**Brand Killers Store brands aren't for losers anymore. In fact, they're downright sizzling. And that scares the soap out of the folks who bring us Tide and Minute Maid and Alpo and...**

**By Matthew Boyle**

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(FORTUNE Magazine) – Melanie Turner has forgotten her shopping list. But the 42-year-old pension consultant, who has just entered Costco's 133,000-square-foot warehouse store in Norwalk, Conn., doesn't seem to mind. Turner knows right where she's going. In the dish detergent section, her hand goes past Procter & Gamble's Cascade to grab two 96-ounce bottles of Kirkland Signature, the in-store brand that Costco has plastered on everything from cashews to cross-trainer sneakers. Trolling for some fresh fish for dinner, she hauls in a 2 1/2-pound package of tilapia--it, too, emblazoned with the bold red, white, and black Kirkland logo. Then it's off to the paper aisle, where she picks up mammoth packs of Kirkland dinner napkins, Kirkland toilet paper, and ... wait, where are the Kirkland paper towels? Her eyes scan the store's maze of hulking pallets--no sign of them--before coming to rest on a 12-pack of Bounty. A moment of decision. "I'll wait on this," she says finally.

And there, in microcosm, is why Melanie Turner scares the pants off Procter & Gamble, Unilever, Kraft, and just about every consumer goods company out there. Her shopping cart is headed for the checkout aisle, and there's hardly a national brand in it.

Not so long ago the great American brand wouldn't have stood for that sort of treatment. You were a symbol of the good life: the pause that refreshed, the breakfast of champions, the filtered cigarette with the unfiltered taste. Everyone wanted a piece of you. But you've come a long way, baby--down. No, brand loyalty isn't dead. We've heard that knell sounded before, most notably following Marlboro Friday in 1993, when Philip Morris cut its prices 40%, sending investors into a panic that lopped nearly $50 billion off the market caps of 25 top brandmakers. But there's always been a swoosh or an apple to seduce us back into buying brands. In fact, Melanie Turner is just as brand loyal as her mother was in the 1960s when she kept the cupboard in their Queens home: "We were a Skippy family," Turner recalls. What's different today is who owns and creates the products Turner is loyal to.

An almost imperceptible tectonic shift has been reshaping the world of brands. Retailers--once the lowly peddlers of brands that were made and marketed by big, important manufacturers--are now behaving like full-fledged marketers. And here's the earthquake part: It is their brands--not those of traditional powerhouses like Kraft or Coke--that are winning over the Melanie Turners in the greatest numbers.

They're brands like Wal-Mart's Ol' Roy dog food, which has quietly surpassed Nestle's venerable Purina as the world's top-selling dog chow--or the George line of apparel, which has knocked Liz Claiborne's duds out of Wal-Mart. They're brands like Charles Shaw wine (a.k.a. Two-Buck Chuck, after its inconceivably low price), available at gourmet grocer Trader Joe's, where customers have been known to haul away a dozen cases at a time. They're the Michael Graves line of housewares at Target, where an estimated 50% of all products are private brands, and the 4,300 food and drink items that grocery giant Kroger cranks out of the 41 factories it owns and operates. And there's more to come. 7-Eleven has launched its own beer, Santiago, brewed in El Salvador and designed to steal market share from Mexican import Corona. Barnes & Noble recently expanded its imprint of store-brand books. Rite Aid will add about 250 private-label items this year, some under its new brands Pure Spring and 411. One out of two ceiling fans sold in the U.S. is from Home Depot, and most of those are its Hampton Bay brand. Once happy to serve as passive landlords of shelf space, "retailers are now becoming brand managers," says Dan Stanek, executive vice president at consulting company Retail Forward.

Private-label goods are nothing new, of course, having been around since the days when A&P owned vast coffee plantations in South America. Back in 1930, a new magazine called FORTUNE, commenting on the struggle between retailers and manufacturers, noted, "No issue, except Prohibition, is more violently discussed." But there are big differences this time around--beginning with the products themselves. Picturing those no-name, black-and-white cans labeled simply BEANS? Picture instead a slender glass bottle of Harvest Moon asparagus spears from Texas grocery chain H-E-B, with an elegant label (a soft crescent moon, interlocking o's) that makes the Del Monte canned product sitting next to it look cheap--except that Harvest Moon is 20 cents cheaper. The quality can be better too: Take Winn-Dixie's chocolate ice cream, which Consumer Reports magazine ranked ahead of Breyers. Or Kroger's potato chips, found to be tastier than Ruffles and Pringles--for less money. Wal-Mart employs a creative team devoted to designing logos and writing marketing copy, while everyone from France's Carrefour to Wegmans in Rochester, N.Y., is developing branding programs that emphasize quality, image, and innovation--not just price. "Get rid of the term 'private label,'" says Merrill Lynch analyst Mark Husson. "They possess an independent personality. They are brands."

