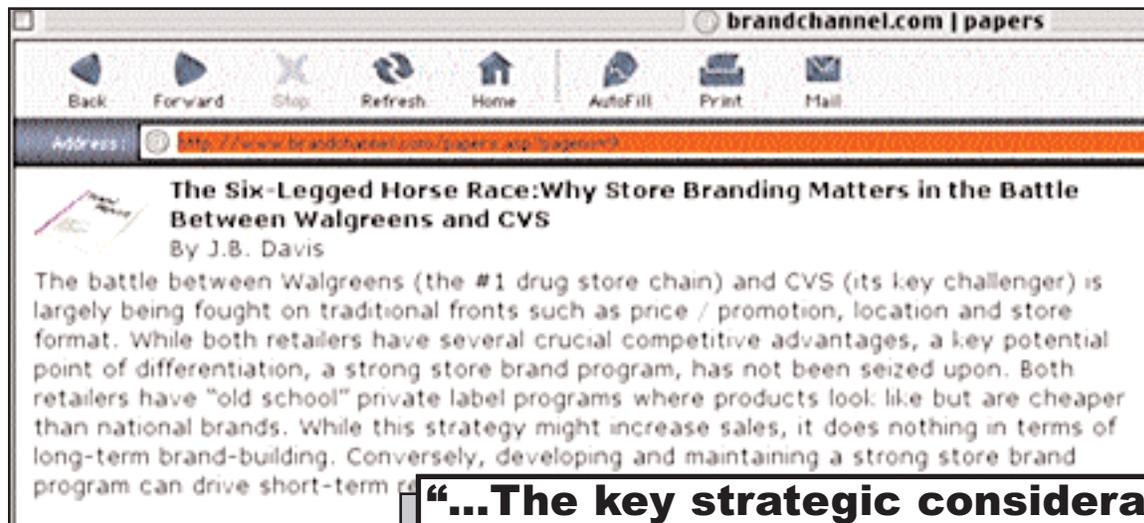


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**“...The key strategic consideration for CVS and Walgreens, however, isn’t whether a strong store brand program offers short- and long-term advantages in the drug store battle, but whether they are adequately preparing for the larger war against Wal-Mart and Target.”**

# The Six-Legged Horse Race: Why Store Branding Matters in the Battle Between Walgreens and CVS

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## Abstract

The battle between Walgreens (the #1 drug store chain) and CVS (its key challenger) is largely being fought on traditional fronts such as price / promotion, location and store format. While both retailers have several crucial competitive advantages, a key potential point of differentiation, a strong store brand program, has not been seized upon. Both retailers have “old school” private label programs where products look like but are cheaper than national brands. While this strategy might increase sales, it does nothing in terms of long-term brand-building. Conversely, developing and maintaining a strong store brand program can drive short-term revenue and help support long-term brand positioning.

The key strategic consideration, however, isn't whether a strong store brand program offers short- and long-term advantages in the drug store battle, but whether CVS and Walgreens are adequately preparing for the larger war against Wal-Mart and Target, two retailers that (a) have more advanced store brand programs than CVS or Walgreens and (b) are on a path to continue grabbing revenue from traditional drug stores.

All is not lost, however, as there are both “revolutionary” and “evolutionary” changes that Walgreens and CVS can adopt. But the marketplace isn't going to stand still.

## Background: Three-Legged Horses Don't Win Races

The Walgreens - CVS battle is largely being fought along traditional lines: merchandising mix; pricing and promotion; store format and location. Both chains are run by smart senior managers who know how to adjust circulars to drive traffic; know how to pick sites to capitalize on population shifts and know how to mix merchandise and store formats to reflect changing consumer tastes.

It's a neck and neck battle, with the difference between #1 player Walgreens and key challenger CVS close in terms of revenue, store count etc. And, along with a few other retail battles, the CVS-Walgreens slugfest is one of the most interesting fights around.

It's particularly interesting, therefore, that neither Walgreens nor CVS have taken advantage of a potentially powerfully weapon at their disposal: a strong

store brand system.

In the old, old days, “generic” products became famous for their “black on white” packaging. Generics, which were often found in low-involvement categories such as paper goods and everyday canned goods, were nothing more than a low cost option for shoppers.

Generics gradually lost shelf space to “private labels”, products that were “branded” by the store; looked like the national brands and were cheaper than their branded competitors. Implicit in their knock-off designs was the idea that they were cheaper than national brands but of about the same quality.

