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Private Label Agreements: No More 'Low Brand' Store Brands

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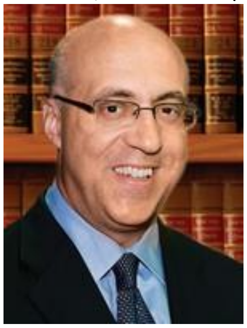


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Downturns in the economy can be challenging, but they also offer opportunities for manufacturers to find new ways to market their products and generate additional revenue. One alternative is to enter into a private label agreement under which the manufacturer produces goods to be sold under the name or brand of another company, typically a well-known retailer. Such products are often referred to as "store brands" (and are sold under the retailer’s brand) instead of the more common and more heavily promoted "name brands" sold under the manufacturer's name. Private labeling is common in many industries, especially with products sold in grocery and drug stores.

This article will cover some of the factors to determine if a private label arrangement is the right business move; reasons for a manufacturer to consider entering into a private label agreement; and considerations that a manufacturer should think through and discuss with its counsel when negotiating the contract.

Is a Private Label Arrangement the Right Move?

There are several factors that help determine whether a private label deal is the right move for a manufacturer, some of which include: sales potential of the product; the manufacturing process; and quality.

A manufacturer that produces products with significant sales potential and that satisfy a mass market is usually the most successful in a private labeling arrangement. Retailers are not interested in branding low-demand items. When a manufacturer’s name brand product has been pretested and retailers and consumers are already familiar with it, the product should be desirable in a private label arrangement as it can now be sold in a new package because it will self-sell.

Another key factor in determining if private labeling is the right business move is the manufacturing process. It is important to consider whether the manufacturer has the ability to produce a substantial amount of the product, be reliable and ensure on-time delivery. An additional aspect of the manufacturing process is the manufacturer's flexibility and ability to increase production in order to meet demand. The ability to meet a retailer's needs plays favorably in this type of arrangement.

Finally, it is often important to ensure that the private label product is of high quality. Consumer perceptions about private label products have increased significantly in the last few years. Consumers reaching for store brands are no longer just looking for value. They also expect a store name product to have equal or greater quality to brand name products. The quality includes both the product itself, as well as the appearance of the product. It is important to capitalize on this now favorable consumer perspective and factor it into the product and label development process.

Reasons for Manufacturers to Enter into a Private Label Agreement

During the recent economic recession, private label arrangements became more common for manufacturers. Now the trend seems to be here to stay, and has resulted in an explosion of sales of private label brands. It has become a valued strategy by manufacturers of any size, especially those that have established recognized name brands of their own. Even small and medium-sized manufacturers have new opportunities using private labeling because these companies may gain additional market share and no longer have to compete directly with large manufacturers. Now manufacturers of any size can grow their business by marketing their products to retailers.

Entering into this type of business arrangement allows the manufacturer's product to reach a larger audience. It also allows the product to have more credibility because it bears the label of a store that already has a brand identity of its own. Retailers may be interested in this business strategy as a way to introduce new product lines or source products from specialized manufacturers because it is a more economical alternative to establishing their own production and manufacturing facility.

One major benefit for a manufacturer in a private label arrangement is that it does not have to incur advertising expenses to promote the products. Name brand products tend to cost more than their generic store-brand counterparts. That is mostly because branded products carry all of the costs of promotion, but private label products carry no such costs. Instead, the retailer becomes responsible for advertising and marketing.

Further, manufacturers and retailers are providing a combination of price and value to the consumer. When a store brand product and a brand name product come out of the same manufacturing plant, they are often the same item with different labels. The result is that consumers that switch to store brands save money, because the price does not include the manufacturer's advertising and marketing costs, and also do not have to sacrifice quality.

Factors to Consider When Negotiating a Private Label Agreement

There are several factors to consider when negotiating a private label agreement. In addition to the considerations provided below, each industry may have specific issues that need to be included in the agreement. It is essential for a manufacturer to have discussions with its lawyer as to its specific needs in order to ensure that the agreement accurately covers all of the necessary elements of the deal.

Exclusivity is an extremely important issue to consider during the negotiation process. If the agreement states that the retailer has the exclusive retail rights and/or private label rights to a manufacturer's product, the manufacturer may be preventing itself from selling the products under its brand name and/or selling store brand products to other retailers. Exclusivity to a specific territory may prevent the manufacturer from selling products directly in that location. The manufacturer should look to be free to continue to sell product under its own brand and to other private label retailers, if possible. It is recommended that a manufacturer should not allow any one retailer to account for more than 15 percent of its sales. It may even be included in the contract that the name brand product and the store brand product have different images and consumer perceptions in order to reduce direct competition between the brands. The manufacturer will also want to avoid or limit giving its private label retailer "first refusal" rights on future manufacturer products.

During the negotiation of the agreement, the lawyer should discuss minimum order requirements for the private label product. The volume commitment establishes the minimum amount of the product the retailer must order within a specified time period. Additionally, the lawyer should discuss the amount of packaging that the manufacturer must keep in stock. Manufacturers will want to keep the minimum order amount high, and the stock requirement amount low. If possible, the manufacturer should negotiate to include a clause in the agreement that states the retailer will reimburse it for any unused packaging.

Intellectual property should be protected in a private label agreement. The manufacturer must retain all of its intellectual property rights, including trademarks, trade dress, service marks, patents and copyrights, in its company, products and all related materials. The retailer will want to retain its store brand intellectual property.

Parties to a private label agreement may exchange confidential information and, therefore, should protect that information by including a confidentiality clause in the agreement. This clause may cover product costs, company overhead costs, recipes or product development plans, distribution plans and other proprietary information. The manufacturer should restrict the sharing of its confidential information to the greatest extent possible. Additionally, the manufacturer may want the retailer to be prohibited from disclosing the terms of the agreement and even the private label relationship with the manufacturer.

Additional provisions that may be discussed during the negotiation and drafting stages of the private label agreement include quality control, term of the agreement, order procedure, pricing, billing and payment methods, delivery, labeling obligations, warranties, limitations on damages, insurance and indemnification obligations.

The manufacturer should avoid giving the retailer any "most favored nation" rights as to pricing or other business terms. Such rights are often hard for the manufacturer to manage and comply with, and could prove devastating down the road.

As the retailer is often a competitor or potential competitor of the manufacturer, anti-trust laws should always be considered, especially in the area of pricing.

Conclusion

Manufacturers, always looking to generate additional revenue, are finding private labeling an increasingly attractive option. Many have created separate divisions specifically for the purpose of identifying and manufacturing private label products. This is true even if the manufacturer has a well-known brand of its own. It is an alternative that many manufacturers should consider as part of their overall business strategy.

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