Retailers love this trend. Because overhead is low and marketing costs are nil, private-label products bring 10% higher margins, on average, than branded goods do. But more than that, a trusted store brand can differentiate a chain from its competitors. Shoppers will drive the extra mile to Costco to buy Kirkland cashews, filling their carts with other goods while they're at it.

The numbers look good for the retailers too. According to A.C. Nielsen, unit sales of store-brand goods grew 8.6% during the past two years, vs. 1.5% for national brands. All told, one in five items sold in U.S. stores is now store branded, which sounds like a lot--until you learn that in Europe that percentage has reached 40%. Consumers here keep warming to them. A 2001 Gallup poll found 45% of shoppers more likely to switch to a store brand, while only 31% said so in 1996.

If your job is assistant brand manager at Duracell, those are the numbers that keep you awake at night. "It's a mistake to think that store brands are not 'real' brands," P&G chief A.G. Lafley said in a February speech to employees. "In some categories these brands are tougher competitors than traditional brands." (Neither Lafley nor executives from most major consumer-products companies would comment for this story.) The immediacy of the threat has been clear in Lafley's actions. While flagships like Tide still have a magnetic pull for shoppers, a second-tier P&G offering like Era detergent is in a whole different world of hurt: P&G slashed its ad spending on Era from $13.9 million to $5.3 million last year, according to TNS Media Intelligence/CMR. Rival Unilever, meanwhile, has pared its brands from 1,600 in the mid-1990s to just 200. A spokesperson explains that "all our innovation and marketing support" will focus on leading brands like Dove, Hellmann's, and Lipton. "The future is three and out," says Ken Harris of Cannondale Associates, which is a consultant to consumer packaged-goods makers. "Either you're among the top three brands or you're out."

Yet even as they cull their stables to the strongest horses, many branded manufacturers are pursuing a fallback strategy. Years ago a Gillette executive equated producing private-label razors to "selling your soul." Now Kraft, Nestle, Kimberly-Clark, H.J. Heinz, Del Monte, Unilever, and others have selectively taken an "if you can't beat 'em, join 'em" strategy. "Ten or 15 years ago branded manufacturers wouldn't [make] private labels, or, if they did, they lied about it," says retail consultant Bill Bishop. "Today more and more have a strategy to do both." Even Campbell Soup--its classic label iconized by Andy Warhol in the '60s--turns out soup for European retailers. "Many of our products are made by the same guys that pack national brands," says Bill Moran, CEO of the 1,170-store "extreme value" chain Save-a-Lot. "We have to be careful how we tell people about that. For instance, [ConAgra's] Chef Boyardee packs our canned pasta products. They wouldn't want you to know that."

Nor would P&G want you to know that it's making other people's brands. But it is. Quietly, and until now undetected by the outside world--including analysts who have followed the company for years--its paper products division has been churning out store-brand toilet paper and paper towels in Europe. (It has done so in the U.S. in the past, but no longer.) A spokesperson at the maker of Charmin and Bounty stresses that it is a "tiny, tiny" piece of its business--less than 5% of its Family Care division, valued at $4 billion by analysts--and that it produces private labels only to fulfill contracts of acquired companies or to maximize production at its plants. That makes sense: P&G needs to keep its works running full and steady.

Still, that the world's leading brand company would even consider a reduction to subcontractor status speaks volumes about the seismic shifts taking place. And now the role reversal seems complete: Grocery giant Albertsons has appointed a "vice president of corporate brands" to roll out a premium brand called Essensia. We'll learn of its merits later this year, when TV spots featuring Everybody Loves Raymond star Patricia Heaton hit the air. When store brands go prime time, something has changed.