Historically, it has been an effective pricing strategy for stealing share from national brands. Retailers have been attracted to private labels because the margins are often higher than national brands. The Federal Reserve of Boston reported that “on average, retailers reap a profit

margin 27 percent greater on these private label items than on national brands”. Why? As KPMG reported earlier this year, private label margins tend to be higher because their marketing costs are lower than national brands, among other factors. Moreover, as a Working Paper from the University of Pennsylvania’s Wharton School of Business noted, while branded manufacturers across a range of categories and segments are regularly locked in wars of attrition that suppress their ability to grow, private labels frequently have relatively higher growth trajectories.

Stealing revenue from “the big boys” is a perfectly fine strategic rationale for CVS’ and Walgreens’ private label programs. And to the extent that the two retailers have similar private labels, the programs probably cancel each other out as a competitive advantage.

While both retailers have evolved some categories, overall Walgreens’ and CVS’ private label programs do nothing toward long-term brand-building. Leading-edge retailers, first in Europe and then in the United States, long ago realized that it was possible to evolve private labels from a rather neutral component of their overall business strategies to a key competitive advantage. They have, as has been noted in Brand Channel and elsewhere, created true “store brands”. These retailers have created identities for their brands that are equal to or greater than national brands. Evocative and easy-to-shop packaging (a key consideration for time-pressed consumers) have been key parts of the equa-

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tion; the other component is great products.

The key strategic consideration for CVS and Walgreens, however, isn’t whether a strong store brand program offers short- and long-term advantages in the drug store battle, but whether Walgreens and CVS are adequately preparing for the larger war against Wal-Mart and Target, two retailers that (a) have more advanced store brand programs than CVS or Walgreens and (b) are on a path to continue grabbing revenue from traditional drug stores.

### **A Qualifying Note**

Rather than get mired down in issues of vernacular and brand architecture – such as the fact that Target’s Restore & Restyle home improvement line is clearly a store brand but the Michael Graves line (which is sold exclusively at the retailer and carries the retailer’s name on the back panel) may or may not be because Michael Graves is a “brand” apart from Target – this article offers a simple definition. Private labels are last generation products that mimic national brands in look & feel and are generally perceived as being about the same level of quality, or maybe a little less so. Private labels may add to a retailer’s bottom line but rarely help to build a retailer’s brand. Conversely, store brands have more evocative shelf presences; are generally perceived as being equal to or greater than the nationals and are part of a larger branding strategy.

### **Why Store Brands Matter**

As noted above, the larger strategic consideration isn’t gaining advantage in the CVS-Walgreens battle but in preparing for the war with Wal-Mart and Target, two retailers that (a) have more advanced store brand programs than CVS or Walgreens and (b) are on a path to continue grabbing revenue from traditional drug stores. In order to prepare for this wider fight, Walgreens and

CVS should revamp their private label / store brand programs. Why? Because a strong store brand program, in addition to possibly adding revenue, might serve as a potential defense against Wal-Mart and Target.

### Revenue Considerations

Store Brands Can Play An Important Role In Retailer's Merchandise Mix -- But Shouldn't Be Part of A Backdoor Every Day Low Price Strategy

Walgreens and CVS have roughly equal private label programs, so under the current state of affairs, private label probably isn't "about" building competitive advantage in their fight. It's about driving revenue by taking share from branded manufacturers. In fact, both retailers benefit from the consistency between price (lower than branded manufacturers) and shelf presence (packaging that look somewhat like the "big boys" but a less

**There is a decided sense of brand loyalty among private label shoppers for the store brands they purchase**

expensive version of what they have to offer).

But private label can play an even greater revenue role.

Drug Store News recently reported "that there is a decided sense of brand loyalty among private label shoppers for the store brands they purchase. One quarter of consumers who buy store brand in drug stores said the quality of the store brands in the stores they regularly shop is usually better than store brand from other drug stores". A weak private label / store brand program is troubling because it's usually easier to increase revenue from existing customers than it is to find new customers -- and this highly-involved segment of "true believers" (as one branding expert called them)

represents an under-realized revenue stream. Moreover, because there is a "fair degree of crossover among private label shoppers in food, drug and mass", as a trade publication noted, a weak program has the potential to drive potentially loyal customers into the arms of retailers from other channels.

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But while

Walgreens' and CVS' private label programs make sense as a tool *against branded products*, the current programs make less sense *against other retailers*. As a complete matter of conjecture, let's say that their private label programs are what they are not because they've been ignored, but because they're viewed as part of a de facto everyday low price (EDLP) strategy -- that having so many lower cost SKUs allows both chains to, implicitly, stake a value positioning.

