

PLMA 2009 Roundtable Report

INNOVATION FOR SUCCESS

**How Product Ingredients
Add Value to Store Brands**

Presented by the Private Label Manufacturers Association

How Product Ingredients Add Value to Store Brands

Store brand product development has changed dramatically over the past decade. Historically, private label programs rarely ventured beyond the standards of national brands. In recent years, the goal of ensuring quality that is equal to or better than leading branded counterparts has been largely accomplished. This is reflected in the growing majority of U.S. shoppers who have attested to outstanding store brand quality in consumer surveys. Now, store brands are advancing well past the “me-too” mentality and carving powerful new brand and product identities and, in the process, claiming more shelf space and market basket share.

Private label is clearly on the doorstep of a promising new era. However, in order to realize the full potential of store brands, it is essential for all parties involved in their manufacture and marketing to adopt an even stronger strategic position in leveraging the opportunities that exist in today’s marketplace and those that will emerge in the future. One way to achieve this is a commitment to genuinely new product development and innovation, particularly with respect to items that incorporate unique ingredients, product formulations and manufacturing technologies.

New product opportunities, whether through the development or discovery of innovative ingredients or the appearance of new demographic-driven niches in the marketplace, are arising every day. Private label manufacturers and their ingredient supply partners, and in collaboration with their retailer customers, must continue to be innovative to take advantage of these opportunities.

There is a new day for ingredient suppliers as well. Seeing their own possibilities expanding, they are more entrepreneurial and take a greater initiative in selling their expertise. Suppliers now offer an unprecedented number of special ingredients that can create differentiation and add value. The ingredi-

ents market is transforming from “push” to “pull” and suppliers are becoming full partners with food and non-food manufacturers by offering state of the art innovation modules. There are also an increasing number of ingredient branding collaborations that can impact the performance of both brand owners.



The PLMA Industry Roundtable, “Innovation for Success: How Product Ingredients Add Value to Store Brands,” examined the challenges and opportunities that innovation and ingredients can provide for all of the partners in the private label industry, and discussed their potential ramifications for the growth of store brands. Particular focus was on the evolving role of ingredient suppliers and what best practices should be exercised by private label manufacturers and retailers in their relationships with suppliers.

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1 INNOVATIVE PRODUCTS CAN DRIVE GROWTH.

In the midst of an unprecedented surge in sales, the U.S. private label industry is on the doorstep of an opportunity to consolidate those gains; ensure solid, continuing growth, and intensify the differentiation store brands provide retailers in the marketplace. For that to occur, innovation in private label products—particularly in contents but also in messaging and labeling, packaging, merchandising and environmental impact—must be emphasized and raised to a new level.

2 INGREDIENTS ARE KEY TO INNOVATION.

The principal tools to accomplish this are value-added ingredients. Still a nascent enterprise in store brands, the increased use of unique, marketable and “better” ingredients has the potential to be the central element in private label product innovation.

3 THE RETAILER HAS AN ADVANTAGE.

Retailers can utilize products with value-added ingredients to further break away from national brands and the lingering me-too mentality that pervaded the private label industry for decades. Ingredients can also distinguish one chain’s store brands from another’s. Retailers can experiment with and adopt such ingredients more easily and operate under the radar to a greater degree than national brands, who are concerned about possible cannibalization of sales and devaluation of their brand franchises.

4 CHAINS SEEK PRODUCTS TO STAY AHEAD OF MARKET.

While retailers are increasingly looking for innovative products, they are also demanding store brand items that are “authentic.” Retailers are asking their manufacturing partners and their testing firms: “Can we be unique and can we prove it?” That directive puts greater responsibility on every player and step in the supply chain.

5 PRIVATE LABEL IS THE RIGHT PLACE FOR INNOVATION.

Private label is the right place to be for independent product development teams doing leading-edge innovation. It is easier and faster to go to market than with the big brands. Retailers are less risk averse than national brands regarding the deployment of products with new and innovative ingredients. Ingredient suppliers should be out enthusiastically looking for that kind of collaborative relationship with a retailer and with a private label manufacturer.

6 INGREDIENT SUPPLIERS ARE TAKING A MORE AGGRESSIVE ROLE.

Ingredient makers have recognized a need to be more aggressive in terms of selling their own goods. As a result, many now take a triangulation approach, placing themselves between the manufacturer and the retailer. Traditionally, they sold only directly to manufacturers. Now they work both sides of the fence, dealing with manufacturers and also going directly to the retailers.

7 **SUSTAINABLE IS A VAST OPPORTUNITY.**

Sustainability represents a vast opportunity for private label. Compared with the leading CPG companies, retailers can engage in marketing products touting sustainable qualities at less risk to their brand equity and at lower prices to shoppers. Consumers are primed for this. The success of organics, for some consumers a similar ecological cause, logically leads to this area of new growth.

8 **PACKAGING CAN ALSO BE VALUE-ADDED.**

Considerations of new and value-added components should also include packaging. Packaging and messaging, or labeling, are important aspects of marketing that can gain if executed with value-added materials and techniques.

9 **INGREDIENTS ARE IMPORTANT IN ALL PRODUCT TIERS.**

Innovative ingredients have already been helpful to retailers, enabling the chains to more effectively develop multiple tiers of private label, especially on the premium side. But better ingredients don't just reside at the top end of private label tiers. Consumers want to trust their store brands wherever they sit on the value spectrum.

10 **WHO'S IN CHARGE OF PRIVATE LABEL PROCESS?**

There is no doubt that many large private label manufacturers are relying more on the expertise of their suppliers. But do ingredient suppliers really understand private label and its unique business model well enough? The time is right to educate ingredient suppliers regarding the private label process and exactly how the business works. One problem is the absence of a traditional relationship between ingredient suppliers and the private label industry. The private label business model can inhibit suppliers who are stronger in R&D than marketing.