The change can be boiled down to this: The retail universe has consolidated, and the media universe has shattered. In brands' golden age the three big TV networks gave brand giants like Colgate a direct conduit to the American public. But as the mass media have de-massified into 1,000 bits--500 channels, DirecTV, blogs, and the mass marketer's worst nightmare, TiVo--you don't see as many Colgate ads on TV. In short, brandmakers are losing their connection to the consumer. Willard Bishop Consulting found that in 1995 it took three TV commercials to reach 80% of 18- to 49-year-old women. In 2000, just five years later, it took 97 ads to reach the same group. "Short of being embroiled in a scandal," concludes ad agency Doremus in a recent newsletter, "it's almost impossible to get your name in enough channels to build substantial awareness."

Meanwhile, guess who's been building a direct connection to more and more American consumers? That's right, the "mass channel," as the big superstores are known in the trade. The consolidation of retail into a few mega-megachains means the ten biggest account for some 80% of the average manufacturer's business, vs. about 30% a decade ago. It's that mass channel, not the mass media, that is now attracting the bulk of marketing dollars. Almost 60% of manufacturers' marketing budgets flow to retailers in the form of so-called trade spending (ads in shopper circulars, merchandising displays), compared with 36% two decades ago, according to Cannondale.

In other words, the news for manufacturers is doubly bad: Not only are your customers launching their own brands, but more and more they are managing yours. Looking for a big TV audience to push your new deodorant? Try Wal-Mart's in-store TV screens, said to reach 100 million shoppers every month. Want to sell your tasty new cupcakes? Have Costco whip up a batch for customers to nosh on while they shop. It makes you wonder how far-fetched Forrester Research was when it came to this conclusion in a 2002 report: "Wal-Mart will become the next P&G."

As incredible as that sounds, don't discount it. P&G's Lafley speaks often about how the customer is, in fact, two separate people: the consumer and the shopper. P&G's job, his logic goes, is to prime the consumer to want a given product. The retailer's job is to close the deal with the shopper. But here again, the numbers aren't on Lafley's side: 72% of purchasing decisions are made in the store, not in front of the tube, according to Point-of-Purchase Advertising International. Time isn't on his side either: The longer a store brand is on the shelves--Ol' Roy has been around since 1983--the more comfortable shoppers become with it. So while merchants act like marketers, marketers like P&G are forced to act like ... merchants.

An odd but increasingly common sight is that of the FORTUNE 500 CEO in aisle four muttering about the placement of his products. Lafley has been spotted pondering P&G's Swiffer floor cleaner in a department store in Greece. Visiting a Wal-Mart store in Maryland last fall, Newell Rubbermaid CEO Joseph Galli took copious notes on the display of his company's Sharpie pens. Hasbro CEO Alan Hassenfeld frequently traipses the aisles of Targets and Wal-Marts. "One of our very important jobs is to figure out how to get more people in the stores," Hassenfeld said earlier this year.

If the makers of Crest, PaperMate, and Play-Doh are scrambling for shelf space, it's easy to imagine what life is like for a lesser-known brand like Mrs. Paul's frozen seafood. It gives new meaning to the term shelf life. Frank Weise, CEO of Cott, which makes store-brand soft drinks, including Wal-Mart's huge-selling Sam's Choice, says he's stealing market share mainly from Orange Crush, Shasta, and Hires Root Beer. "You don't see them much anymore," he says. Nor do you see Nuprin, the pain reliever from Bristol Myers-Squibb that tennis great Jimmy Connors used to shill for. It got caught between Advil and store-brand ibuprofen. "Just Nupe it," indeed.

So what happens if your company's whole strategy consists of pushing Nuprins and Orange Crushes? Ask Aurora Foods. In the mid-1990s it got the idea of buying up "orphaned brands"--Mrs. Butterworth's and Log Cabin syrups, Duncan Hines cake mix, Van de Kamp's frozen fish--and giving them the love they weren't getting from their caretakers. Though at first applauded by Wall Street, the company soon discovered it was marching backward into the future: What the orphans really lacked was love from retailers, not marketers. Retail giants wanted to deal with Jolly Green Giants, not a bunch of lovable but underweight orphans. After searching in vain for a home for its orphans--and oh, yeah, seeing its CEO jailed for securities fraud--Aurora recently announced its intention to declare Chapter 11 bankruptcy. (It will continue to do business while in bankruptcy.)

