Why Commodity Inflation Helps CPGs

Because private label brands are being hit even harder. By VANESSA L. FACENDA

CRUDE OIL HIT $100 A BARREL last week and over the last year wheat prices rose 10%. Prices for other commodities ranging from sugar to rubber are also surging.

While that’s cause for whoops of joy from oilmen, farmers and rubber producers, the same is true for marketers of packaged goods—at least in the short term.

The reasoning seems counterintuitive. After all, the conventional wisdom is that higher raw materials costs will eat into margins. That does seem to be the case, but only with brands that didn’t raise their prices.

For instance, at the Consumer Analyst Group of New York conference in Boca Raton, Fla., last week, ConAgra Foods CEO and president Gary Rodkin admitted the company was “too slow to the dance this year” with regard to price increases. He promised the firm, which markets Orville Redenbacher popcorn, Chef Boyardee and other food brands, will benefit by across-the-board price hikes on March 24.

Likewise, Campbell Soup CEO Doug Conant blamed the company’s foot-dragging on price increases for “troubled” margins. “Our pricing now is designed to position us to get back on a margin growth track,” Conant told analysts.

Companies that have raised prices, meanwhile, have happily found that so far there’s been little defection to private label. “Kellogg, General Mills and Heinz have implemented strong price increases while maintaining solid volume and market share trends,” Conant told analysts.

That’s partially because the price increases have been fairly minor, but also because CPGs buy commodities in larger volumes than their private label competitors so their price increases are proportionately smaller. According to research conducted by Citi and AC Nielsen (which, like Brandweek, is owned by Nielsen Co.), private label price increases eclipsed those of their branded rivals in several categories, including cheese, cookies, yogurt and popcorn for the 12 weeks ended Jan. 26.

Such data led Driscoll to conclude that the threat of consumers trading down to private label “appears minimal.” Ken Harris, managing director of Cannondale Associates, Evanston, Ill., agreed: “On the face, this seems bad, but it has not yet dissipated consumer purchasing behavior in a material way.” But Harris cautioned that, “We’re a price increase or two away from this.”

Others echoed that concern. Jan Benedict E.M. Steenkamp, a professor of marketing at the University of North Carolina, Chapel Hill, noted that historically private label brands have thrived during recessions and tend to increase their share afterwards. “Even when both manufacturer brands and private labels increase prices, private labels remain cheaper and offer the potential for price savings.” After that, consumers who try private label often become fans after they find out the quality is decent, he said.

Nirmalya Kumar, professor of marketing at London Business School, concurred: “Part of the private label share increase over the coming recession will be ‘permanent’ because a significant proportion of consumers who moved their purchases from manufacturer brands to private labels will remain loyal to private labels even after the need to economize is over.”

Nevertheless, CPGs are largely shrugging off such concerns, arguing among other things that inflation will prompt consumers to go out to eat less and therefore buy more packaged goods; and that when commodity inflation eases, their margins will rise even further. Companies are also touting cost savings, in General Mills’ case, by reducing the number of pretzel shapes in its Chex snack mixes to three from 14 and similarly paring the number of pasta shapes in Hamburger Helper.

The sunny outlook has extended into ad spending as well. Data from Nielsen Monitor-Plus shows that while some, like Colgate, cut spending for the first 11 months of 2007, most CPGs increased their budgets compared to the same period in 2006 (see chart, left).

The thinking is that more advertising will increase brand strength and override price concerns. “Cutting back on marketing is not a good strategy,” said Connie Maneaty, analyst at BMO Capital Markets. “Brands have to keep [themselves] in front of the consumer; consumers have to believe what they are buying is better than the other choices out there.”

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