

THE 5-TON ELEPHANT

Could privately labeled products one day crush some established electrical brands? Electrical distributors speak out on private labeling in this exclusive *Electrical Wholesaling* survey.

By Allen Ray and David Gordon

Priate labeling has always been that 5-ton elephant in the room that no one wants to talk about. Everyone always knew it was occurring and some distributors have private-labeled portions of their product line for years, but few people were willing to talk openly about it.

That may be changing. Distributors are asking themselves two questions:

Should I source products myself and offer private-label products?

If not, how can I compete with lower profit margins and higher priced products?

This 5-ton elephant barged into the recent Eastern Regional Conference held Nov. 8-10 by the National Association of Electrical Distributors (NAED), St. Louis, in San Antonio. Attendees voiced concerns about the impact of private labeling on the electrical market during the conference's open session, in the hotel lobby and in manufacturers' hotel suites.

Some large independent and national distributors now private-label products. They source material directly from overseas suppliers, product brokers or partner with brand-name manufacturers to produce or package product exclusively for them. Because of the reported reductions in material costs and reported increases in margins, many other distributors now wonder if private labeling is an opportunity for them.

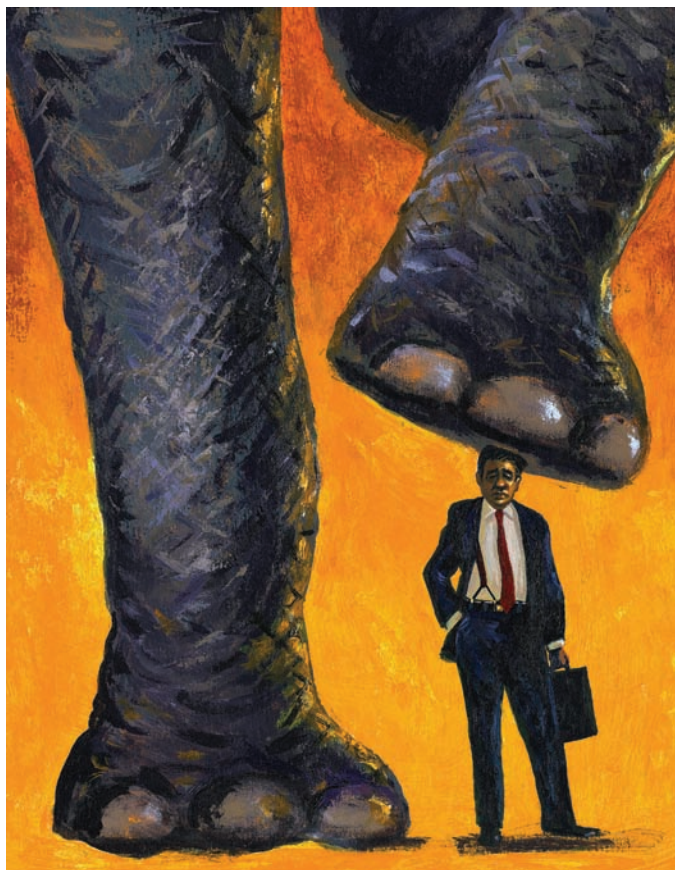
Private labeling may very well be a natural stage of evolution in a maturing industry undergoing consolidation. It's commonplace in the automotive aftermarket, apparel,

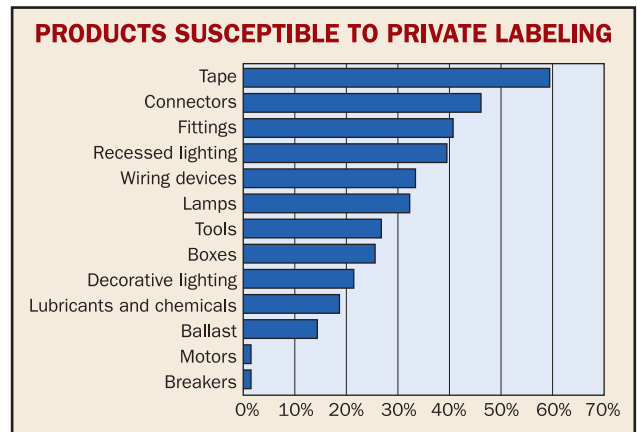
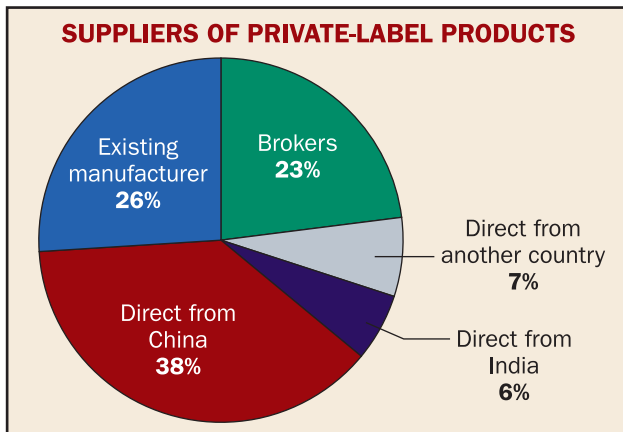
grocery and pharmaceutical industries, which have adapted to waves of consolidation over the years. In the wholesale-distribution world, the plumbing and industrial supply industries have been exposed to privately labeled products and distributor-imported products for several years.