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PLMA industry roundtables bring together a group of experts from a variety of disciplines to examine issues of strategic importance to retailing and private label. This industry roundtable focuses on innovation and how product ingredients add value to store brands.

The roundtable began with a discussion of how much ingredients can contribute to a product's success. "It's the insides that count," offered one panelist.

"Consumers buy products for a lot of reasons, and that includes private label. There is taste and convenience, but they are also looking to meet their hunger and wellness needs. So for them, it's what the product delivers in that regard, not how it looks, its price or size. It's the contents."

"Ingredients are the key to success," agreed another. "Most consumers buy their favorite item because it delivers a familiar taste. So it always comes down to making a quality product. And to do that, you need to use premium ingredients to start with."

"At the PLMA trade show, there were lots of small companies displaying products with new and unique and premium ingredients. At the same time, a number of the larger manufacturers were still emphasizing products whose sole purpose is to emulate national brands. But that ratio is clearly changing."

One private label manufacturer noted: "Ingredients matter very much to the national brands and they should to store brands as well. Ingredients are 'spec'd' into products to ensure that the R&D and consumer research work is carried through to the final product. And ingredients can very much contribute to the success of a product."



"Specific ingredients can be both an asset to a brand and a liability. They are an asset when they provide a health benefit, or leverage a consumer trend. They are a liability when the ingredient is not consistently available, or it becomes too expensive. Examples as an asset include Campbell's use of an ingredient to lower salt in soups without affecting the taste; as a liability, in general, using an ingredient sourced from China or when the product on the front panel is visually different from the product inside." It was noted

that Campbell's reduced-sodium soups rang up some \$650 million in retail sales in 2008, vs. \$100 million in 2003. The lower-sodium soup line was the top-selling new food product introduction of 2007, according to IRI.

CREATING SUCCESSFUL NEW PRODUCTS

Ingredients have changed the course of whole product categories. For example, some of the all-time important ingredients include simethicone, which when added to shampoo deposits itself onto the surface of the hair and acts as an emollient and imparts gloss to the hair. "It enables easy, tangle-free combing and is clearly a key ingredient." Added vitamins and minerals have also been well received; elements such as glucosamine and chondroitin "have had a dramatic impact in the supplement category."

"In the past six months, I have seen lots of new product development by national brands that emphasize new ingredients, especially in the pizza and entrée categories," said a private label supplier. "Private label is bound to follow. Chains like Kroger and Costco will always take it to a different level."

"For a retailer, the essential question regarding bearing the cost of new ingredients, however, is how you think your consumer values your brand and is it worth it in incremental sales to innovate beyond that. Innovation with ingredients is taking place

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most intensively on the periphery of the store; those sections are growing in importance to the retail chain and are where the real private label action is. The center store is much less active.”

Industry observers believe retailers can successfully use ingredients to break away from national brands and the lingering me-too mentality. Plus, retailers may be able to experiment and adopt ingredients more easily and operate under the radar to a greater degree than national brands that have to take some risks and commit to and promote their new recipes and formulations, to the possible detriment of their existing, established products.

Kroger is among retailers who are increasingly adding premium store brand items like organics or creating innovative products that have no direct national brand competition. The chain developed three-minute microwaveable pizzas as an easy snack for children when they return home from school. Its focus is on developing store brand products that offer something other than low prices, like premium ingredients or innovative packaging; for example, cut vegetables that are microwaveable, compact fluorescent light bulbs that are environmentally friendly and dog food with natural ingredients.

“But don’t go to sleep on national brands; they are getting more ingredient savvy,” pointed out a panel member. Nestlé, for one, is working closer than ever with its ingredients suppliers, ranging from Cargill to BASF to TetraPak, to bring external innovation to the company. These innovation partnerships are a give-and-take activity; a sharing of information, know-how and resources within a framework of confidentiality and with expectations in solutions, timing, and costs. Nestlé has branded 13 functional ingredients ranging from pro- and prebiotics to calcium to omega-3s to fiber and plant sterols.

BRANDING INGREDIENTS

The branding of ingredients is another intriguing development. One panelist pointed out that some

retailers are even starting to use branded ingredients in their store brand items. “Is that a contradiction, or an important new trend,” he asked. Another panelist answered, “Private label is a brand as much as the national brands. We have to start thinking of private label as a brand and when we do, there’s no conflict in retailers using branded ingredients in their private label lines.”

But do consumers really care? Will they respond as well as consumers have to the successful and widely recognized “Intel Inside” campaign that touts an important ingredient—the chip—in a personal computer? While some are skeptical about the extent to which consumers respond to ingredient branding in the grocery space, double-branded healthy foods and drinks have become more common: such as, Tropicana orange juice incorporating Ocean Nutrition Canada’s Meg-3 omega-3 ingredient and Danone Danonino one-shot dairy drink with Martek’s DHA.

Ingredient branding can connote quality and added value at the business-to-business level, but do consumers respond to separate ingredient logos on products and do they take the time to find out what the logos mean? Are they willing to pay more for products, or choose products on the basis of ingredient brands and logos?

FINDING VALUE-ADDED

Some of the most recent successful ingredients include natural ingredients without preservatives or additives, frozen vegetables where the flavor and visual appeal is created by replacing quick frozen vegetables with fire-roasted versions, a low-salt product that lowers sodium without impacting the flavor for soup, and other canned and frozen products. But there are limits to the role ingredients can play in marketing. Explained a manufacturer, “Too many messages confuse consumers plus there is only so much space on the package to convey nutritional and promotable information.”

