

# Trading Down in Tough Times

## Food Buying Habits in a Consumer Downturn



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It is of wide-spread belief in life that food retailing is a defensive business model.

This may be attributed to the fact that people cannot do without food.

Food volumes are believed to be largely stable through cycle peaks and troughs due to their non-discretionary nature. This may be attributed to the fact that food lies at the base of Maslow's hierarchy of needs. It is a basic human need. What Maslow proposes is that, before any other needs are taken care of, the first needs to be addressed will always be food, water and sleep. And while this may be true of food in general, not all foods are equal.

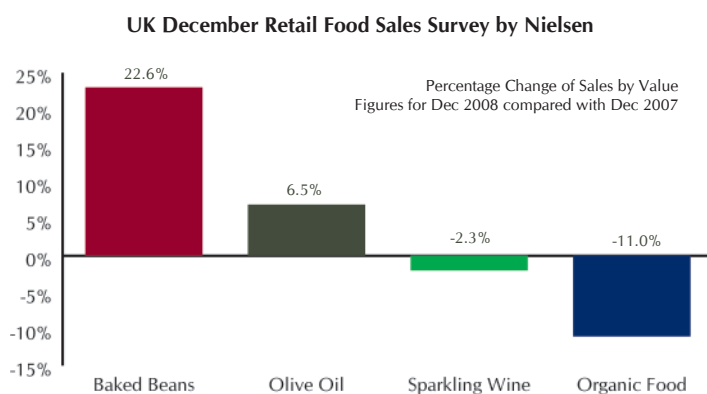


Source: [http://www.abraham-maslow.com/m\\_motivation/Hierarchy\\_of\\_Needs.asp](http://www.abraham-maslow.com/m_motivation/Hierarchy_of_Needs.asp)

On closer inspection, we are able to see that some food groups are more discretionary than others. Caviar and sushi, for instance, are not what I think would fall into the category of 'basic human needs', whereas bread, milk and vegetables are more likely the kinds of foods one cannot do without. That is a fairly obvious distinction to observe, however there is a further division that needs to be highlighted and that is between branded and non-branded food items. Is it really necessary that your tomato sauce be All Gold, or is the no-name brand alternative just as good? What is the real difference between the retail owned brand pasta or Fattis & Monis? In some cases, such as Woolworths, the in-store branded products are seen to be superior to the branded alternatives. We explore these distinctions in food categories, and see how each of these sub-categories respond to different economic climates and why.

What we have seen globally, due to the global economic slowdown, is that consumers have become increasingly spend-thrift, particularly on discretionary items. This can be seen in the severe and prolonged downturn in sales of automobiles, jewellery, furniture and even clothing. A recent Nielsen survey in the UK showed that although overall food sales were down in December 2008, baked bean sales were up 22.6%. It would appear from the chart

below that there is an attitude to cut back on luxuries and get back to the bare necessities. Organic foods, which perhaps fall into the top category of Maslow's needs (self-actualisation), saw a substantial decline in sales of 11%.



Source: <http://news.bbc.co.uk/2/hi/business/7824072.stm>

Consumers across the globe have been seen to be trading down in tougher times, to try and make their money go further. The term 'trading down' refers to a change in the buying habits of consumers in favour of cheaper alternatives, due to constraints in their disposable income. When faced with a decline in disposable incomes, consumers track down Maslow's needs, thereby abandoning the higher, esteem-related needs, to focus on the most fundamental needs: physiological and safety. Because different foods satisfy different levels of these needs, the consumers' trading down patterns begin to show in the sales growth disparity of the different product categories. What the Figure alongside shows is a few examples of various food products, categorised into Maslow's needs. Usually, the foods that lie in the bottom rung of Maslow's hierarchy are inferior goods<sup>1</sup>. According to consumer theory, inferior goods (unlike normal goods) are goods whose consumption decreases when disposable incomes increase; and (as is the case now) consumption increases when disposable incomes decrease. With this kind of insight, one can begin to predict which product categories are likely to outperform in a consumer slowdown, and which are likely to do well when the consumer ultimately recovers.