More electrical distributors are talking now about offering private-labeled products. The conversations have been loudest concerning the increased profit margin potential and in more hushed tones about the potential product liability. For the most part, the distributors who have dabbled in private-labeled products offer a few product categories and limited stock-keeping units (SKUs). With the increase in the number of electrical manufacturers that now source products versus manufacture them, electrical distributors sense an opportunity to improve their margins — sometimes reportedly increasing their margins by over 50 percent.

To explore the breadth and depth of the issue, Channel Marketing Group, Raleigh, N.C., and Allen Ray Associates, Arlington, Texas, teamed up to survey electrical distributors. The survey was designed to determine the prevalence and potential

future of private-label products (by distributor name or brand) within the electrical wholesaling industry. This article is the first in a multi-part series on private labeling to be published in *Electrical Wholesaling*. This first article will share preliminary survey results (the survey is still open and can be taken at www.channelmkt.com or www.allenray.com). Future articles will share input we have





received from manufacturers, distributors and independent manufacturers' reps, as well as ideas on how private labeling may impact electrical wholesaling.

Distributors, manufacturers and reps have strong opinions for and against private-labeled products. The purpose of this survey and series of articles is not to make a pitch for or against private-labeled products; it's to report on current opinions on the subject and share our observations on this practice based on the survey results we receive.

DISTRIBUTORS VOICE THEIR OPINIONS

The survey was e-mailed to a wide array of distributor personnel Nov. 15 and as mentioned earlier is still open for any other distributors who would like to offer their views on the subject. As of Jan. 1, we have received more than 130 responses. While the results are not definitive, they do provide some fascinating insight into the thought process of leading distributors as they decide whether or not to offer private-labeled electrical products.

As the responses flowed in, it became apparent that many electrical distributors were willing to offer their thoughts about private-labeled products, as long as their comments were protected by anonymity. While respondents are very concerned about the related product liability and marketing issues, private labeling is apparently a strategy many distributors still want to explore because of the potential for increased margins and their need to offer lower-priced products. Additionally, the responses reflected a growing belief that many electrical manufacturers are not investing in their brands, product innovation and sales/marketing support. Many respondents apparently believe most manufacturers don't manufacture, but instead source products.

The survey also detected a definite trend in the size of electrical distributors that consider private labeling. While many larger distributors are apparently considering private labeling, respondents from smaller electrical distributors don't seem to believe private-label products are a viable solution for them. They don't believe their companies have the critical mass to take advantage of the cost benefits of private-labeled electrical products.

Many of the respondents who do not want to private label products still want a low-cost alternative brand to offer as appropriate. But these distributors believe if they build their brands, differentiate themselves, have strong customer relationships and partner with leading manu-

facturers, they can effectively compete with the privately labeled electrical products that they believe are inferior in quality to the products they stock from traditional electrical manufacturers.

Survey says. Although more than 65 percent of the survey's respondents said their company currently does not offer private-labeled product, more than 50 percent of these distributors said their company is considering the possibility of offering some private-labeled products.

Two-thirds of respondents said they know of other electrical distributors now offering private-label products. When asked whom, the most frequently mentioned companies were CES (City Electric Supply), Orlando, Fla.; Rexel Inc., Dallas; Graybar Electric Co.; St. Louis; Home Depot Supply, Atlanta; Hagemeyer North America, Charleston, S.C.; Ferguson Enterprises Inc., Newport News, Va.; and W.W. Grainger Inc., Lake Forest, Ill. (Note: this is based upon survey response and has not been verified by the authors.)

Products to private label. When asked which types of electrical product they are either currently private labeling or believe are feasible to private label, the top five product categories were:

- Tape
- Connectors
- Fittings
- Recessed lighting
- Wiring devices

Several respondents said Rexel and CES currently private label a wider array of products. The sidebar on this page offers more details on the electrical products that respondents believed were most susceptible to private labeling.