Value-added ingredients are not all arcane new discoveries from labs and globetrotting scientists and nutritionists. They can be commonplace. “Olive oil is



a fabulous ingredient,” suggested a panelist. “It is ubiquitous in so many items now. As well, some manufacturers are finding new uses for familiar ingredients in other categories, even jumping from non-food health and beauty categories to the food section. The key elements of the familiar product Metamucil are now being touted as valuable ‘new’ ingredients in food products, for example.”

Artificial sweeteners and exotic flavors, such as man-gosteen and boysenberry, are moving into many new items, and that includes private label. “They are coming into the U.S. market from all over the world. Ingredient hunting has become a cottage industry.” Country-of-origin labeling laws have had an impact. “They allow the consumer to recognize and pick up on the new ingredients that are coming into play. They also put a focus on the global aspect of where exactly we get this food.”

“The growing advent of value-added ingredients in private label was most clearly seen in products featured at the Idea Supermarket at the PLMA show,” reported one panelist. “You could see the increasing influence of ‘ethnic’ in many items. That brings the opportunity to use new and different flavors, such as gorgonzola pita chips. From retailers like Sam’s and Costco, and many others, there is diversity in ethnic and prepared meals whose unique ingredients are their principal selling point. Ingredients have contributed to some of the most successful private label products in the U.S., such as adding omega 3 fatty acids and eliminating PCBs to create ‘clean’ items.”

“Private label’s mantra is increasingly, quality in, quality out, when it comes to ingredients. We have to go back to basics and take a look at real food ingredients,” he said. One caveat, whether in private label items or national brands, is that a branded ingredient not thoroughly vetted for performance with the consumer can bring the entire product line and even the product brand down, such as with Olestra in potato chips. “Now that was a failed branded ingredient for the ages.”

MEDIA CREATES DEMAND

The impact on consumers of cable food channels is powerful. “You can’t underestimate that,” advised a



panel member. “Consumers want to buy what they see on TV, and that includes hyped-up new and value-added ingredients.” Take the immense popularity of the Food Network, add the increased availability of more exotic spices and ingredients and the newfound time among boomers, and you have all the right ingredients for a surge in gourmet products. Wherever the consumer creates a desire for a particular food item, it is ‘taste memory’ that is most important. “Once a product starts to change its taste, such as Classic Coke, then the product is in trouble. Don’t mess with the taste profile, is the message.”

In Europe, private label takes a backseat to no one when it comes to bringing to market functional ingredients, offered a panelist. “Tesco and its store brand suppliers actually outdistance P&G and other big brands in the quality and efficacy of such value-added items, and so do several other major retailers. In some categories here in the U.S., some of the competitive testing we do for private label is against European private label, such as Tesco’s, rather than against big brands like Tropicana or other national brands.”

Too much of a good thing can be a mistake, too. For example, calcium is an important ingredient in orange juice, but national brands are putting too much other stuff into their orange juice. “It’s the kitchen sink approach and it’s wrong. You have to be just as careful about adding too much as not enough.”

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Another example is omega 3, “sure, it’s a great ingredient but you have to be wary of which products you put it into. It’s not a panacea for good health, or for sales.”

There were other caveats offered by the panel. “New ingredients, especially those that are marketed to the public as game-changers, do make a consumer become more suspicious too. Ingredients per se are, increasingly, something people read and care about and a lot of times, what’s not in the product is most important.” Look at the “soup wars” now being conducted by Campbell’s and Progresso. It’s being waged on the grounds of ingredients, both what is in and what is not in the product. MSG is the bad guy and “non-MSG real ingredients” is the good guy. Soup is a pretty simple comfort and economic food, but these big brands are trying to capitalize on ingredients to gain marketing advantage.

AVOIDING CONSUMER CONFUSION

“There is an unfortunate tendency to pile on with claims for value-added ingredients, so much so that the consumer says it’s ‘too good to be true.’ That also leads to consumer confusion, certainly not the goal of any marketer. Clean, simple and straightforward labels and promotional materials prevent that from happening,” said one member of the group.

“Some products are festooned with labels bragging about value-added ingredients so much they look like something out of NASCAR,” warned another. “Uniformity is the best approach, and some sense of balance. Consumers are smarter than ever.” One bad result of confusion is some ingredients, such as fructose, will get demonized and while that may be fair or unfair it certainly doesn’t help sales.

As more value-added ingredients pop up in everyday items, there is the chance that consumers will tire of all the claims and simply opt for those products that are in their view “clean,” and that don’t make exorbitant claims. Krispy Kreme whole grain donuts sounded unlikely but promising at first but in the end the company really pushed past credibility with the

consumer, and, predictably, the item failed. There has to be consistency with the main brand proposition.



There are some products that fare differently than others with the addition of “better” ingredients. Some represent a better marketing opportunity as a result. Snacks, for example, “are here to stay with the American consumer. So if manufacturers can make snacking just a little bit healthier, or less unhealthy—with the reduction of sodium and trans fats for example—then that offers important sales leverage. But, again, there has to be balance. Going too far, promoting the new snacks as good for you, can have a negative effect.”

Just mentioning some ingredients can be dangerous. “Manufacturers have to be careful talking about ingredients,” one panelist said. Look at the baby food sector. Once consumers became aware that Beech Nut items contained some sugar, largely a benign element, the company lost a big share of the market.

Another example: Organics have become a hot product feature, if not a true ingredient. Have we reached overkill yet with organic claims? “No,” offered a panelist. “Consumers still want more choices. That continues to be a strong positive with respect to organic products, even if they come from another country.” But the continuing growth of organics, while very strong in recent years, remains to be seen due to the economic environment. The products still cost more, and that’s a factor going forward.

