Adding value – everyone is a winner

Andrew Brown

Banana sandwiches for lunch and beans on toast for tea. In the early 1990s you could feed a family of four a fairly nutritious (albeit vegetarian and rather restricted) diet for under 20p. A large loaf of bread could be bought for 9p, bananas for 5p each and a tin of baked beans for 4p. It was the time of the bread wars, the banana wars and the baked bean wars, when a combination of manufacturer/supplier overcapacity, fierce retail competition and a consumer recession led to below-cost selling of a number of grocery products.

So was this an example of a free-market economy working efficiently or does below-cost selling distort markets and is ultimately not in consumers' interests? Should governments legislate against it as in other countries? The European Commission is currently looking into the issue, so should manufacturers be lobbying hard for action?

The debate about whether or not to legislate is legitimate but manufacturers, whatever their feelings, would be unwise to rely on this as a solution. After all, legislation will not solve some of the fundamental market problems which lead to below-cost selling, in particular commoditisation and overcapacity. Manufacturers should seek solutions which lie in their own hands. The example of what has happened to the wrapped- bread market since those dark days of the early 1990s is a good one to follow.

Wrapped bread in the early 1990's was a commodity market. Private label dominated and the bulk of volume sold was 'standard white bread', an undifferentiated, basic product whatever retailer you bought it from. Brands did exist, though mainly in the Co-op and independent channels and again the products were all the same. Manufacturers were good at changing the wrappers but did not like changing the product as this slowed down production. So bread manufacturers treated brands as just different labels to be put on the same product. The industry had got itself into a vicious spiral of price, volume and cost efficiency. Product differentiation and therefore all innovation was seen as adding cost, making the product uncompetitive on price and damaging volume. There were some premium branded offerings, particularly in brown and wholemeal, but these were seen as peripheral.

What was the result of all this? Nobody (with a few exceptions) was making money out of bread. Retailers justified it as a means of making a price statement about their whole grocery offering while manufacturers struggled to survive. Some didn't. It could be argued that the consumer was getting a very good deal. Well, yes, if they liked the basic white product, a product which became increasingly value-engineered to lowest cost. If, however, consumers wanted choice and better quality then they were not getting what they wanted.

What has happened in the 10–15 years since is remarkable. Today there has been a switch around between brands and private label, with some three-quarters of the market now branded. Warburtons, Hovis and Kingsmill are now counted within the top 20 grocery brands in the UK, across all categories. Today's fixture is unrecognisable from that of fifteen years ago, with an enormous range of different products at different price levels. There has been sustained product development and innovation with most years bringing new offerings to the market. So while market volume has fallen over that time (retail bread volumes have been declining for decades as diets have become more varied and out-of-home consumption, such as pre-wrapped sandwiches, has increased), the market value has increased substantially.

How did it happen? No one manufacturer or retailer was responsible but the market recognised back in the early 1990s that adding value was the *only* way forward. This adding of value was led by the brands, but with the active support of many retailers. If anyone led the way it was Warburtons, in those days a regional player in the north of England, who showed that there was a substantial market for a high quality product at a price 3–4 times higher than the 19p which became the benchmark for a 'value' loaf. Allied Bakeries then began to increase support behind their Kingsmill brand and British Bakeries took the bold step of launching Hovis into the white market with a new premium product. The momentum provided by these three brands, all vying for market share, kick-started the process. The products were continually upgraded and a series of innovations and product introductions followed, segmenting the market further: sandwich loaves, 'toastie' loaves, farmhouse loaves, crusty loaves, white loaves with added fibre, white loaves with the health benefits of wholemeal and most recently 'crustless' loaves. The focus of this value-adding activity was in the white bread category but innovation followed in brown, wholemeal and grained products. The choice today is phenomenal and the quality of the offerings a transformation from fifteen years ago.

The history of market pricing over this time is fascinating. In 1990 the cheapest 800g loaf of wrapped bread was 47p. Within two years this had dropped to 19p as retailers exploited industry oversupply to negotiate better prices. It was clear that 47p was not a sustainable price for a commodity product but it was only after this price collapsed that manufacturers were kick-started into pursuing an added-value strategy. Today, prices vary from around 25p for a 'value' loaf to over £1 for the most premium branded offerings. Crucially the consumer gets different products in each price tier - a very basic white loaf at 25p and a very high quality product using premium ingredients at the 75p+ level. Interestingly the vast bulk of the market is now sold at prices over 75p, proving that the consumer wants, and is willing to pay for, the added value.

The result of all this has been win–win–win. The manufacturers can now make a return out of added-value bread, retailers make good profits out of wrapped bread and see it as an attractive category, while the consumer is getting a much greater choice of high quality products. It really is a case of everyone being a winner.

Clearly the issue of below-cost selling is important, not least for small retailers. However from the manufacturers' perspective, the message is clear. Lobby government against below-cost selling by all means but don't put all your efforts into this. Revisit your strategy, add value and you may find the solution lies in your own hands.

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