**Food Products Categorised by Maslow's Needs**



Conversely, when disposable incomes are increasing, consumers begin trading up to more sophisticated and expensive food products, thereby satisfying higher needs, like social status and esteem. During an upswing in the consumer cycle, we should expect the sales of baked beans and white bread to fall, juxtaposed against a surge in the sale of salmon and cream cheese at Woolworths.

Locally, although for quite different reasons, South African consumers suffered a severe hit to their disposable incomes. In the 2008 calendar year, household disposable incomes were hit by a perfect storm. Petrol prices were up 34% on average, interest rates increased a further 200bps and peaked; and food inflation averaged roughly 16%. It then comes as no surprise that during the six months to March 2009, Tiger Brands Ltd reported a 26% increase in sales volumes of baked beans, versus a 12% decline in value-added meats volumes<sup>2</sup>. It is equally unsurprising that the underlying theme of that particular presentation of results was the growing threat of private label products due to consumers' tendency to trade down.

Not only are customers trading down from higher price foods to cheaper foods, but they are also exchanging branded products for private label goods. Private label products offer buyers the option to trade down on price, but still maintain the same products in their grocery basket.

Penetration levels of private label products traditionally have been inhibited by consumers' general perception of inferior quality. The global average penetration in 2008 was 20%, according to a Planet Retail study, with South Africa far below that at only 8%. According to company management, Pick n Pay's no name brand makes up

<sup>1</sup>Source: <http://moneyterms.co.uk/inferior-good/>  
<sup>2</sup>Source: Tiger Brands Ltd Investor Presentations

11-12% of total sales, and Shoprite's in-house brands only make up about 5%.

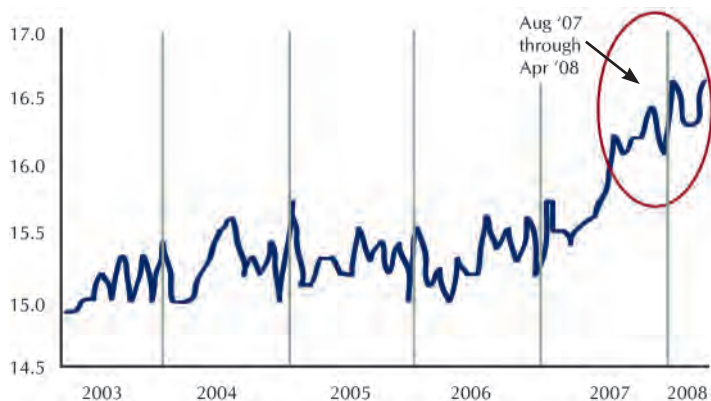
Global Private Label Penetration in 2008



Source: www.planetretail.net

There is, however, a growing acceptance of private label products, with an uptake of these products having grown recently as consumers' pockets have come under strain. Ordinarily, consumers are willing to 'pay for quality', but in tougher times, there is a growing leniency on quality in favour of a more accessible price in the private label product.

Private Label Share Growth

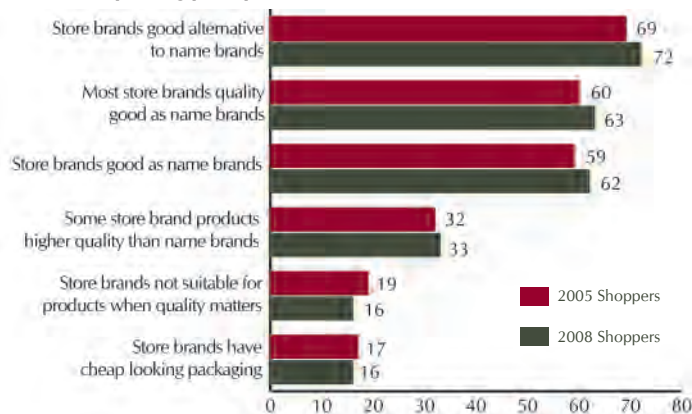


Source: Nielsen Consumer Insight Magazine Issue 11 – October 2008

Since grave circumstances have forced consumers to trade down into some private label goods, their experience has proven to be in stark contrast to their previous myths about private label quality. There has been a growing awareness of these brands, and with it, a realisation that some of these no-name products are just as good, and in some cases better, than their branded counterparts. The chart below is from a study, performed on US households, showing improving customer perception of private label quality.

