The game has changed

The recession has spelt disaster for most brands of packaged goods, but not all.

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Just last year, when Alan Lafley, the boss at the time of Procter & Gamble (P&G) released his book "The Game-Changer: How You Can Drive Revenue and Profit Growth With Innovation", readers flocked to understand the business strategy of the world's largest consumer-goods firm, then worshipped as a paragon of strong management and profitability. Now, however, the company is confronting a game-changer that Mr Lafley had not foreseen: a global economic downturn.

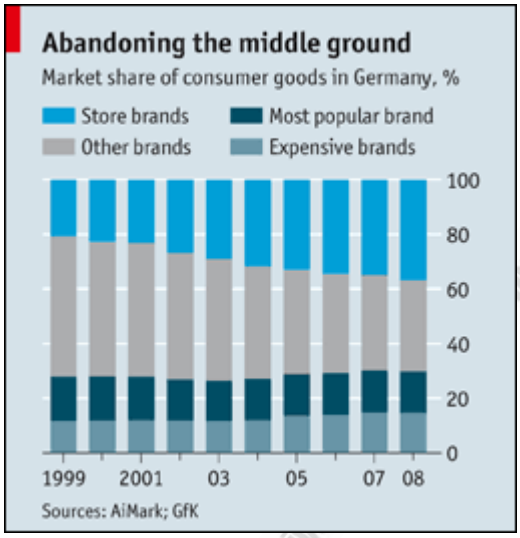
Earlier this month P&G reported profits of $2.5 billion, down 18% in the most recent quarter from a year earlier. Sales of its products—which include such brands as Bounty paper towels and Tide detergent—were down 11%. Analysts worry that it might take years for the company to restore its profits to their former levels.

For most packaged-goods firms, recent earnings reports were grim. Unilever, the world's third-largest consumer-goods firm by sales, announced this month that profits in the second quarter were down 17% from a year ago. Kimberly-Clark, the maker of Kleenex tissues and Scott paper towels, Sara Lee, a manufacturer of frozen foods, and Colgate-Palmolive, with its eponymous toothpaste and soap, all saw revenues drop in the past quarter. Firms that specialise in food, including Nestlé, Kraft and Kellogg, are holding up better than those that sell products for cleaning and grooming, but only because consumers are preparing more meals at home.

Consumer goods were once believed to be as recession-proof as any industry can be. Shoppers might not be able to afford Rolex watches and champagne during a downturn, the theory ran, but everyone still needs staples such as soap and toilet paper. Yet sales have fallen in this downturn, thanks largely to growing competition from stores' own brands, or "private labels". Private-label goods tend to cost about a quarter less than branded ones, and so appeal to penny-pinching consumers. Some shoppers are also forgoing altogether items that they used to consider staples, such as air fresheners or special detergents for sensitive skin. The big brands' recent, ill-timed price hikes of as much as a fifth in response to rising commodity prices have accelerated the trend.

Retailers have also been giving more shelf space to their own products, on which they earn better margins, further squeezing the big brands by making them less visible. Jan-Benedict Steenkamp, a marketing expert at the University of North Carolina, estimates that the share of private-label goods is now 20% at Wal-Mart and 35% at Kroger, two huge American retailers.

In the past year private-label sales have grown by around 9% in America and 5% in Europe, gaining market share from branded goods in many categories. Middle-market brands, measured by price or sales, are particularly vulnerable to competition from private labels; even in countries like Germany, where private labels now account for almost 40% of sales, the best-selling and most expensive brands have not lost much ground (see chart).



Many analysts believe that the flight to private labels will outlast the downturn. Ali Dibadj of Sanford C. Bernstein, a research firm, estimates that about half the people who have recently switched to private labels will never go back. The quality of private-label goods has improved, making it harder for consumers to discern any difference between a store's brand and a more expensive rival, particularly for commodities such as paper towels or milk.

Yet not all consumer-goods firms have succumbed to the onslaught of the private label. Reckitt Benckiser, a medium-sized British firm, reported a 14% increase in profits in the second quarter compared with the previous year, and an 8% increase in sales. The firm, which is the world's biggest manufacturer of household cleaning supplies, such as Lysol disinfectants and Spray 'n Wash stain remover, has raised its sales and profit targets for the year, whereas P&G has reduced them and Unilever has scrapped them altogether. This was not just a lucky quarter. While Reckitt's net revenue grew by 9% between 2005 and 2008, P&G's was up only 5% and Unilever's 6%.

Reckitt puts its success down to management, marketing and the positioning of its brands. Its hierarchy is surprisingly shallow: there are only one or two managers between the chief executive and his regional marketing officers. This allows the firm to make decisions more quickly than its competitors, says Bart Becht, Reckitt's boss. The firm can turn ideas into goods on shelves in around nine months, at least three months faster than its rivals.

Mr Becht insists that consumers can still be persuaded to pay for more expensive, branded goods. Reckitt increased its spending on marketing by 25% last year, when most of its competitors were cutting back. The firm takes pains to cater to all budgets. It sells four versions of its Finish dishwashing detergent, for example, at different prices. (The latest and most expensive version of Finish, called "Finish Quantum", costs more than twice as much as the most basic variety.) Reckitt is still adding extra frills to its goods, and pricing them

accordingly. It recently released a new air freshener with a motion sensor to tell it when to spray its perfume, which is a fifth more expensive than the humbler sort, for example. Mr Becht says consumers will not pay for minor alterations, such as new flavours and scents, but they will for more significant innovations. “We’ve proven that in a downturn, consumers don’t walk away from better products,” he says.

This is a very different strategy from that of Reckitt’s rivals, which, after years of sprucing up their products and pushing up their prices, are scrambling to introduce cheaper options. P&G, which has one of the most high-end brand portfolios of any of the packaged-goods firms, has tried to attract customers by launching “basic” versions of its popular brands. It recently released Tide Basic, which costs around a fifth less than its more upmarket cousin. But taking an existing brand downmarket in this way can be dangerous, analysts say. Consumers are unlikely to revert to the more expensive version if they are offered a similar product for less.

Unilever, P&G and others are also cutting their prices and increasing sizes to compete with private labels—although that can obviously cut into profits. Targeted advertising, which directly compares the quality of a branded product with a private-label rival, is also a short-term solution for consumer-goods companies, which are keen to remind their customers why paying more is a good idea.

The worst of the pressure on consumer-goods firms should dissipate when the recession ends. But if the pessimists are correct, and a good number of Western consumers stick to the frugal habits they have learned in recent months, branded products will continue to suffer. One way to revive growth will be to place a greater emphasis on emerging markets in Asia and Latin America, where private labels are unlikely to take hold in the near term, since retailers are smaller and do not have the knowledge or resources to produce their own brands. In that regard Unilever, which already gets over half its revenue from emerging markets, is better positioned than P&G.

Another strategy would be to sidestep retailers completely and sell directly to consumers through the internet. P&G’s new boss, Bob McDonald, has alluded to this sort of plan. It could be exactly the type of “game-changer” his company desperately needs.

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