual assistant brand manager were allowed to design their own company logo? This is what happens to retailers that are not organized to ensure consistency in store execution. Their brands become muddled, as shoppers do not know what to expect from one store to the next. Retailers like Target and Lowe's do a great job of measuring store manager performance against standards and rewarding store managers who build a typical, excellent store.

We would expect the flip side to be struggling retailers (and this is true — see "Efficient Operations" below), but Wal-Mart and Home Depot are two retailers that have struggled mightily with this challenge, as they have a legacy of strong store manager empowerment. Home Depot has spent much of the last five years unwinding that part of its culture, causing tremendous organizational turmoil but getting to a point where its massive investments in media-based branding can be realized through consistent stores. This will be a major part of Wal-Mart's branding effort — to bring a higher and more consistent level of execution to its store base (Figure 4).

- Retail branding is as much about retail as it is about branding: To understand the most successful retailers' brands, there are three areas of a retailer's business that are most critical to understanding a retailer's ability to brand (Figure 5):
 - Efficient Operations: A retailer that cannot run the fundamentals of its business stands little chance of building a strong retail brand over time. This is partially through systems and technology to the store and partially through associate satisfaction in the store — Wal-Mart in particular has talked extensively about the correlation between associate satisfaction and customer satisfaction in recent months. In fact, much of its store opening strategy has been around reducing volumes/building to a point where the return on capital on a store might be lower, but the asso-

ciate satisfaction is higher (due to a less hectic work environment). This satisfaction translates into lower turnover and employee replacement costs, and also into higher customer satisfaction (Figure 5).

- Economic Returns: A retailer that cannot build a model that consistently generates cash flow and profits will struggle to keep its stores adequately staffed — stores forced to reduce staffing levels due to declining sales/profits usually find it hard to maintain base levels of service, and achieve any type of brand success.
- Fun to Shop: Most retailers that build strong brands build them on the back of a fun shopping experience — there is a need to connect to the shopper emotionally that draws heavily on the experience the shopper has in-store.
- Retail product brands become interesting when they stand on their own, not leverage a supplier brand to create a value perception. The development of retailer product brands is most interesting when these brands take one of two positions which are not simple Brand Equivalent Private Label:
- Extreme value: Aldi’s family of brands is the best example of this (Figure 6 shows some of its wine and beer brands and Figure 7 is its proprietary Mexican food brand). Here products are presented in an appealing way but without brand references — but at price points that are significantly lower than a national brand can achieve. Other retailers (notably European players like Tesco and the Canadian retailer Loblaw’s) have gone with a bare-bones packaging strategy for opening price point private label which creates a strong, retailer-centered value perception.
- High quality: Aldi in Europe is regarded as being both value priced and high quality (though it has yet to attain that status here). More specialty players do a terrific job here (particularly Trader Joe’s of course), and Loblaw’s President’s Choice is probably the most famous example of this strategy in North America; however, the largest premium retailer brand in the US is Costco’s Kirkland Signature — at approximately USD8 billion in sales, it is one of the largest premium brands in the US, period!

The core conclusion is that retailers that use their own brand architecture to support differentiated product offerings are far more challenging to CPG suppliers than retailers that simply