It would appear that US consumers are able to make a far bigger saving on their food and grocery expenses by switching to private labels, while the same may not be true for the average South African food basket. Results of a recent study performed by the Private Label Manufacturers' Association (PLMA) shows that a US consumer can save up to 29%. It's fairly obvious to see how private label penetration can increase in an environment where savings are significant and quality is not altogether compromised. The same, unfortunately, cannot be said for South African private labels, and this would explain the very low penetration in comparison to global averages.

Improving perception of Private Label brands in the US



Source: [http://en-us.nielsen.com/main/news/news\\_releases/2008/november/nearly\\_three-quarters](http://en-us.nielsen.com/main/news/news_releases/2008/november/nearly_three-quarters)

We conducted a similar study on 10 May 2009, using one of our leading food retailer's online shopping facility, measuring the saving on a basket of goods if a consumer would opt to buy no-name branded goods versus the cheapest branded alternative. This saving only amounted to 9%. It seems that the benefit to South African consumers of trading down to private label goods is too low. In many

cases, the disparity in quality between the in-store branded goods and the branded goods is far too wide to sacrifice, especially if the saving is only 9%.

#### Consumer Saving from Switching to Private Label in SA vs US

Afena Survey	Branded	No Name	Save	PLMA Survey	Branded	Store Brand	Save
<b>Food Items</b>				<b>Food items</b>			
Cooking Oil 750ml	R 13.99	R 10.99	21.4%	American cheese	\$3.99	\$2.99	25.1%
White rice 1kg	R 12.99	R 11.79	9.2%	Canned chilli	\$1.21	\$1.39	-14.9%
Maize meal 2.5kg	R 10.89	R 9.99	8.3%	Canned corn	\$1.27	\$0.84	33.9%
White bread 700 g loaf	R 7.29	R 5.99	17.8%	Canned cranberry sauce	\$1.79	\$0.95	46.9%
Instant coffee 250g	R 19.49	R 19.99	-2.6%	Canned pork & beans	\$0.60	\$0.87	-45.0%
Tagless Teabags 100pk	R 9.49	R 10.49	-10.5%	Canned soup	\$2.34	\$2.00	14.5%
White sugar 1kg	R 7.59	R 7.89	-4.0%	Cold cereal	\$3.09	\$2.13	31.1%
Apricot Jam 450g	R 8.99	R 8.39	6.7%	Dry pasta	\$1.28	\$1.17	8.6%
Peanut butter	R 36.24	R 30.99	14.5%	Dry stuffing mix	\$2.19	\$1.50	31.5%
Oats 1kg	R 14.89	R 12.99	12.8%	Frozen fish sticks	\$4.14	\$3.50	15.5%
Fresh milk 1l sachet	R 5.99	R 6.49	-8.3%	Frozen pizza	\$7.16	\$5.49	23.3%
Full Cream Maas 2l	R 17.99	R 14.99	16.7%	Hot chocolate mix	\$1.50	\$1.33	11.3%
Large eggs 30pk	R 33.99	R 33.49	1.5%	Hot dogs	\$3.89	\$3.39	12.9%
Polony 1kg	R 19.99	R 18.99	5.0%	Instant oatmeal	\$3.57	\$2.13	40.3%
Baked beans 410g	R 4.99	R 4.99	0.0%	Ketchup	\$1.69	\$1.29	23.7%
Canned Corned meat 300g	R 11.49	R 9.99	13.1%	Maple syrup	\$4.99	\$2.99	40.1%
Tuna in Water 170g	R 10.99	R 7.99	27.3%	Packaged mac & cheese	\$1.20	\$0.76	36.7%
Mayonnaise 750g	R 19.99	R 18.99	5.0%	Peanut butter	\$2.79	\$2.19	21.5%
Tomato sauce 750ml	R 10.99	R 8.79	20.0%	Prepared mustard	\$2.29	\$1.69	26.2%
Coarse salt grinder 100g	R 19.99	R 16.59	17.0%	Prepared pasta sauce	\$2.50	\$1.57	37.2%
Frozen Veg 1kg	R 15.29	R 16.59	-8.5%	Refrigerated orange juice	\$3.41	\$2.57	24.6%
Juice concentrate 2l	R 18.99	R 24.99	-31.6%	Saltine crackers	\$3.00	\$1.50	50.0%
<b>Non-Food Items</b>				<b>Non-Food Items</b>			
Beauty soap 200g	R 7.49	R 4.99	33.4%	Body lotion	\$9.99	\$5.00	49.9%
Dishwashing liquid 750ml	R 18.59	R 11.99	35.5%	Cough syrup	\$5.99	\$4.74	20.9%
2ply toilet roll 9pk	R 42.99	R 36.99	14.0%	Facial tissue	\$1.92	\$0.99	48.4%
Washing powder 1kg	R 25.99	R 19.99	23.1%	Lip balm	\$1.29	\$0.99	23.3%
Fabric softener 2l	R 20.99	R 20.99	0.0%	Toilet paper	\$1.00	\$0.66	34.0%
	<b>R 448.57</b>	<b>R 407.33</b>	<b>9.2%</b>		<b>\$80.08</b>	<b>\$56.62</b>	<b>29.3%</b>