Profit potential. While private-label products are not thought to represent a significant percentage of total distributor sales, they apparently can significantly impact distributor profitability. In the survey, 57 percent of respondents feel that these products will represent only 1 percent to 10 percent of distributor sales. However, 28.7 percent of the respondents believe these sales could represent up to 25 percent of a distributors' revenues. Another 9.5 percent of the respondents believe private-label products represent even more potential.

From a profitability viewpoint, respondents said private-label products can represent incremental margin opportunities of 20 percent to 50 percent. Almost 51 percent of respondents said private-labeled products must generate

a minimum of a 20 percent advantage.

Judging from the survey results, a number of these product categories may very well be slowly migrating to private labeling. But these product categories tend to represent a small percentage of distributor sales, and the corresponding margin improvement would generate small incremental gross profit dollars.

It can be assumed electrical distributors that do not pursue a private-label strategy will either pursue lower pricing from their incumbent manufacturers or be forced to seek additional suppliers that will help them remain price competitive on selected product categories where price is the key determining factor.

For instance, residentially oriented distributors said their customers are extremely price sensitive, and that while they desire quality, price is the primary product determinant. In the residential market — and products that crossover to the commercial market — high-volume stock-keeping units (SKUs) will be the most susceptible to private labeling and will require more aggressive pricing by manufacturers to retain their volume through non-private-labeling distributors. Perhaps Wal-Mart's "Everyday Low Price" strategy will migrate to the electrical industry.

Distributor concerns. A number of electrical distributors said while they are interesting in pursuing a private-label strategy, they either don't have the personnel resources, time or knowledge to enter the market at this time. When respondents were asked about their concerns over offering private-labeled products to their customers, the top five concerns were:

- Product liability
- Losing influence with a manufacturer for other products. (Influence was defined as sales support, access to remainder of product line at the "right" price, marketing resources and rebate income.)
- Product certification (UL, CSA) rating
- Customer acceptance of the product
- Responsibility to market a private-label brand

Product liability concerns. Many electrical distributors currently try to shield their businesses from product liability by using various manufacturer/broker insurance riders or umbrella insurance policies. Recent events across the marketplace are now making distributors wonder if this means of product liability protection is really worth it. There have been reported incidents where distributors have sought legal remedies to get manufacturers or product brokers to honor insurance commitments.

For some distributors that have had consigned manufacturer inventory and have been burned by the manufacturer's insurance carrier subrogating back to the distributor's insurance carrier, they feel "umbrella liability" policies will cover their product liability, even if the distributor offers private-labeled offshore product.

In considering their potential liability, survey respondents are using or considering the following options: existing liability policy (28.6 percent); an agreement with the private-label manufacturers that lists them on that manufacturer's insurance policy (21.4 percent); separate product-liability policy for private-label products (11.4 percent); and a direct contract with a reinsurance company or group such as EDIC (2.9 percent).

But are these insurance strategies really enough to

TOP 10 DISTRIBUTOR CONCERNS IN CONSIDERING PRIVATE LABELING

1. Being responsible for product liability
2. Losing influence with manufacturer for other products
3. Product certification (UL, CSA) rating
4. Customer acceptance of the product
5. Becoming responsible for marketing a private label brand
6. Lack of marketplace differentiation
7. Becoming a "price" house
8. Offering a "short product line" versus a complete product line
9. The need to place large orders to ensure inventory (because of shipping/turnaround time)
10. Moving the "manufacturer" forecasting to you

cover the true exposure? Some insurance underwriters are indicating that without the possibility of recouping at least some funds or protection from a manufacturer (read insurance policy), they are excluding private-labeled product coverage from distributor product liability and umbrella liability policies.

Summary. As with any new product initiative, there are many pros and cons to offering private-label products. While private labeling represents an opportunity to improve margins, serious potential risks and challenges exist:

- A negative impact on existing manufacturer relationships.
- New responsibility for the sales and marketing of a privately labeled product line.
- Need to develop demand forecasting.
- Managing container loads of material and the associated warehousing and distribution of these products.
- Interacting with customs.
- Potential product liability insurance concerns.

So what are manufacturers, distributors and reps saying? Where is private labeling heading and what should you consider? Do you need to follow or are there alternative strategies? How will this affect distributor relationships with manufacturers and distributors? Can marketing groups help? What are the pitfalls? And what are the alternate strategies? Check back next month and we'll share insights from interviews we are conducting, offer some analysis and provide updated survey results. □

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