Is this a place they want to be? Probably not, because not only does it put them at odds with the historic retail axiom of "live by price, die by price", it potentially puts them on a collision course with Wal-Mart. Whether its promotions on national brands or EDLP private label products, it's hard to beat Wal-Mart on price. Just ask K-Mart, whose disastrous price war with Wal-Mart over the last year helped drive them into bankruptcy.

Historically, private label has been about *stealing share away from branded manufacturers*. However, in today's hyper-competitive environment, store brands can be a point of differentiation *against other retailers*, whether it's within the drug store channel or against big box retailers. And it stands to reason that to be better

differentiated is to be in a better position to sell more stuff.

### Brand-Building Considerations

A strong store brand program can help build the CVS and Walgreens brands because it can infuse the brands with two higher order emotional benefits that are particularly important to drug stores: convenience and quality / trust.

#### The Store Brands - Convenience Connection

Store brands can support a convenience positioning because of shifts in the retail landscape.

Retail channels have blurred, with supermarkets selling gasoline; mass merchants offering prescriptions and drug stores resembling convenience stores, among many, many other shifts. One drug store channel observer noted that “gone are the days when a good greeting card assortment and friendly pharmacist were the only differentiating factors a drug store needed. Cards are now sold across multiple channels – including online -- and supermarkets and mass chains increasingly are emphasizing the efficiency and effectiveness of their pharmacies”.

In fact, drug store chains long ago lost their leadership position within the HBA mega category, with discounters increasing their share to 38.6% versus drug stores’ 31.8% in 2000, according to IRI. Drug store chains have attempted to make-up for this lost revenue by carrying more seasonal and general merchandise, becoming, as one chain president observed, “a neighborhood pharmacy and a convenience store”.

In a nation where people are working longer hours and facing longer commutes each year, there are plenty of

people who want retail solutions such as one stop shopping. But just because a retailer offers one stop shopping doesn’t necessarily mean that it’s convenient. For a store to be a true solution for harried shoppers, the in-store experience has to be easy to shop. And a tried-and-true way of creating an atmosphere of shop-ability has been carrying brands that serve as short hands for decision-making.

**But just because a retailer offers one stop shopping doesn’t necessarily mean that it’s convenient.**

Design and branding pioneer Walter Landor observed that a “brand is a promise that creates a preference”. The same should be true for store brands. A weak private

label offering, however, doesn’t really help mom, who is coming from work en route to day care and just wants to feel confident that she’s making the right decision by buying generic cold medicine for her family.

Or, stated differently: saying you’re convenient is one thing, being convenient is another.

#### The Store Brands - Quality / Trust Connection

Which retailer (or even which channel) is more convenient is an important long-term issue of brand positioning for CVS and Walgreens. Equally important is the issue of quality.

In what is either a virtuous or vicious cycle (depending on if the retail chain you manage has a strong or weak private label / store brand program), 70% of those surveyed recently by Gallup said that they believed store brands were as good as or better than national brands. This perception of quality, in turn, arguably leads to an expectation of quality, which is good for some retailers

and less good for others.

Arguably, over the long-term consumers will be less inclined to purchase private label products that aren't perceived as being as good or better than the nationals. Go back to mom, who now has three choices: the national brand; the private label product that she perceives as good or better than the national brand and a private label option that might be lower quality. Assuming that price isn't the only driver -- and with Wal-Mart in the picture, would you want price to be the only driver? -- it would be hard to bet on the third option. And the Gallup respondents were the general

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population; the hard core drug store private label users will probably cut sub-par private label products even less slack.

Shouldn't CVS and Walgreens, as national

drug chains, "own" the higher order (and long-term brand-building) emotional benefits of trust and quality?

Why is it important for CVS and Walgreens to be concerned about both pricing and branding issues relating to store brands? Because Wal-Mart and Target have more advanced store brand programs and are on a path to continue grabbing revenue from traditional drug stores.

Just as drug stores have lost their market leadership in total HBA sales (as noted above), the growth rate of drug stores' private label strongly trails mass merchants' growth rate. The Private Label Manufacturing Association (PLMA) reported that between 2000-2001, mass merchant private label sales grew by 12.2% versus private label sales in supermarkets and drug

stores, which grew by an anemic 1.1%.

