Tier 2 Brands Bring Innovation, Excitement and Growth

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Sun care has been engaged in an extended debate about the role and importance of Tier 2 brands in the category. By Tier 2, we mean any brand with less than a 5% market share. This is not to be confused with Tier 3 brands, which are classified as brands with less than 1% share and plummeting sales of at least -25%. As each sun care season roles around, the Tier 1 brands present their case to retailers that the Tier 1 brands plus private label represent over 80% of sales; therefore, there is no reason to stock any Tier 2 brands. The issue was even a topic for a moderated discussion at an ECRM event a few years ago.

It's important to note that the issue is not just confined to sun care, or even non-foods, for that matter. The arguments and specious analytical techniques to keep the "little brand" down are consistent across categories and are well known by all. After analyzing dozens of categories, we wanted to set the record straight on the importance of Tier 2 brands to the overall strength of any category.

To prove the statement that Tier 2 brands are important, let's review the most prevalent arguments against the second-tier players and consider the factual rebuttals.

Common Misstatements to Eliminate Tier 2 Brands

1 The cost of carrying extra vendors exceeds the incremental sales they generate at retail.

This is probably the most prevalent and oppressive of the strategies to remove competition from smaller vendors. It is the old "save money through vendor consolidation" argument. Interestingly, we have never seen anyone, either vendor or retailer, quantify the specific savings from vendor consolidation, probably because the ability to do so doesn't exist. While there may be some theoretical level of significant vendor reduction that can drive tangible costs out of the system, there certainly is no meaningful savings to be gathered from the elimination of one or two vendors. Can a retailer cut in-store personnel? Close loading docks? Reduce traffic managers? So as these purveyors of untruth continue to search for the elusive cost savings from vendor reduction, we can certainly point to significant increased sales from the Tier 2 brands.

For the 2004 sun care season, Tier 2 brands generated over five times the increase in dollar sales compared to Tier 1 brands. In cosmetics, the top four brands were down 4% in 2004; Tier 2 brands were +3%. In foot care, Tier 1 brands are flat; Tier 2 brands are +11%.

Additionally, in all the abovementioned categories, our studies have shown retailers with a broader vendor assortment significantly outperform retailers that do not. One specific example is Wal-Mart foot care, where they jumpstarted a dormant category with the inclusion of more items from Tier 2 brands. While the category is flat on a general market basis, Wal-Mart same store sales have grown by over 20%.

2 Tier 2 brands are typically lower priced than larger, national brands. Why trade down your consumer and reduce your profit?

This argument is based on two flawed assumptions: first, it assumes every purchase of a lower-priced brand cannibalizes sales of a higher-priced brand, and second, even if it is entirely a trade-down, there is no profit value from the swap. In actuality, our analysis shows that at least 50% of the sales from second tier brands are incremental to the category, and this level is even higher for value brands. Second, this argument assumes that the higher retail translates to a higher profit. In fact, most Tier 2 brands usually provide a higher gross margin percentage (% GM) (35% to 45%) compared to Tier 1 brands (25% to 32%), and, consequently, generally delivers a better return on inventory dollars.

Specifically, the average retail for Tier 1 sun care brands last season was $7.85 compared to $6.83 for Tier 2 brands. However, the average Tier 2 brand generated 10% more profit per unit than Tier 1.

One national drug chain tripled the quantity of lower-priced, higher margin value brands in the cosmetics category at the expense of higher-priced national brands. Sales growth on the national brands went from 11% to 10%; growth on value cosmetics went from 5% to 225%. Net Change Results: 15% category growth as 95% of value cosmetic gains was incremental to the category; Weighted Total Category % GM gained a full two points.

3 Only national brands invest in consumer advertising and drive traffic to your stores. Tier 2 brands do not, therefore, you should reward them by providing space in the planogram.

While consumer advertising is important to announce new products and innovation, today's competitive retail landscape makes it paramount that buyers utilize trade promotion to bring customers to their stores as well as stimulate incremental and non-planned purchases when the customer is in the store. Tier 2 brands spend a higher percentage of their marketing dollars with the trade, as they know how important it is to win the in-store purchase decision.

4 Large brands invest in R&D and research to drive innovation.

There are numerous instances where the Tier 2 brands have brought category altering innovation to market; Bioré pore strips, Airborne immune supplement and Atkins controlled-carb products, just to name a few. While Tier 2 brands do not have the equivalent R&D budget as Tier 1 brands, they also do not have the corporate constraints and blinders that keep them from thinking outside the box. Additionally, Tier 2 brands rarely have the opportunity to fall prey to the cynical line extension strategies of Tier 1 brands. A cursory check of any retail shelf will identify hundreds of items from Tier 1 brands launched for the purposes of holding shelf space and juicing up pipeline volume. Tapped out on any true innovation? How about a line extension with "Essentials," "Select," "Naturals," "Ultra" or any other number of hackneyed line extension tags with no real value to the consumer?

In summary, there are actually no reasons not to allocate an appropriate amount of shelf space to Tier 2 brands. These brands, on average, deliver incremental sales, higher profits, more innovation and higher trade spending as a percentage of sales than comparable Tier 1 brands. F

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