Source: <http://mybrand.com/tag/plma/>

Although Pick n Pay recorded higher sales growth in their private label brands than overall sales growth, they do not attribute all of this to trading down. They have put in a huge effort to market their new in-house brand, increased shelf space and improved quality. Shoprite did see some trading down to their in-store brands. The sales growth of 23.4% to March 2009 was fairly in line with the rest of the branded goods sales. It would appear that South African consumers remain more brand-conscious or, more likely, have been less severely hit by the global crisis than global peers. Their buying down has been limited to changing one food item for another by, for example, buying less salmon and more baked beans, but they have remained mostly loyal to branded products. Tiger Brands re-affirms this, recording stable and growing market shares in their key grocery products, even in a slowing market.

**Tiger Brands Market Shares to February 2009**

Volume Share (%)	12mm		6mm	
	2008	2009	2008	2009
Baked Beans	65.5	69.3	67.0	73.8
Tomato Sauce	71.6	73.9	73.9	74.7
Peanut Butter	45.5	44.5	45.6	44.2
Jam	62.2	62.0	61.2	62.7
Canned Veg	64.7	65.2	64.2	66.4
Pasta	37.6	38.2	31.9	43.8

Source: Tiger Brands Investor Presentations

Their success has been attributed to good marketing and product innovation to keep customers loyal to their brands. It's not just about selling tomato sauce, but about being the leader in new packaging (squeeze bottle) and a broader product range (mustard and 1000 island sauces) that keeps the customer coming back to the All Gold brand.

There are some key benefits of private labels to the retailers<sup>3</sup>:

- they earn higher margins than the branded products;
- creates stronger customer loyalty;
- freedom to create and schedule own marketing plans;
- greater freedom with pricing strategy.

Our discussions with Pick n Pay management lead us to conclude that they will be continuing with their drive to increase the penetration

of their new and improved private label offering. They confirm that they do earn a better margin on these products as they don't have to pay the manufacturers as much for the packaging and royalties on the brand. It is however disconcerting to note that Pick n Pay's pricing strategy on these products is following more along the lines of premium private label offering, much like Woolworths'. The buyer will be getting a good quality in-store brand product, but will be paying as much, if not more, than the branded alternative. On the other hand, Shoprite seems unenthused by the margin they earn on in-house products, given the fact that they have to run their own marketing on these brands to move volumes.

Against this backdrop, it doesn't seem that private label penetration is likely to race ahead of branded goods in South Africa as has been the case globally, firstly because the quality of private labels is simply not on par with the branded goods; and where the quality is right, the price is too high to incentivise consumers to switch.

It is fair to say that the size of the food basket does not vary much from year to year because people must eat, thereby making food a defensive business model. It is however clear to see that not all food categories are non-discretionary. What is important is to look inside the food basket as it is in the composition of the basket that better insight is provided into where we are in the consumer cycle.

<sup>3</sup>Source: www.retailrise.com