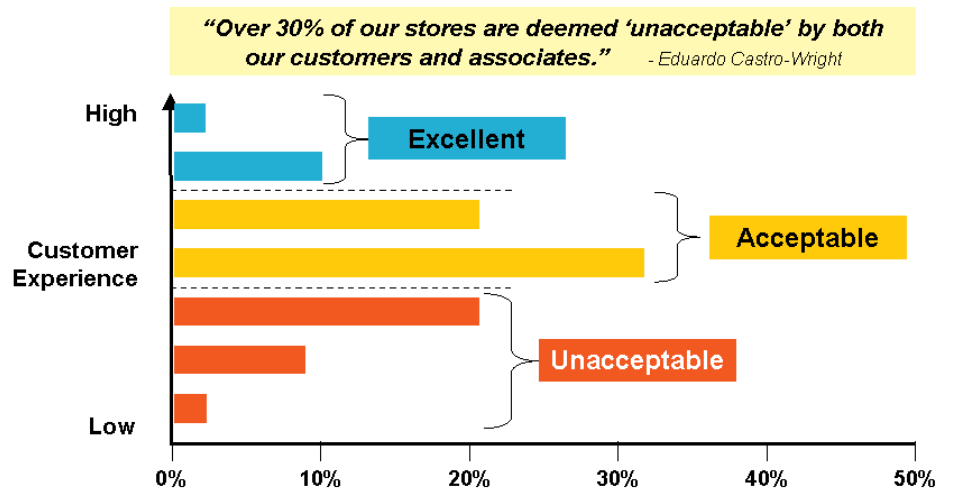


Figure 4: Wal-Mart's Customer Experience

Source: MVI research, company reports

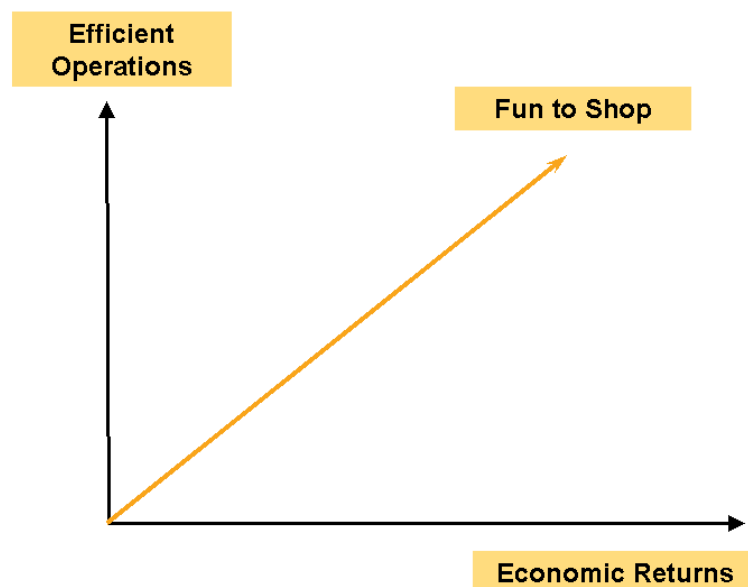


Figure 5: Three Elements of Retail Branding

Source: MVI research



Figure 6: Aldi's Wine & Beer Brands



Figure 7: Aldi's Mexican Food

Source: Aldi

replicate trade dress to communicate value.

- In a 21st century demand creation environment, retailers may be better positioned to brand themselves than suppliers. Think, at a top level, about the types of branding that dominated late 20th century brand architecture:
 - Mass communication;
 - A fairly homogenous population;
 - A shopper at home to receive passive broadcast imaging — significant economies of scale in developing that imaging and purchasing the distribution of it;
 - Homogenous, one-way execution — a consistent standardized approach works best;
 - Huge economies of scale in R&D/intelligence to innovate; and
 - A consumer who relied on manufacturers as “portals” to the rest of the world or to the future — with imperfect information.
- Every one of these favored a centralized, scaled approach to brand and product development. Now, with these six criteria revamped for 21st century branding, let's see what they look like:
 - Fragmented communication;
 - A diverse population demographically,

and an increasingly “tribal” population in terms of affinities and interests;

- A shopper at work who values her time more than her money — where products and service are king, and where the cost of developing messaging and distributing it are more level (except in areas where effectiveness is declining, like mass media!);
- Tailored/personalized execution that is more of a conversation than a mandate;
- A significantly lower cost of entry for R&D/development for all but the biggest of ideas due to lower cost manufacturing and IT; and
- A consumer who relies on a variety of sources as their “portals” to the world or the future — and who can see innovation far more globally in things they care about than they used to.

The core conclusion, and the mission critical challenge for CPG companies, is that almost all of these changing factors lend themselves better to a retailer's brand architecture — the clustered, tribal, fragmented, conversational, service-oriented brand sounds more like a retail brand than a conventional manufacturer brand. The real risk to CPG companies is not commoditization in this retail environment, but irrelevance — is your company ready?