Occasionally a castoff can return to haunt its parent. In the late 1990s, P&G dropped its White Cloud toilet paper label to focus on the stronger Charmin. It made good sense--until an entrepreneur named Tony Gelbart noticed that thanks to the use-it-or-lose-it policy that governs trademarks, P&G's claim to the White Cloud label had lapsed. Gelbart snapped it up for a song before offering Wal-Mart the rights to the White Cloud label. Today Wal-Mart's aisles are filled with White Cloud toilet tissue and even diapers--it's an "undead" brand, as one observer puts it, that gives P&G the unenviable distinction of having to compete against a label it created.

You wouldn't think that a trend as diffuse as this could be traced to one man. Then you meet Dave Nichol. Picture a grumpier Dave Thomas with a law degree, a master's from Harvard, the paunch of a lifelong food lover, and an ego to match. "Where are those softshell crabs?" he roars to his assistant from his thickly wooded living room. In the stately South Forest Hill section of Toronto, Nichol has recreated a tropical resort, with fountains and palm trees, the glow of a big-screen TV penetrating the fauna. Tonight he's not only storyteller but chef. "This wine is from my own vineyard," he crows, pouring his visitor a glass of cabernet and diving into his tale.

After a stint at McKinsey & Co., Nichol was hired by Canadian grocer Loblaws in 1972 and three years later was named president of its supermarkets. "I started off running Loblaws like every other retailer in North America, which is getting people in the store by giving Coke and Tide away below cost. I remember one time I ran chuck steaks at 99 cents. I killed every cow between here and Moose Jaw," he deadpans. "It was a disaster. I finally said, 'This is a fool's errand.'"

It was time for a new plan. Nichol remembered seeing how London retailer Marks & Spencer had featured its own store brand, St. Michael, which was not only less expensive but also higher in quality than the leading brands. "This stuck in my head," says Nichol, who also got private-label inspiration from England's J. Sainsbury, Germany's Aldi, and France's Carrefour. He began simply in 1978, offering basic knockoff products under the brand name No Name. (He nicked that idea from Carrefour.) "For five or six years I did nothing but go into people's living rooms and say, 'Here's one basket of national brands for $150, and here are the same products from No Name for $100. If you don't like them, we'll give you the national brands free.'"

No Name was a commercial success--but Nichol wasn't happy selling canned veggies. "I was food-obsessed," he says. "That was my passion. So I started creating products." The first--a coffee he called President's Blend, which was modeled after the brew sold in a top Toronto restaurant--was good, but nothing compared to his ambitions for his next project. Nichol would bake the world's tastiest chocolate chip cookie. It took him two years. The prototypes exchanged real butter for hydrogenated coconut oil, and quality chocolate for artificial chips, but the recipe ultimately hinged on this: "I tried to find the maximum amount of chips you could cram into a cookie," says Nichol. "That turned out to be 39%. Chips Ahoy was 19%."

The product that emerged from the lab--Nichol dubbed it the Decadent--wasn't just tasty; it was truly delicious. And it swept all of Canada, becoming the country's top seller within a year or two. Shoppers began to take notice. "If you liked my chocolate-chip cookie," Nichol recalls thinking, "you will really like my cereal." His approach here was identical: "Kellogg's had two scoops of raisins, so I said, 'We've got twice the number of raisins. And oh, yes, it's cheaper.'"

This strange idea--a store brand whose quality was better than national brands--was only one in a series of firsts. His next had to do with packaging. Toronto-based Cott, at the time an also-ran in soda, was making President's Choice cola using a formula based on RC Cola. Don Watt, a package-design expert then working with Cott, took the logo for President's Choice cola and reduced it to a simple, highly stylized "PC." That fresh visual representation "became the next wave," Watt recalls, and sales shot up from 680,000 cases per year to two million.

Nichol's next brainstorm was to export President's Choice products to North America, so he brought in a man named Tom Stephens to sign deals with regional grocers, like D'Agostino in New York and Jewel in Chicago. He told them a strong store brand would free them from the tyranny of manufacturers. Many American grocers scoffed at the idea, calling it "Canadian lunacy," Stephens remembers. "The stores that took President's Choice," he says over a plate of risotto at a quiet Toronto trattoria, "were either desperate or brilliant." By 1994, 15 chains in 36 states were carrying President's Choice, Stephens says. That's how, around 1990, Nichol ended up in the office of Sam Walton.

Walton's proposition was simple: He didn't want to carry President's Choice in his stores. But could he tap the expertise of Nichol and his team to develop a private-label strategy for Wal-Mart?