“As well, a lot of consumers are very picky about what they look for and buy in the organics sector. It’s yes on foods but generally no on snacks. Older consumers are the pickiest. There will likely be a slowdown in sales of organics due to their price, and we are starting to see a decline in advertising of organics in certain categories, while we never saw any advertising of organics at all in some other categories.” On the other hand, other areas are opening up for organics. Even pet products are seeing new and innovative ingredients, including organics.

SUSTAINABILITY: THE NEXT OPPORTUNITY

The overall success of organics is leading to the next logical big opportunity, the advent of “sustainable products,” items across a wide variety of food and non-food categories that are promoted as being locally sourced, or involve minimum supply chain travel, feature simple to understand value-added ingredients, and offer environmentally friendly packaging that also includes their shipping, palleting and storing. “Sustainable is the next big watch word and marketing angle,” predicted a panelist. “It will buzz past organics in the years to come.”

At the PLMA show, among the non-food items heralding sustainability benefits were unique plastic packages that cut back on size and space and are recyclable. In one case, sugar and corn byproducts were used to make everyday plates and cups; they were both attractive and biodegradable.

In the non-food area, skin care will be a boom area, said a panelist. “Great new anti-wrinkle products with significant benefits are in the pipeline. The days of the market predominance of Oil of Olay, or ‘Oil of Old Lady,’ are gone. But when it comes to such products, every major retailer wants his private label to be protected. Value-added ingredients are fine, they say, but tell me how to prove they are effective and how they make a contribution to the consumer.”

With respect to innovative ingredients, retailers are asking their private label partners and their testing firms, “Can we be unique and can we prove it?” That directive puts greater responsibility on every player and every step in the supply chain, from raw ingredient source to shelf management.

Global sourcing is an important new element of ingredient supply and often a complicated one. There

is a big presence of international food providers, both in final products and ingredients. That is true in private label as well, as evidenced in the PLMA Chicago show and the PLMA show in Amsterdam. The private label version of Splenda, or sucralose, is an example. Part of the latest strategy of retailers and their suppliers in sourcing this ingredient is to get the blessing from the owner of Splenda, and also to establish that the source of the product is not China, but India. Still, the bulk of private label sucralose comes from China.

PACKAGING PLAYS A ROLE

New and value-added private label ingredients can include the packaging, too. At the PLMA show, one panelist was “fascinated by mixing packets in the stick category. One exhibitor displayed multi SKUs of dry cocktail mix in such packets, you just add water and liquor and you have a mojito. I am not aware of any national brand equivalency to these items so far.”

“Packaging and messaging, or labeling, are important aspects of marketing that can gain if they are considered improved ingredients,”

said a member of the panel. “Private label marketers should promote the greater inclusion of societal-sensitive, fair trade and environmentally friendly ingredients in their products. Marketing them along with the store brand would be something not common as yet.”

Wegmans, the supermarket chain, does this very well, said a panelist. “Their stores provide meal stations that include instructions in the benefits of various ingredients, as offered by the store’s own chef. As an alternative to teaching the shopper how to prepare the meal at home, Wegmans also offers ready-made versions that are brought home and reheated. This is a great example of the importance of commu-



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nicating the functional benefits of the food and is very important. Consumers are leery, now more than ever, and marketers need to have the integrity to explain the pluses and minuses of ingredient use.”

Also reflecting on products viewed at the show, panelists said there is “explosive” potential in both the non-food and food areas for continuous spray technology. “It’s a non-aerosol methodology that private label is doing widely, not the national brands. We first saw it in fake tanning sprays, but now we are seeing it in a range of non-food and even food items, such as in cooling products and first aid, and in mousses and salad dressings. It’s still limited though, due to restrictions and standards on cans and packaging, but this use will explode in new categories like ointments,” said a panelist.

One major benefit for the retailer is that surveys show usage rates by consumers are up one hundredfold with this methodology over the same product using other delivery systems, such as tubes of solid product. That means more shelf turnover, more profit and more brand loyalty. So in this case, the uniqueness that’s paying off is the new package, not the familiar product.

There is always more of a willingness by consumers to pay a premium for value-added ingredients in products they ingest. “But there is a non-food exception to that premise,” observed a panelist. “When it comes to facial cream, especially those that promise an anti-wrinkle effect, consumers are willing to spend more. In the view of most experts, only about half of these products really work as advertised; the challenge to the consumer is: Do you know in which half your favorite product falls?”

COMBINING INGREDIENTS

Different combinations of ingredients also pass the inventive and innovative test, suggested one panelist. “Cereal and meal replacement bars are popular and varied in both brands and private label, but at the PLMA show I saw one store brand version that really caught my eye. It combined buffalo meat with cranberries and, I have to say, they went together very well.” There were also good looking boxed “dinners to go” in private label at the show, and from a variety of retailers ranging from Sam’s to Hannaford Brothers. They both offered a dinner and meal product that was laid out in an unusual box.



The panel agreed that value-added ingredients are far from being a panacea for marketers, whatever the category. “The consumer is not always 100% focused on the ingredients of a product. She or he is also focused on accessing the product ‘experience,’” explained a panelist.

“Moreover, smart people—so-called ‘experiential consumers’—sometimes don’t do the smart thing in search of a good product experience.”

But value-added ingredients have been particularly useful to retailers, allowing the chains to more effectively develop multiple tiers of private label, especially on the premium side. Said one panelist: “That was quite evident in the store brand lines that were displayed in the Idea Supermarket. At the core of many of those lines is unique ingredients or, in the case of Safeway’s O Organics line, a value-added sourcing process.”

INNOVATION AT ALL PRICE POINTS

Better ingredients don’t just reside at the top end of private label tiers. “They are certainly hot in the premium private label lines, but with the economy

struggling and consumers looking to save, count on their showing up in store brands across the board. For example, Walmart, in response to the economy, is relaunching its Great Value line, clearly on the other end of the spectrum,” added a panelist.