### **Wal-Mart's Pricing Advantage Isn't Its Only Threat**

Wal-Mart built its brand on, among other things, low prices on branded products. Seeking to capture even more revenue, it has strongly embraced promoting its own brands. Wal-Mart has a blended strategy, ranging from private label knock-offs to stand-alone store brands. Their Equate brand "dental rinse", for example, compares itself on the front of the packaging to its branded competitor, Plax. The packaging design is probably cleaner (no pun intended) than CVS' but not as nice as Target's.

On the other end of the spectrum, the brand identity of Wal-Mart's Ol' Roy dog food products is as strong as branded competitors and has helped vault the line to a position of market leadership.

Moreover, in certain categories, Wal-Mart employs a segmentation strategy. Its Great Value brand chocolate chip cookies, for example, is priced lower than its Sam's Choice chocolate cookies, which have a much stronger shelf presence (and, deliberately or not, evoke President's Choice, the mega brand that had a large part in nudging private label products into a higher quality positioning).

If Wal-Mart's private label / store brand pricing is competitive or better than CVS' and Walgreens'; if the brand identity of its Equate brand is more powerful than the two retailers; if it more aggressively uses both segmentation and "as good or better than the national brands" strategies, Walgreens and CVS have some big long term problems on their hands.

## **Target's Best-of-Class Store Brand Program Is A Threat to Walgreens and CVS**

While Wal-Mart is always considered the biggest threat across a wide variety of channels and categories -- which isn't surprising because it's bigger than the next four largest retailers combined -- it's actually Target, with its cutting-edge store brand program, that might represent the bigger threat to Walgreens and CVS.

Going back to the dental rinse example cited above, while Target's product is a knock-off to the extent that it explicitly references a national brand (Wintergreen Listerine), it simply has stronger shelf presence than similar products from CVS and Walgreens. Other categories, such as baby products and body washes, show similar strides. Target's products in traditional drug store categories are, therefore, better than last generation private labels but not quite full-fledged store brands.

Better package design, in-and-of-itself, is not necessarily enough to keep senior Walgreens and CVS managers up at night. What's more troubling is Target's leading-edge work in other categories and how these (internal) best practices could be leveraged to make greater inroads in traditional drug store categories. While the Michael Graves products have garnered most of the press' attention -- and deservedly so, they're funky products at affordable prices presented in simple yet evocative packaging -- it is by no means Target's only powerful store brand. Their everyday kitchen utensils, for example, might be classified under the "Post-It" School of Package Design -- so simple, why didn't *I* think of that. Simple, yet funky, they serve a price point function while supporting the Target brand identity of making their customers feel cool that he or she just got a

bargain. The kitchen category, with the Squeaky Clean products, fulfill a different niche. And one could imagine finding their Restore & Restyle home improvement line (which includes shelving for kids' rooms and other DIY items) at an upscale retailer.

[Target isn't, of course, the only retailer to combine design aesthetics and quality products to build its brand. For example, the store brand balsamic vinegar sold at Whole Foods, a national upscale food retailer, was good enough to win the top ranking by a national consumer food magazine. The vinegar, sold under Whole Foods' 365 store brand, also looks great on shelf and supports the retailer's quality / upscale positioning.]

The point is not which firm should win a lifetime design award. The point is that store brands help drive traffic to Target and provide the retailer with a real point of differentiation.

## **Walgreens and CVS Can Still Use Store Brands As A Competitive Advantage**

But, as they say, all is not lost.

In an ideal world, CVS and Walgreens would undertake a revolutionary change from private label to store branding -- which would include the "sizzle" of revitalized brand identities and the "steak" of new product sourcing. Their movement from lower-end private label to higher-value store brands would help with both sales and brand positioning.

That ideal world, of course, might not exist because of the hyper-competitive retail environment in which CVS and Walgreens operate.

There are many ways, however, that the retailers could undertake an evolution.

Walgreens and CVS could create an “umbrella brand” across the entire store. Key “front store” categories could be slated for wholesale revitalization. These efforts might involve developing sub-brands or could be differentiated through design cues such as color coding or iconography. Proprietary packaging structures could be developed. CVS and Walgreens could update their brandmarks and use these revitalized identities as stronger endorsements of the private label SKUs. For higher-involvement categories such as vitamins and OTC, point-of-sale materials could be used to help with at-shelf decision-making. Loyalty programs could serve the dual function of driving sales to the revitalized items and tracking program effectiveness.

Whatever path the retailers might, one day, decide to go down, it’s important to keep in mind that the CVS-Walgreens battle is merely a prelude to the larger war with Wal-Mart and Target. The drug store chains will need everything possible to remain competitive.

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