Nichol's initial recommendation was a radical one: Build a Sam Walton Innovation Center dedicated to new-product development while simultaneously buying up faded but still-resonant brands like the detergent Purex. Wal-Mart could flood each category and dominate it with its own brands. "If Wal-Mart had adopted that strategy, they would rule the world," Nichol says. Wal-Mart rejected the proposal because it insisted--and still does--that it needed national brands to pull customers into its stores. "The food business in the U.S.--when they say their prayers, they should thank God I did not convince them that that was the way to go," says Nichol.

But the actual outcome was big enough. In 1991, Wal-Mart launched its premium Sam's Choice brand, modeled after President's Choice. Two years later Great Value, an even less expensive store brand, hit the shelves. In 2000 the company devoted an entire page of its annual report to its store brands, which now make up 40% of total sales, according to Private Label magazine estimates. The stable includes Equate nasal spray and ibuprofen, Great Value beef jerky and bleach, Spring Valley vitamins, Sam's Choice tuna, and, of course, Ol' Roy. "Everything that a brand would do, we have to live up to," says Bob Anderson, Wal-Mart's head of store-brand food products, who helped launch Great Value in 1993 and is now moving the brand into China. While Wal-Mart won't disclose sales of its store brands, one analyst estimated to Private Label Buyer magazine that Wal-Mart was responsible for 75% of the growth of store-brand sales last year.

No doubt aware of what he helped create, Nichol dives into his dinner of delectable soft-shell crab and yams, washed down with some of his wine. "When you think about private label in North America," he says between bites, "you think about Dave Nichol."

Where will it stop? When Wal-Mart launched an in-house line of batteries called EverActive in 1999, Rayovac CEO David Johnson called the competition "much ado about nothing," predicting the store-brand share would stay below 3%. Three years later sales were at 8%--"which I think is where they're going to be," he said last December: "8% to 10%." Tops.

But as each line in the sand turns out to be just that, manufacturers are finding they have few moves left. They could never compete with store brands on price. Now many of them can't compete on quality either. So besides getting into private-label production, how do you compete against the store brands? One answer: You don't. You go after other targets--like the $600 visit to the dentist. That's what P&G has done with its do-it-yourself $25 Whitestrips (marketed under the Crest umbrella, along with the equally successful SpinBrush), notes Harvard Business School professor Clayton Christensen. That, along with Lafley's main strategy--refocusing around 12 superbrands like Iams, Pantene, and Pampers and selling the heck out of them--has produced cheering results. P&G's stock is up a dividend-adjusted 34% over the past two years.

P&G and others had better keep moving. The cycle of innovation followed by imitation is faster than ever. In fact, Whitestrips are now up against Colgate SimplyWhite and store-brand whitening gel.

The manufacturers' reliance on old standbys raises another question: Why do we buy brands, anyway? Above all else, it's about trust. There's also the intangible aspirational quality. For Susana MacLean, 40, store brands conjure memories of growing up without luxuries. But already there are signs that the store-brand stigma is disappearing. First, shoppers are catching on to the quality thing--seven out of ten polled by Gallup in 2001 said that the quality of store brands was equal to or better than national brands. Trust? Shoppers trust Wal-Mart's Equate nasal spray enough to stick it up their nose. Aspiration? How's this: "I really like the Michael Graves brand," says 32-year-old Jean Trujillo of Hillsborough, N.J., "and have gone out of my way to see if they sell something I'm looking for."

Most store brands will never attain the heights of Ol' Roy and Michael Graves: Branding is a tricky business, as much art as science, and brand loyalties die hard. "House brands have no appeal to me," says Susan Gifford, 46. If she subbed Shop Rite's store brand "sandwich cookies" for Oreos, her kids would throw a fit. But if you listen closely, you can almost hear the tectonic plates shifting. "I definitely still have the perception--which I suspect is wrong--that the quality of store-brand products is not as high," she says. Her self-questioning deepens when she thinks about how Target brands appeal to her. "I might even buy them if they were offered in another store," Gifford says. "Now that I think about it, I'd probably give a lot of store brands a try, just to see how we liked them, and then stick with them if they're just as good." When asked why she isn't trying them now, Gifford has an answer that would put the fear of God into the most self-possessed branded manufacturer: "Good question. Maybe I will."

http://money.cnn.com/magazines/fortune/fortune\_archive/2003/08/11/346850/index.htm