Some observers believe private label seems to be either on one end of the spectrum—the very indulgent or premium space—or the other end—the basics-only place. There seems to be fewer store brand programs that fill the middle space, certainly among new ones that focus on value-added ingredients.

New and unique ingredients, particularly those sourced offshore, also bring with them the challenge of traceability. “Unfortunately, due to a number of product crises consumers have become much more aware of the need to know where a product came from and what journey led it to the pantry. When you have retailers like Target, which has more than two dozen meal solutions available in its Archer Farms line, you had better be able to answer such questions when a consumer picks one up and puts in into the shopping cart.”



One result of the rush to new and better ingredients is there is a lot more consumer paneling of products going on, especially in the non-food area. “Documenting consumers’ good responses to your products in a trial setting is always helpful in establishing selling strategies,” said a panelist, “and the introduction of new and value-added ingredients makes it even more important.” Other new sources of validation for products with unusual ingredients are well received from authoritative publications like Prevention magazine. The magazines make product claims that consumers accept, offered a panelist; they have an impact similar to Consumer Reports in the hard goods area.

DIFFERENT RULES FOR FOODSERVICE

An area where the pluses and minuses of ingredients are not an issue is the huge U.S. foodservice industry, the panel agreed. “That’s remarkable and just

wrong,” said one member, “Certainly some consumers want such information in that sector, but it’s just not being made available in foodservice, an industry that, for the most part, does not adhere to the same requirements that confront the grocery and consumer packaged goods industries.”

One caveat was offered: Consumers are accustomed to making all kinds of changes in an established foodservice menu before they eat the items. So that makes it very hard for foodservice vendors to post accurate ingredient values, such as calories, fats and other content information.

Still, the panel was adamant that, politically, the consumer packaged goods industry has “taken a big hit in terms of government regulation when compared to the relatively light oversight placed on foodservice, which seems to have carte blanche to focus on the sensory aspects of food, to good advantage over grocery.”

There are other considerations. “Many patrons of mid-range restaurants are looking for a vacation from nutritional labels and concerns on content. In addition, some diners make the incorrect assumption that restaurant food is prepared in that establishment. The truth is that it comes to the restaurant in ‘speed scratch’ form from the central food service distribution point used by the restaurant.”

FACTORING IN THE ECONOMY

The ingredients business is buffeted by factors beyond the battle at the store shelf. Chief among them are the economy and the cost of energy. “Commodity prices are very volatile right now and that has a huge impact on the ingredients business and the manufacturing business, especially private label,” said a panelist. “Global sourcing only adds to the instability. The strategy of risk management in the costs of commodities is a necessity.”

In order of importance, commodity and energy costs will have the greatest impact on the ingredients business in 2009, followed by safety and supply issues, health and wellness concerns, and new culinary

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trends. Commodity and energy costs and safety issues will impact private label and national brands about the same, while the brands have in the past been quicker to react to health and wellness and culinary trends, said a panelist.

“Volatility in commodity markets is here to stay,” offered another panelist. There are also political components, as evidenced by the “ethanol craze.” The redirection of farm crops from food to fuel, once hailed as a key part of the country’s energy independence policy, has resulted in price increases in everything that is corn-based, from tortillas to poultry.

“Retailers are still largely uneducated on sound risk management techniques with respect to the fluctuating prices and costs of commodities,” suggested a panel member. “I have yet to see them engaged in the subject. Rather, they glaze over when a discussion starts on how they might better manage ingredient sourcing risks, especially those that take place on a global level.” Cost optimization is one approach worth pursuing: Having the flexibility of going from one commodity to another. For their part, private label manufacturers want that kind of flexibility upfront, so that there is no need to reformulate.



NEW ROLE FOR SUPPLIERS

The role of ingredient suppliers is changing dramatically. The traditional role of all but silent partner to manufacturers is transforming, agreed the panel. “The whole ingredient industry has gone the way of other elements of the food business, and suppliers now face many of the same challenges, such as consolidation. That has led to a large stable of ingredient firms and a whole new product profile that emphasizes innovation and uniqueness in the manufacturer’s end product. The larger firms can also offer manufacturers a better way to do business and a more qualified and better prepared partner.”

“The way ingredient makers conduct their business is clearly changing,” agreed a manufacturer on the

panel. “Ingredient makers have recognized a need to be more aggressive in terms of selling their product. As a result, many now take a triangulation approach, positioning themselves between the manufacturer and the retailer. Traditionally, ingredient makers sold only directly to manufacturers. It was a one-way relationship.”

“Now ingredient suppliers work both sides of the fence. They deal with manufacturers and, when they know who they are, they also go directly to the retail customers. They close the circle, so to speak. Yes, they have to tread carefully, but they also have to be more proactive. This represents a change for their business and is a better way to grow sales,” one panelist said. “Tons of value-added services are now being provided by ingredient suppliers to their customers,” added another. “They have correctly concluded that it is left for ingredient suppliers to teach manufacturers how new and innovative ingredients might look in their own products. On top of that, they also conduct the crucial cost optimization process that so many manufacturers are not capable of or are experienced with.”

Among the services ingredient suppliers can offer beyond their products are R&D, and insights into culinary and foodservice trends, basically intelligence gained from working with a wide variety of products and other customers.

UNDERSTANDING PRIVATE LABEL

“There is no doubt that many large private label manufacturers are relying more and more on the expertise of their ingredient suppliers.” One panelist asked: “Do ingredient suppliers really understand private label and its unique business model well enough to be a major beneficial factor?”

“No, they don’t,” responded a member of the panel. “Frankly, ingredient suppliers have a hard time determining who’s in charge.” Figuring out who the principal decision-maker is in the private label supply chain is a challenge for them. Also, too often it is not clear to ingredient suppliers if the retailers and their store brand suppliers are just interested in

knocking off national brands or in bringing to market really new and inventive products.”

“One problem is that there has not been a traditional relationship between ingredients suppliers and the private label industry,” said a panelist. “Yes, ingredient suppliers have good long standing relationships with national brands. In those cases, ingredient suppliers are contacted when projects are in the concept stage and through development.

But that’s not to say that if you understand food manufacturing you can’t understand both national brands and private label. Ingredient suppliers don’t need to learn that much, but retailers need to learn how national brands have successfully interacted with ingredient suppliers and, in doing so, they can create their own relationships with ingredient makers and their private label suppliers.

“Adding to the situation, the business of supplying ingredients is itself changing. As food safety and supply issues blossom the role of ingredients grows. There is some history. Ingredient suppliers have fostered relationships with brand co-packers, which could be private label manufacturers, to further develop the business relationship so that other of its ingredients can be included in other products. Once the ingredient supplier is established with a manufacturer customer, the goal is to sell the use of other ingredients to keep the number of rival suppliers to that manufacturer at a minimum. As always, greater volume means lower transportation costs and faster delivery.”

“The time is right to educate ingredient suppliers as to who is in charge of the private label process and exactly how the business works,” implored a panelist. “It is a difficult environment. There’s circularity in the process, involving ingredient suppliers, private



label manufacturers and retailers. That’s confusing and hard to handle for the ingredient makers who don’t have the same situation with their national brand customers. The retailer will sometimes listen to the ingredient supplier, or will sometimes say, go talk to the private label manufacturer. There is no blueprint for how it should work.”

RETAILERS TAKING THE LEAD

“As a best practice, the retailer should be smarter and get all the

parties in one room at the same time to talk about product innovation and how to achieve it. It is in the best interest of the retailer to do this because ingredient suppliers are the ones teaching the new gospel of innovation.”

Despite this environment, there are still expanding opportunities for ingredient suppliers to get involved in private label. “Without breaking confidentiality, key information can be shared on past experiences with products,” said one participant. Working across businesses, ingredient makers can share key insights.

It will be difficult for private label manufacturers to support increasing investments in R&D and product innovation if the business is subject to reverse auctions and the products are not innovative. There is also the question: Will retailers support R&D and innovation for their manufacturers and provide staff to work closely with those manufacturers?

For their part, manufacturers can benefit from the expertise of their ingredient supply partners in sourcing, technology, research and innovation. They can also better understand what the brands are doing. Retailers can grow their manufacturer base and they can more effectively develop their lines like the brands.

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Things are a little better for such partnerships on the non-food side, compared to the food business, explained a panelist. “The three-way relationships are not as nascent. There’s a lot more work experience in the private label non-food business among ingredient suppliers, manufacturers and retailers. But the responsibility has always been on the manufacturer to bring finished products to the retailer. A good model for the U.S. non-food industry can be found in Europe, where private label and not national brands drives the HBA business.”



INNOVATION VS. BRAND MATCHING

One inherent issue is whether the retailer wants to just match or be truly innovative. “It’s a choice that has us completely confused,” said a panelist. “Private label shoppers say loudly in survey after survey that they want their store brands to be more innovative. But the chains are still into matching the national brands, and they complain that being innovative is just too expensive. So the matching approach wins out and that is still the industry paradigm in most cases.”

“But that depends on the category,” disagreed another. “In most categories, there is a little bit of both—matching and innovation. That is becoming the new paradigm. Beverages, for example, has been an excellent category for retailers to introduce private label items that feature innovative ingredients, especially in the area of dietary supplements. This has been

true even though the category is among the most traditional, and national brand dominates in the store. Now we are seeing larger categories of products starting to emulate the beverage section in this way.

“Private label is the right place to be for product development teams doing innovation, particularly with unique ingredients. It’s easier and faster to go to market than with the big brands. Retailers are less risk averse than national brands regarding the deployment of products with new and innovative ingredients. This has been especially true in the health and wellness sector. Ingredient suppliers should be out enthusiastically looking for that kind of collaborative relationship with a retailer and with a private label manufacturer.”

As well, relationships between ingredient firms and manufacturers are evolving. For their part, ingredient suppliers believe, we don’t sell an ingredient, we offer a solution. But timing is important and the attitude of the end user, the retailer, will always be paramount. “Is building private label a core strategy of the chain? Are private label manufacturers standing up and doing actual innovation then going out and finding a reliable ingredient supplier? Those are key questions.”

The best practice is to build the product and then proceed to educate the retailer as to how that product would benefit him. “Private label needs to catch up. This kind of salesmanship is prevalent on the other side of the street, with the CPG companies,” said a panelist. “This is done day in and day out, CPG firms understand they have to proactively reach out to ingredient suppliers and partner with them.”

CHALLENGES FOR MANUFACTURERS

Of course, private label manufacturers have their own operational issues and restraints when it comes to innovation. “They are often understandably short on funds for R&D owing to low margins. Also, rising fuel costs and componentry costs are hurting them.

“On top of that, until recently retailers had no desire for value-added ingredients in their private label items and programs. Now the tide has shifted somewhat, but not completely, and the bar is still high.

Retailers now say, 'I am not interested unless you bring me a product with an added-value that enables me to be ahead of the market.'"

In response, some of the more ambitious private label manufacturers are actually hiring their own procurement people, individuals who specialize in the acquisition of commodities and are particularly savvy when it comes to managing the fluctuations in both the pricing and the availability of those goods.

One other hopeful new development is that some retailers are adding their own R&D capacity. But that cuts both ways, good and bad, said a panelist. "It can create a kind of paralysis that, ironically, makes it even more difficult to get to market than it was when no in-house R&D was done by the chain. Ingredient suppliers do well when they work with retailers who have a vision." The categories that best exemplify the good results of such an effective partnership are prepared and ready meals and some fresh and frozen selections.

"For a retailer, a best practice is building your store brands as a core strategy then reaching out to ingredient suppliers as appropriate. But before that, retailers also need to fully understand the ingredient source." Of course, there is a second way. A lot of retailers want to see ingredient suppliers come to them directly. At the same time, it is always wise for raw ingredient suppliers to consider bringing some of their ideas to private label manufacturers directly as well.

"Despite these complications, we are seeing more commitment on the part of retailers to innovation. Thirty years ago, going to national brand equivalency was the big and bold move. There is no doubt a new generation of high quality private label as reflected in the increasing number of premium lines. Big national brands are successful when they engage a consumer, when there is an emotional involvement with a particular brand. Premium private label food lines do that and the model of Trader Joe's, and others, will be copied. In drug chains such as Walgreens and CVS exclusive brands achieve the same thing.

Behind those successes, there is almost certainly a solid collaboration among ingredient supplier, manufacturer and retailer and a reliance on value-added services each partner brings to the table."

Still, a persistent problem for ingredient suppliers is that in the private label business model the retailers historically get the limelight and the manufacturer sits back in anonymity. "It's a privacy oriented system that confounds some ingredient makers and often inhibits them. Ingredient suppliers, by and large, are not marketers but rather they tend to be heavy into R&D. They are less inclined to be strong in institutional salesmanship, though that is changing, and that mitigates what they are able to do with pushing their ideas, especially if that involves approaching many private label manufacturers that are accustomed to being a silent partner to retailers."

At the same time, ingredient suppliers are not sitting back and letting the game come to them. "They are increasingly positioning themselves as product developers. That's a new role for them. At the IFT show," reported a panelist, "the exhibit booths of many suppliers featured chefs promoting all kinds of cutting-edge products. It was a very European concept and one that is gaining widespread use here."

THE ROLE OF BROKERS

Since many retailers utilize brokers in their private label sourcing, it would be wise for ingredient suppliers to relate to brokers more. But one panelist warned, some brokers are also doing their own innovation and they would be more inclined to do business with their own ideas than a third party's. Clearly, if the broker isn't doing the innovation why should ingredient suppliers pay them to make the introduction to the retailer? On the other hand, retail buyers have only so much time and getting to them via a broker may be a good strategic choice, particularly with chains that have a strong reliance on their private label broker.



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“However, too many retailers isolate themselves from the whole sourcing process. They just go to their broker and say, ‘Just bring it to us done.’ That’s lazy thinking,” offered a panelist, “and not likely to lead to true product innovation.” Retailers need effective buyers on their staff but they also need “understanders.” Retailers have to get back to sourcing, to sending whole teams to factories and plants and farms of suppliers, said a panelist.

“The purchasing mentality at some retailers has to evolve. It is not very progressive right now. Too frequently, buyers are not adequately concerned with the ‘cost of consequences’ to the chain in terms of adverse shopper reaction when acquiring certain products with certain levels of quality. This new breed of procurement agent is coming into place now, but there are still too few of them. Generally, they are practitioners; they have done it, and walked in the shoes of the manufacturer.”

THE GROWTH OF GLOBAL SOURCING

International sourcing of ingredients has many risks. Going offshore can invite shortages if, for example, China shuts down a production line for some reason. That then puts more pressure on sourcing the same ingredient here. Yet, more and more manufacturers are going overseas, especially to China, with lower costs the big lure. At the same time, South America and India will soon be competing head to head with China for American business.

Doing business in China is tricky. Consumers are very cognizant of China’s poor track record when it comes to product quality and safety. As a result, American firms are strengthening the product quality protocol, raising the bar so to speak. That also raises costs, of course, but the quality gains are worth it for U.S. companies. Also, low cost producers in China get chased out. Surprisingly, a lot of the quality control conducted in China is now actually better than some followed in the U.S., largely because quality-centric Japanese companies were involved in the creation of the Chinese plants.

There are improvements that have been instituted in China. More products are audited and tested right there, in order to be more cost effective and reduce liability. Importers know all too well that “once it’s on the boat, you have bought it.” Moreover, product testing is going farther down the supply chain, even into small farms and factories in the remote back country.



DEFINING VALUE-ADDED

What represents value-added with regard to ingredients? “Whatever the consumer is willing to pay for,” said one panelist. Another added, “Whatever the consumer understands to be value-added.” Functional foods are clearly value-added in the consumer’s mind. Self-medication with such items is growing as pharmaceutical drugs continue to come under increased scrutiny in terms of benefit, side effects and costs. The emphasis on real benefits vs. perceived benefits is an important aspect of value-added. Then

there are less high-minded qualities. As always, instant gratification and convenience also play into the value-added equation.

In the future, product innovation will be driven largely by demographics. Obesity will inspire new products with innovative ingredients, as will a dietary approach to health. The strategy of marketing the intrinsic healthfulness of a food or food component, or incorporating a natural ingredient with a claimed natural health benefit into a food, continues to be the most popular functional foods strategy.

The evolution of nutrition science has revealed the intrinsic health benefits of many components of the diet, and these have been turned into marketing messages. As science advances, the evidence underpinning these benefits can only grow. Success will still be driven by the way you translate your benefit into a convenient format, how your product connects to other key trends, and the marketing skills you apply when the product goes to market.

Clearly, products that were once “boxes of chemicals” are now becoming cleaner with respect to the quality

of the ingredients. But there is a long way to go. Authenticity is a buzzword and a big opportunity for marketers. Consumers want the reality of the products, regardless of the category.

THE FUN FACTOR

There is a caveat, however. “Consumers still want to be playful with their food and non-food purchases. They are still not slaves to everything marketers tell them or try to convince them about; they may never be. However, they may always be slaves to the larger trends. For sure, consumers still want to have fun, and more so in difficult times,” one panelist said.

This “fun factor” should not be lost. Retailers can still make their private label fun; look at Trader Joe’s, for example. Publix, for another, does a great job of keeping their private label fun, especially with packaging. Its private label laundry detergent features a whimsical depiction of a line of laundered clothes.

One of the biggest trends could be items where the main ingredient is actually the product. Yogurt shots that feature plant sterols are an example already on the shelves. In this case, the “food” is merely the delivery system for the ingredient. Cholesterol-fighting plant sterols are a big player in many new and innovative products. Preventative type products will become more plentiful as well. “You can’t cure everything once it becomes a disease. Food can weigh in to help stave off problems. Probiotics is one such ingredient. Besides disease, food will help deal with age related diminution of mental function, eyesight and hearing.”

One category is already hot in this regard. “Consumers are increasingly turning to beverages containing ingredients that address specific health issues. Functional ingredients provide a convenient platform to address specific health issues. The trend toward natural foods and beverages has prompted consumers to address health issues through scientifically proven natural ingredients, rather than chemically derived pills. Such ingredients are calcium, antioxidants, green tea, added fiber, omega 3s, ginseng, pomegranate, caffeine, soy, probiotic bacteria, chromium, taurine, whey and plant sterols.”

“Ingredients can definitely become a marketplace differentiator for consumer attention,” said one panelist. “Certain food categories are prime territory for value-added ingredients. We are seeing more flavors, colors, aromas and vitamin enhancements across the food sector.” This is especially true in areas like drinks, juices and chocolate. Value-added ingredients have been happening in brands for two or three years; it’s now coming fast in private label.”



A ‘NATURAL’ AND ‘HEALTHY’ FUTURE

“No company can afford to ignore the momentum in the success of products with a ‘natural’ or ‘healthy’ aura. The message that a food or food component is naturally and intrinsically healthy is one of the most persuasive in marketing. To a significant swath of consumers the use of the single word natural means healthy,” according to one participant.

Sustainability promises to be an increasingly hot button consumer issue and, consequently, will represent a vast opportunity for private label products with value-added ingredients, especially in the non-food sector. But there are some questions to deal with first: Is sustainability sustainable; and how do you handle the fact that the average consumer doesn’t know anything about sustainability? Will those factors mitigate any potential for marketers hoping to build on the issue?

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“Sustainability and health and wellness products work well together,” said a panelist, “but affordability is the key in the current economic situation. Consumers perceive they cannot afford to pay a premium at this time for products that pair health and wellness and sustainability qualities. But private label, with lowers costs and pricing, has a real opportunity right in front of it. Private label marketers can maximize this advantage by looking not only at the product and sourcing of ingredients but also at packaging and by being innovative across the board. They can follow the trail blazed by private label organics, where store brands soundly beat national brands to the punch. Safeway, Kroger, Walmart and others all started successful, multi SKU private label organic programs across categories in a way that no single CPG manufacturer can ever hope to match.”

Packaging is a visible and easy place to start. Less is more, is the best philosophy. Advances are already being made. Fish sticks, for example, used to come in

a bag, then in a box, with an overwrap. Now they can be found simply in a coated box. Another area ripe for sustainability oriented innovation: Alternative packages for bottled water. Packaging can have real benefits beyond providing marketing glitz. The advent of aseptic packaging, for example, is transforming the soup category. Certain additives that were costly but necessary with previous packages are no longer necessary. So innovative packaging has made the price less and the product better and healthier.

Sometimes the innovation is even simpler. New detergent packages now are basically lightweight, empty containers with only a concentrate inside that is to be mixed with water by the consumer at home. CPG companies realized that they were shipping mostly water and at great expense.

The issue of sustainability now is where health claims were a few decades ago: it represents high potential but needs a boost.



Standards are needed but, so far, nothing has happened. Predictably, tradeoffs will always be part of this and any other innovative trend in the future. For example, is an organic product really better for you and worth the premium if you buy it from China?

Cooking at home is a big trend, especially comfort classics, budget entertaining and easy, exotic recipes. Ingredients and beverages that will be hot are buckwheat, the “next grain;” and anti-inflammatory foods, such as yucca, sugar alternatives, soy sauce crystals, Dutch cheese, anise hyssop, artisanal gins, non-chicken eggs (ostrich and quail), and probiotics.

Look for more fortified products and gluten-free children’s foods; intestinal well-being items that offer detoxification; marine-type nutraceuticals, health ingredients from the sea that embody a “back to blue” approach and go beyond standard fish oils, such as exotic salts, seaweeds, kelp, sea cucumber, coral calcium; bone and joint health products; more

whole grains such as quinoa, amaranth, faro, kasha; exotic herbs and vegetables; nuts and seeds; “brain food” that features DHA omega 3s; “extreme relaxation” beverages that induce a natural calming and soothing effect; floral flavors such as lavender, hibiscus and jasmine in foods and beverages; and “beauty you can eat or drink,” an emerging generation of specially formulated foods and drinks that fight aging and aid skin health.

Consumers will increasingly seek multiple benefits in the food products they buy—convenience, wellness, sustainability, anti-aging and beautiful skin, heart health and joint health, and brain and energy enhancing, all at an affordable price.

Meanwhile, the reduction of “bad ingredients” will continue to be a consumer priority, as exemplified in the battle against sodium with low sodium alternatives.



PLMA 2009 Roundtable Report Innovation for Success

How Product Ingredients Add Value to Store Brands

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